

Green Tax Shift: a discussion

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Outline of the talk

- ① Rationale for price regulation
- ② From 'pigovian tax' to 'tax shift'
- ③ Three key issues

Preliminary comment

- ▶ Fiscal policy has two (somewhat compelling) objectives:
 - to **raise revenue** for public spending
 - to **provide incentives** for behavioural changes

- ▶ Here we focus on the latter issue.

1. The rationale for price regulation

- ▶ Candidate policy instruments are:
 - command-and-control
 - price regulation (taxes or subsidies)
 - cap and trade systems (like EU-ETS on CO₂)
- ▶ In environmental matters, policy makers are used to favoring command-and-control
- ▶ But economic theory shows that, **for some pollutants**, price regulation is more efficient
'efficiency' = to reach a given globally optimal target at the lowest global cost.

Pigovian tax

- ▶ Evidence: **market failures** in the presence of public goods (or public bads)
- ▶ Pigou (1920) proposes taxation as a solution
 - pigovian tax : ‘external marginal cost at the social optimum’
 - requires to associate a monetary value to environmental damages
- ▶ « Polluter Pays Principle » (OECD, 1972; EC)
 - Not to be confused:
 - **efficiency principle:**
internalization of external costs
 - **responsibility principle:**
polluter pays for damages

2. From 'pigovian tax' to 'tax shift'

- ▶ Basic idea:
 - to increase taxation on what is 'bad'
 - to reduce taxation on what is 'good'
- ▶ Examples:
 - pollution is bad
 - innovation is good
- ▶ 'Bad' – 'Good': uneasy to define !
- ▶ So the challenge is twofold:
 - to put taxes on pollutants (which level, which pollutant?)
 - to find the fiscal policy mix that maximizes global welfare

Consensus in international institutions?

- ▶ **European Environment Agency:**
« Ecological Tax Reform can help us to realign a European economy that is still characterised by an insufficient use of labour resources and an excessive use of natural resources », J. McGlade, Executive Director of the EEA, 2007.
- ▶ **OECD:**
Promotes the PPP since 1972.
Proposes to establish *Green Tax Commissions*
Advocates for cancelling 'bad' subsidies (e.g. on coal).
In 2011, will deliver its 'Green Growth Strategy'.

NGOs' positions

- ▶ Basically, most of them are against market mechanisms...
- ▶ ... or they do not know them
(example: discounting)
- ▶ A Belgian counter-example: Inter Environnement Wallonnie's position on the role of fiscal policy
- ▶ Their challenge: to find the fair balance between complementary approaches: economic instruments, command-and-control, citizenship, awareness, education, lobbying...

3. Three key issues

1. What tax level on pollution?
2. Redistributive effects
3. Killing two birds with one stone?

What tax level on pollution?

- ▶ Setting the pigovian tax requires to know the external cost of pollution
 - > need for further empirical studies (ex: ExternE project)
- ▶ Cost-Benefit Analysis: balancing global costs with global benefits

Redistributive effects

- ▶ Redistributive effects may be huge:
 - low-income households typically suffer from environmental taxation (e.g., on CO₂)
 - same at the sectoral level (double dividend, not for all)
- ▶ Not all agents gain to the policy: **political acceptability**
- ▶ A solution : **lump-sum transfers**

Killing two birds with one stone?

- ▶ The order of magnitude from the *shift-effect* may be rather small
- ▶ The tax shift may be less efficient than targeted measures
- ▶ Example: a CO₂ tax with a reduction in employer's social contribution

Concluding remarks

- ▶ There exist **many opportunities** to reshape the fiscal policy towards a greener fiscal system
- ▶ Price regulation is **one among many policy instruments** for environmental regulation
- ▶ **Redistributive effects** may be huge: there is a need for accompanying measures
- ▶ Empirical evaluation of **costs and benefits** is required to set the optimal policy