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A CARBON DIVIDEND AND TAX REFORM

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An increasingly widespread awareness that the objective of reducing climate-changing emissions needs to be pursued with determination must go hand in hand with the acknowledgment of the urgent need to identify the instruments necessary to achieve it. The "Economists' Statement on Carbon Dividends", signed by 27 American Nobel Laureate Economists, clearly states that a carbon tax is the most effective instrument to reduce CO_2 emissions, while clarifying that it is not a question of imposing a new levy, but of correcting a market failure, by sending a price signal to steer producers' and consumers' behaviour towards a carbon-free economy.

In this perspective, it seems appropriate to return to the insight of European Commission President Jacques Delors, who developed a European unilateral strategy to contain CO_2 emissions. This initiative was based in particular on the approval of a directive introducing a carbon/energy tax equal to 10 dollars per barrel of oil. But it also called for a recycling of the resulting revenue to stimulate the economy, by reducing social contributions for companies and workers, thus obtaining the double dividend of improving environmental quality and creating new employment. Delors also thought that if Europe paved the way, other countries would follow, thus seriously tackling the problem of global warming.

Today, 45% of emissions in the European Union are managed through a quantity control mechanism within the framework of the Emission Trading System (ETS). In sectors not covered by this mechanism – transport, the household sector, SMEs and agriculture – which produce 55% of total emissions, it is essential to introduce a carbon price, in addition to imposing a border tax adjustment on imports from countries that do not adopt a carbon pricing system, equal to the price imposed on European production, to avoid incompatibility with WTO rules. This objective was reaffirmed by President Macron in his press conference on 25 April 2019.

The point that needs to be stressed is that imposing a carbon price cannot be used to obtain additional revenue, but rather to launch a profound reform of the public finance structure, both in terms of revenues and expenditures, oriented towards a carbon-free and socially just economy. Essentially, all revenues should be recycled within the economic system through tax relief for low-income households, or reductions in social contributions. This would help non-energy intensive enterprises by reducing labour costs, and aid workers by increasing their net salaries (keeping their gross income unchanged). Public expenditures should be directed towards backing the investment needed to foster the ecological transition.

The scale of this potential tax reform is significant. With the carbon price rising every year by €10, from an initial value of €50 to €100 per tonne/CO_2, revenues would amount to €112.5 billion and would rise as high as €225 billion, since CO_2 emissions in the sectors not included in the ETS reached 2242.65 million tonnes in 2017 in the EU27 (Eurostat data). The price of allowances in the sectors included in the ETS, which will be progressively auctioned, will also rise as an increasingly limited number will be issued, thus generating additional revenue. Finally, the revenue generated by imposing a border tax adjustment should also be considered. Eurostat estimates emissions associated with consumption and investment within the EU – the carbon footprint – at 7.2 tonnes per capita in 2017, 1.2t of which from outside the Union. Imported emissions that will be taxed can therefore be estimated at 525.1 million tonnes, with €26.2 billion in revenue (€52.5 billion in 2025, with a €100 tax rate) that would flow directly to the European budget, as it is an EU own resource.

These data do not necessarily imply that there will be additional revenues for public finance. In some countries, for instance in Sweden where the carbon tax rate is set at €114, no change in the level of the levy it is expected. In other countries, such as Italy, where energy taxation is already high, the tax structure can be changed, with each source levied in proportion to their carbon content. The point that needs to be stressed is that, in any case, total revenues from the imposition of a carbon price in the non-ETS sectors and from auctioning allowances in the ETS sectors will create a price differential between the use of fossil fuels and renewable energies, determining the amount of the carbon dividend which may be used for the ecological and socially just transition of the European economy.

This carbon dividend will make it possible to overhaul the tax system in order to shift the burden of taxation away from labour and business income towards the use of fossil fuels. A portion of the revenues from the carbon price will be allocated to countries to encourage measures aimed at promoting employment and combating poverty, lowering labour taxes (especially for the lower income brackets), and reducing social contributions for companies and workers. A portion of revenues, especially from the border tax adjustment, will have to flow directly to the EU budget, to promote investment in the technological development of the European economy and to finance a European Unemployment Fund, in addition to existing national funds, which would not only have obvious social aims, but also positive effects in terms of counter-cyclical policy, allowing countries in difficulty to receive aid directly from Europe.

However, the most significant portion of the resources allocated to the European budget will finance a *European sustainable development plan*, primarily to guarantee an ecological transition that can promote research and innovation and, at the same time, social equity. In a recent article ("It's Time for a Green EU Deal"), Michel Barnier suggested creating a Sustainability Pact, reminding readers that the European Commission estimates that €180 billion a year will be needed to meet the commitments made by the EU under the Paris Agreement in December 2015. To achieve this objective, financial institutions play a fundamental role in orienting the private sector towards low-emission investment, and the availability of resources provided by imposing a carbon price may also facilitate the issuance of green securities earmarked for implementing the plan.

This allocation of resources clearly demonstrates that the carbon price and border tax adjustment have aims that go beyond the EU area. In fact, launching a European sustainable development plan ensures that revenues are used to promote a Green New Deal, with the main objective of supporting a policy to develop renewable energy sources, which will not only involve Europe, but other areas of the world as well, and in particular the African continent.

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(The opinions expressed here do not necessarily represent the CSF)

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