

EXPERIENCES WITH BUDGET DEFICITS AND CARBON / ENERGY TAXATION /PRICING

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Workshop

MORE GAIN THAN PAIN: CARBON/ENERGY PRICING FOR CLOSING PUBLIC DEFICITS

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Dear ladies and gentlemen,

- Thank you very much for the kind invitation.
- It is a great honour to share my insights into the issues of today's workshop.
- Let me sketch out the structure of my contribution:
Firstly, I will briefly touch upon the current crisis regarding fiscal deficits.
Secondly, I will share my experiences of the Ecological Tax Reform in Germany between 1999 and 2005, introduced and further developed when I was German Minister of Finance.
Thirdly, I will appreciate the further elements of a broader Environmental Fiscal Reform (EFR) which were introduced by the current government.
Fourthly, I will refer to potential contributions from further EFR-elements such as carbon and energy taxation to the reduction of fiscal deficits.
Lastly, I will conclude.

1. The current crisis regarding fiscal deficits

- According to EUROSTAT, the deficit of EU-Member States in 2011 was on average around 4,5% against 6,5 % in 2010. While some Member States like Finland with a surplus of 0,5% or Sweden with a slight deficit of -0,3 perform quite well, others such as Ireland with 13,1 %, Greece 9,1 % or Spain 8,5% are still in a difficult situation.. In the past years the public deficits have grown substantially with a clear need to boost the economy and cutting expenditures where possible at the same time.
- Fiscal consolidation remains a key policy driver in many EU countries. On second March 2012, 25 European leaders signed the Treaty on Stability, Coordination and Governance containing a fiscal compact to limit the structural (cyclically-adjusted) deficit to 0.5 per cent (and for low-debt countries, 1.0 per cent) of gross domestic product (GDP). The Treaty also

requires that general government debt does not exceed, or is sufficiently declining towards, 60 per cent of gross domestic product at market prices. Member states in non-compliance will be subject to the excessive deficit procedure (European Union, 2012, Article 3).

2. Ecological Tax Reform in Germany between 1999 and 2005

- The ETR in Germany was introduced and further developed when I was German Minister of Finance.
- Why and how did we introduce it and what were our experiences?
- The political situation was tough: On the one hand, Germany faced a high unemployment of more than 10%, to which high labour costs, particularly through social security contributions, contributed substantially.
- On the other hand, we needed to trigger eco-innovations for contributing to our climate policies. Greenhouse gas emissions should be reduced by 21% at that time until 2012 against 1990 levels of which we had then reached around 15%.
- To cope with these two parallel challenges, between 1999 and 2003 there were substantial, but gradual increases in fuel duties introduced in five phases:
- Overall, 31% increase in petrol duty, 48% increase in diesel, 50% in light heating fuels, 100% increase in natural gas. The latter was only increased by so much in 2003, when tax rates on natural gas were adjusted to the higher ones on light heating fuels. With this step we wanted to provide a more rational and systematic taxation of the heating fuels. It is a step which is also recommended by the CETRiE-study.
- Furthermore a new electricity tax was introduced, starting with 1 Cent per kilowatthour and then increasing yearly by 0.25 Cent up to overall 2.05 Cents per Kilowatthour from 2003 on.
- in 2003 this ETR raised around € 18.6 billion which equals 0.9% of GDP. In 2009 revenues were €18.9bn, but then only equalling 0.7% of GDP since energy tax rates are frozen since 2003 – as a result, their real value has fallen, and the revenues earmarked for reducing social security contributions (SSC) have fallen as well.

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- This is also due to the fact that energy taxes are based on the physical unit like liter or kilowatt-hour and thus do not increase automatically with prices, but require political decisions. A way out could be automatic indexation which other countries have some experiences with while Germany, so far, has not tested this given its two dramatic experiences with inflations and currency devaluation in the 20th century. But I think, we should test this approach in Germany, too, since it would ensure that the level of incentives is not reduced over time not at least given policy makers are often too shy to take such decisions of increasing environmentally-related taxes.

Revenue uses:

- 89% of the revenues are used to reduce social security contributions (these are roughly split 50:50 between employer and employee contributions). The pension fund contribution rate is 1.7% lower than without the ecotax
- 10% are used for fiscal consolidation, 1% for the promotion of renewables.

- Overall, it was thus almost revenue neutral. To be more precise, until 2002 it was revenue-neutral, but only from 2003 we started using the major part of the additional revenues from some minor tax changes for fiscal consolidation. Hence, Germany already started using the approach we are discussing today.

Administrative Costs:

- Interestingly enough and this confirms the findings from the CETRiE-study: The administrative costs for the public sector were only 0.13 percent of the additional revenues of the Ecological Tax Reform (ETR). These are very low and far lower than those for income or value added taxation. The reasons behind are the few companies from which these taxes have to be levied and the already existing taxes on mineral oils and other energy products so that the administration was mostly in place and it was easy for them to broaden the scope of taxation.

Other experiences:

- According to studies, 250,000 additional jobs were created, CO₂-emissions went down by 3% until 2010. Growth was practically not affected, in fact marginally positive. Hence, a double dividend was achieved.
- But the ETR was not overwhelmingly popular, but this was not due to the ETR itself but the fact that the oil price per barrel (59 liters of crude oil) quadrupled from 9 USD by the end of 1998 until mid 2000 to 35 USD. This coincided with the introduction of the ETR so it was easy for some media and the opposition to blame the entire price increase on the government, but in fact, only a quarter of the price increase for gasoline was due to the ecotax.
- In the end, it was crucial to link the ecotax revenue spending to labour cost reductions as this way there was the likely strongest incentive to keep the ecotax even in these sensitive times because the reduction of labour costs was still more important than all the protests against the ETR.

3. Further elements of a broader Environmental Fiscal Reform (EFR) were introduced by the current government.

- 2005: a heavy vehicle charge on motorways was introduced and slightly extended to some other roads in 2011.
- In 2011, a nuclear fuel tax and an aviation tax were introduced while the reduced energy tax rates for industry were cut back to reduce environmentally harmful subsidies.

However, the air ticket tax was reduced by 2012 by the same amount; the inclusion of the aviation emissions into the EU emissions trading system would increase ticket prices. Hence, factually a cap has been introduced on the air ticket tax which is of course not reasonable. Not at least since the emissions in this sector are still growing and the impacts of the emissions trading system are marginal, the cap seriously also endangers the effectiveness of the aviation tax.

- In 2011, also a bank charge as a first step towards a financial transaction tax was introduced.

This was done even before the EU-Commission proposed such a tax as own contribution to

the financing of the EU-budget within the next EU-budget from 2014 to 2020. EU-wide it expects 55 billion Euros of revenues

4. Potential contributions from further EFR-elements such as carbon and energy taxation to the reduction of fiscal deficits.

- Given these experiences in Germany, but also several other countries such as recently the Netherlands, the findings and recommendations from the CETRiE-study should be seriously considered and taken into account when the budgets for 2013 and following are prepared.

5. Conclusions

- We all know that fiscal consolidation is necessary and that governments are urgently searching for the best way of how to do that with the least negative impact on the economy. Hence, we now observe a debate about which expenditures to cut and which to even increase in order to stimulate growth. Those two measures alone will not be sufficient as also some policy makers admit. But taxes will have to be cautiously increased. Therefore, the CETRiE-study supports my thesis that it is still better to increase and broaden taxation and pricing of carbon and energy than any other indirect or direct taxes like value added tax and corporation or income tax.
- Germany did already first steps in this direction:
- In 2003, it adjusted tax rates on natural gas to the higher ones on light heating oil and it used most of these additional revenues for fiscal consolidation. In 2011, all the additional revenues from the new taxes on air tickets and nuclear fuels were used for fiscal consolidation.
- Of course, these are not the only reasons why Germany has had a relatively strong economy in recent years. But these steps have certainly supported our strong economy. Hence, I am pleased to discuss with you these insights from Germany and their potential relevance for Hungary and other countries and support you with my experiences.