

Brussels, 14th January 2010

**Presentation of the study "*An ever less carbonated Union?*
Towards a better European taxation against climate change" by
Eloi Laurent and Jacques Le Cacheux**

On 14th January, in Brussels, around 80 participants assisted to the presentation of the study « *An ever less carbonated union? Towards a better European taxation against climate change* » by **Eloi Laurent** and **Jacques Le Cacheux**. The presentation of the study by the authors was followed by a debate chaired by **Peter Carl** in which participated **Walter Deffaa**, **Alberto Cornejo Pérez** and **Patrick Ten Brink**

Eloi Laurent started by presenting the purpose of the study, which is to explore the ways and means for the EU to implement a better carbon taxation regime in the perspective of achieving the "20-20-20" strategy goals. The study doesn't question the relevance of the "20-20-20" strategy ends, but it discusses the adequacy of the means available to achieve the ends defined. He clarified that their aim is not to substitute EU ETS by a carbon taxation system; we need to go further considering the present situation, which includes EU ETS.

Laurent stressed that the EU is a global ecological power and we need to reform the climate policy to become the centre of a de-carbonated world. According to him, ecology in the EU might become as important for the European identity as the welfare state. The EU clearly has very ambitious targets concerning climate change; and what the EU needs now is to have the adequate instruments to achieve these targets.

Laurent put the accent on the need to improve EU "credibility" vis-à-vis the rest of the world. He said in particular that the EU needs to build a relation of trust and confidence with the developing countries if we want them to commit in the fight against climate change.

The author also said that EU ETS is a good idea but it faces some problems. Other than covering only less than 50% of EU emissions, it leads to a low and unstable price of CO₂.

This poses two types of problems: first, it doesn't guarantee a reduction of emissions within the ETS system, as industries have no incentive to choose greener technologies. Second, as the ETS price is frequently taken as a benchmark for national carbon taxes, a low carbon price within the ETS system leads to low carbon tax rates. Finally, the EU ETS also poses a problem of international competition ("carbon leakage") as it increases the production costs of firms located in Europe.

Jacques Le Cacheux presented the four scenarios towards a better European carbon taxation described in the study. The first scenario ("taxify the EU ETS") consists in introducing reforms into the ETS system in order to make carbon price within EU ETS more stable and higher. This is the least ambitious scenario, taking into account that EU ETS deals with only half of the emissions problem. The second scenario ("climatize national tax systems") consists in scenario one plus the conversion of existing national energy taxes into climate change taxes. The problem of this option is that there would be multiple prices for carbon what would lead to tax competition in the internal market. The third scenario ("European green shift") would be scenario one plus the creation of a single European Union carbon tax. This would ensure a unified carbon tax rate in Europe. Yet, this scenario would face a problem of institutional feasibility, as unanimity is required on tax matters – a problem which could be resolved by using the instrument of "enhanced cooperation". Besides, as the two previous options, it would not resolve the problem of international competition (only firms producing in Europe would be charged by this EU carbon tax). The fourth scenario consists in the creation of a European carbon added tax. Even if this scenario would have several advantages, namely the no discrimination between domestic and foreign goods, the author recognises that it would face a problem of technical and institutional feasibility.

Le Cacheux underlined that we can expect geopolitical, economic, democratic and political benefits if the EU goes further on tackling climate change. He finalised his speech by making some points on the question of creating an EU carbon tariff on the borders. While recognising that this question will be essential in future debates on carbon taxation, he stressed the nonsense of adopting an absolute position of being for or against such a tax. According to him, the appropriateness of an EU carbon tariff must be considered by taking into account the state of international negotiations, whether or not it is WTO compatible and the existence or absence of "carbon leakage" problems in Europe.

After the presentation of the study by the authors, the panel discussion started with the intervention of **Patrick Ten Brink** (Institute for European Environmental Policy).

Ten Brink started by saying that he considered the study very interesting but he had several doubts concerning the political feasibility of the various scenarios sketched out in the study. He underlined member states' diversity and, concerning the possibility of using 'enhanced cooperation', asked to the authors which countries in their opinion could form the core of this cooperation. He also wondered whether it would be possible to adopt a stepwise approach to introduce these reforms, by using in a first stage the Open Method of Co-ordination and, only in case it fails, resorting to enhanced cooperation. Ten Brink also expressed some doubts concerning the technical feasibility of an EU carbon added tax, and wondered at what rate should the EU carbon tax be set up in order to foster a shift towards a de-carbonated Europe while preventing major competitiveness losses ("where is the threshold between pain and encouragement to innovation?").

Walter Deffaa (Director General on Taxation and Customs Union, European Commission) started his speech by welcoming the fact that "taxation is back on the agenda". As regarding the study, he considered that the authors were very critical on the functioning of ETS. According to him, the question to be addressed is what to do with the 50% of emissions not covered by ETS. Deffaa considered the second option as being more in line with the current thinking on this subject. He defended the introduction of a carbon element in the framework of the Energy Taxation Directive, underlining that we will only have an effective CO₂ taxation if we do it at the EU level. He warned in particular on the risks of tax competition if this move is not coordinated at the EU level, and illustrated this point by making reference to the Swedish case: the Swedes, he explained, have a national carbon/energy tax, but in order to avoid problems of tax competition they have very high tax rates for households and transport and very low rates for enterprises.

For the Director General of DG Taxation and Customs Union, Laurent and Le Cacheux's third scenario would be technically feasible but politically not feasible. He reminded in this respect that we have set national differentiated reduction objectives concerning emissions outside ETS within the EU Energy-Climate Package. Thus, he said, we cannot apply a "one size fits all" approach. As regarding the fourth scenario, he considered not only politically but also technically unfeasible. Deffaa concluded by highlighting that we need to concentrate on the second policy option and to work on the European framework.

Alberto Cornejo Pérez (Director for Excise Duties and Foreign Trade Taxes, Spanish Ministry of Finances) explained that Spain would be favourable to change the current EU framework on energy taxation in order to make it more compatible with EU's

environmental aims. The Spanish government does not count with a national CO₂ tax, but considers essential to take into account the experience of those EU Member States who have already created such a tax for the definition of a new European framework on energy taxation. As concerning the Spanish presidency, Cornejo Pérez stated that Spain would support the European Commission's proposal of reforming the EU energy tax directive by introducing a carbon component into the framework. He raised however some doubts on the way to transpose this change in terms of national legislation, and pointed out the need to analyse in detail the impact of such a change on the economy before putting it into practice.

Finally, the president of the panel, **Peter Carl** (former Director General on Trade and former Director General on Environment at the European Commission), expressed his views on the issue at debate. He reminded that the ETS is not a mature market and suffers from a lack of predictability, which makes highly recommendable the introduction of a 'floor price' (as suggested by the authors in their first scenario). Carl also highlighted that the border adjustment is a real issue, as the ETS increases European firms' production costs, and therefore may lead enterprises to leave the European territory to go to other regions where they will have lower production costs.

In their reply to the questions posed by the panellists, the authors raised the following issues. Concerning which countries would form the core of an "enhanced cooperation", Laurent identified the United Kingdom as the key player for a potential EU "climate coalition". To the question of what would be the right EU carbon tax rate, Le Cacheux replied that the optimal price would be the price that makes a number of alternative energy sources become profitable. Finally, to those doubting on the technical feasibility of the EU Carbon Added Tax, Le Cacheux recognised the technical difficulties but pointed out that they are not insurmountable. He highlighted the parallelism between the current scepticism and the scepticism and doubts that existed on the technical feasibility of VAT, when this tax was created for the first time in France.

During the debate several questions were raised by the participants, namely concerning the possibility of introducing housing and transports into the EU ETS system. With respect to this point, Laurent recalled that this is the option taken by the US ETS project, which is currently on negotiation. He declared himself unconvinced on the benefits of making such a step, as "cap and trade" makes sense for concentrated emissions but is difficult to apply for diffuse emissions such as those providing of housing and transports.