



From energy to carbon taxation: Socio-ecological guidelines for the revision of the Energy Tax Directive

Key points

- An ambitious revision of the Energy Taxation Directive towards an EU-wide carbon tax is a key element of the European Union's Green Deal and makes an important contribution to strengthening the internal market. It is clearly preferable to an expansion of the EU's Emissions Trading System because it guarantees the necessary stability to support green investment and organize accompanying measures to shield against the social costs of carbon pricing.
- The taxation of fossil fuels and emission has negative distributional effects, which should be mitigated by refunding tax revenues to households and corporations at member state level. The right design of the compensation mechanism is essential for distributional outcomes. Calculations for Austria show that reducing income tax rates or social security contributions exacerbates the regressive effects of a carbon price. A better solution is a lump-sum transfer (Ecobonus), supplemented by additional support for particularly affected groups such as commuters and energy-poor households (Ecobonus PLUS).
- In the revision of the Energy Taxation Directive, AK calls in particular for minimum tax rates to be linked to the energy and carbon content of energy sources and for their gradual increase in a transparent, phased plan until at least 2030, along with the abolition of the climate-damaging exemptions for kerosene and marine diesel.

Background

The 2003 Energy Taxation Directive was an important step on the path to a functioning internal market and made a vital contribution to ensuring more efficient energy taxation in the European Union. A great deal has happened since then. The internal market, technologies and tax systems have all evolved. A thorough revision of the Energy Taxation Directive is now essential. Above all, it is clear that the Energy Taxation Directive is a key element of the European Union's Green Deal and should in future make a greater contribution to achieving its climate targets. AK believes it must also focus on social equity. Successful socio-ecological transformation of the economy and society can only be achieved if no one is left behind.

EU-wide carbon tax instead of expanding the Emission Trading System

Environmental taxes are no silver bullet for solving the climate crisis and can only be effective when they are part of a larger package of public investment and clear regulatory requirements. A carbon tax can only help to steer people away from fossil fuels if climate-neutral alternatives to the internal combustion engine and oil-fired heating are available. As part of the European Green Deal, therefore, a revision of the Energy Taxation Directive could make a major contribution to ensuring the EU is climate neutral by 2050.

The political process of conducting the revision is underway. As mandated by the Council of Finance Ministers, the European Commission has carried out a comprehensive evaluation of the [Energy Taxation Directive](#). A public consultation to which AK contributed alongside many other stakeholders, ran until mid-October. The next step is a concrete proposal for amending the Directive, which is expected in early 2021.

Main Findings

According to the Commission's Evaluation, there are two main problems with the Directive: 1) It fails to send out consistent price signals for energy consumption and associated carbon emissions, which is why its contribution to achieving climate targets remains limited 2) In addition, the lack of consistency in taxation and the vast array of exemptions have led to proliferation of national rules, which hampers the proper functioning of the internal market. A good example is the rise of national carbon taxes that – in the absence of clear signals from the EU – are enacted by the Member States in addition to conventional energy taxes.

If the Energy Taxation Directive is to make an effective contribution to achieving climate targets and strengthening the internal market, it has to undergo an ambitious and wide-ranging overhaul. AK believes the main priorities should be as follows:

1) Systematic linking of the minimum tax rates of the Energy Taxation Directive to the energy and carbon content of the energy carrier, as laid down in the Proposal for a Council Directive amending Directive COM(2011) 169 final – 2011/0092 (CNS) dated 2011. In terms of sending consistent price signals throughout the EU, the defined ratio between energy and carbon taxation should also apply to national rates exceeding those minimum rates.

2) A clear, phased plan for gradually increasing minimum tax rates to 2030.

3) Ending the exemption for kerosene and marine diesel, at least for transportation within the EU. The option of giving public transport preferential energy tax rates should be retained. Special arrangements for individual Member States should be phased out within a reasonable transition period.

4) Adoption of the Energy Taxation Directive by majority vote, as also requested by the Commission. Unanimity makes it difficult to coordinate energy taxation with environmental and climate policy, which is decided by majority vote.

5) Alignment of the revision with the amendment of the EU Emissions Trading Directive for energy-intensive industrial operations and the planned carbon border mechanism. In terms of climate targets, preferential treatments or tax reductions like the ones in Article 17 of the Directive should be reconsidered or revised.

An EU-wide carbon tax within the framework of the Energy Taxation Directive has the potential to systematise the emerging "patchwork" of national carbon pri-

cing systems and to provide consistent price signals for the consumption of fossil fuels across the EU.

AK also prefers such an EU-wide carbon tax to extending emissions trading to the areas of transport and space heating, as is being considered by the EU Commission. The Emissions Trading System for heavy industry certainly has advantages in terms of climate policy (e.g. cap and trade), but it cannot be transferred 1:1 to the economy as a whole. One disadvantage of emissions trading is that the carbon price is highly volatile and reacts pro-cyclically to changes in the global economy. It is easier for large companies in heavy industry to compensate for the associated reduction in planning certainty than it is for small and medium-sized enterprises and private households. This could lead to green investments either being delayed or not made at all. The accompanying social and distributional measures of a carbon pricing system, which are vital in terms of a "just transition" to secure broad political support, would also be made considerably more difficult as fluctuating prices also lead to fluctuating revenues for compensation.

Distributional effects of a carbon pricing system: New study by AK highlights challenges and potential solutions

The distributional effects of energy and carbon taxes are linked to a number of factors. These include the specific area of application, the question of the use of funds, the incidence, i.e. the extent to which the tax is passed on to consumers, behavioural changes and macroeconomic second round effects. Studies may come to different conclusions, depending on their focus.

However, the majority of studies confirm that the static distributional effect of higher energy taxes is regressive. Low and middle income earners are relatively more burdened than higher earners because they have to spend a higher proportion of their income on fossil fuels. The dynamic distributional effects are less clear. Due to a lack of data, many studies approximate lifetime income with consumption expenditure, which logically leads to fewer regressive effects. However, very few studies examine the investment and steering effects of ecotaxes in light of financial and credit constraints on low and middle income earners. This blind spot of the scientific literature is problematic, as it is plausible to assume that high-income earners would find it easier to adapt to a carbon tax and switch to climate-neutral technologies. Over time, this would not mitigate but amplify the regressive static effects of a carbon tax.

In terms of distributional effects, higher taxation of heating fuels and electricity is a particularly sensitive issue. Firstly, because many people, such as tenants, have no control over what heating system they use;

Table 1: Evaluation of different refund systems based on Austrian consumer data

Refund	Distributional effect	Evaluation
Reducing income tax or social security contributions	Very regressive, many groups do not benefit at all (e.g. the unemployed)	--
Ecobonus (lump-sum transfer to all households)	On average progressive, BUT many low and middle income earners lose out; in Austria around one third	-~
Income-dependent bonus (bonus decreases from €X income)	On average progressive, number of losers can be reduced slightly below the levels of "normal" bonus	~
Eco bonus PLUS	Reimbursement of more than 100% of tax revenues by combining the Ecobonus with additional funds for particularly affected groups	~+

and secondly because these energy sources are favoured in the current system. Higher taxation could become a particular problem for energy-poor households, which are faced with high energy costs and low incomes.

AK believes the distributional challenges of higher energy taxes must be a key focus of the revision of the Energy Taxation Directive. Refunding tax revenues is a key issue here. A new study commissioned by AK uses consumption data for Austrian households to show that it is not just a question of "whether" but above all of "how" tax revenues are recycled. The specific design of the refund system has a major impact on whether the negative distributional effects of higher ecotaxes are mitigated or actually exacerbated.

Table 1 provides an overview of the distributional effects of different refund systems.

Making refunds via reductions in income tax and/or social security contributions is clearly negative. The specific effects depend on the exact design of the refund system, but in practically every variant, higher income earners benefit more than low and middle income earners, at least in absolute figures. As a result, these variants do not mitigate the regressive effects of carbon pricing, but actually exacerbate them.

A better solution in terms of distributional effects is the so-called Ecobonus, a lump-sum transfer to all households. On average, the regressive effect of carbon pricing can be offset, especially in the income-de-

pendent type of refund. But here, too, the calculations for Austria show that, due to the strong dispersion of carbon emissions within the income groups, about one third of low- and middle-income earners lose out in net terms, despite the Ecobonus. This might be because they have to commute to work by car or heat their homes with oil or gas. Depending on the level of the carbon tax, these losses can be considerable.

In order to more effectively minimise the social costs of a carbon pricing system, AK proposes departing from the principle of a revenue-neutral carbon pricing system and investing in additional budgetary funds in a carbon pricing system (Ecobonus PLUS). The additional funds could, for example, be invested in a fairer and more ecofriendly commuter subsidy or in special grants for energy-poor households. A promising approach in this respect is the [AK's proposed Energy and Climate Aid Fund](#), which aims to support energy-poor households with the implementation of climate protection measures (see next page). This approach not only makes sense in terms of steering effects but is also necessary with regard to distributional effects because the social issue of climate policy is not only about higher consumer prices, but also encompasses access to new, climate-neutral technologies.

Demands

Revise minimum tax rates:

In order for minimum tax rates to provide an effective incentive for reducing carbon emissions in the future, they should be linked to the energy and carbon content of fossil fuels and gradually increase until 2030. Such an EU-wide carbon tax is clearly preferable to an expansion of the EU's Emissions Trading System because it guarantees the necessary stability to support green investment and organize accompanying measures to shield against the social costs of carbon pricing.

Abolish exemptions:

The existing Directive contains numerous exceptions and exemptions, some of which are counterproductive. The exemption for kerosene and marine diesel (Article 14) is particularly problematic from a climate policy point of view and should be abolished.

Social cushioning:

A realignment of energy taxation hits low and middle income earners particularly hard. In order for it to be perceived as fair, the carbon tax revenue must be refunded to private households as a lump-sum transfer, supplemented by additional support for particularly affected groups like commuters or energy-poor households (Ecobonus PLUS).

Establishment of an Energy and Climate Aid Fund for Europe:

Energy-poor households should be given special support during the social and environmental transition. The energy transition and climate policies pose a particular challenge for these households because they have to cope with high energy costs and low incomes. This is why AK has long been calling for the establishment of an Energy and Climate Aid Fund at national level in order to comprehensively and sustainably combat energy poverty. The fund should serve as a hub for networking and capacity building in the area of energy poverty and the provision of financial and technical/administrative support for affected households with regard to changing heating systems and similar measures. In its recommendation on energy poverty in the wake of the Renovation Wave (EU 2020/1563 and C(2020) 9600 final), the EU Commission views the National Observatory in Italy as a best practice example and points out the importance of multi-stakeholder cooperation and of national indicators to measure energy poverty. A possible lever for the EU-wide rollout of such interfaces are the energy and climate plans of Member States. According to AK, the EU Commission should call for the establishment of such interfaces, also with a view to coordinating the interaction of social and energy policy measures that are required by the EU Commission as part of the Renovation Wave.

Literature

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