



GreenBudgetEurope

**Green Budget Europe
European Environmental Bureau
Transport & Environment**

**Proposals for an effective revision
of the Energy Tax Directive**

1. Energy Tax Directive: The Commission proposal and its impact

We welcome the publication of a revision of the Energy Tax Directive. EU-level energy taxation policy is crucial in the promotion of at least four key EU policies:

1. **Climate policy:** Keeping global warming well below 2°C, for which the European Council re-confirmed in February 2011 the EU objective of reducing greenhouse gas emissions by 80-95% by 2050 compared to 1990. The Commission has published a Low Carbon Roadmap for 2050 outlining how that objective can be achieved¹;
2. **Energy policy:** Increasing energy efficiency and energy saving, improving energy security and diversity, promoting renewable energy and reducing energy imports;
3. **Market policy:** Improve the functioning of the internal market, in particular for those forms of energy that cross borders (notably in transport);
4. **Fiscal policy:** The modernisation, reorientation and greening of the national tax structures to shift away from high labour taxation and towards the taxation of environmental pollution and energy use, as set out in the Europe 2020 Strategy². Such a tax shift could also contribute to fiscal consolidation, innovation, a greening of the economy, enhanced competitiveness and quality job creation. It would also contribute to resource efficiency in general.

¹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A Roadmap for moving to a competitive low carbon economy in 2050, COM(2011)112, Brussels, March 2011.

² Europe 2020: A European strategy for smart, sustainable and inclusive growth, March 2010.

Bearing in mind the rapidly accelerating destabilisation of world climate, there is an imperative need for clear and ambitious decisions which take Europe on a path of energy efficiency and security and a switch from fossil fuels to renewables. In the light of this, the Commission's recent proposal for a revision of the Energy Tax Directive, COM (2011)169 introduces three welcome new elements in the Directive:

1. **It introduces a CO₂ and an energy component** to minimum tax rates stipulated in the Directive, which enables the Directive to work well alongside the Emissions Trading Scheme (ETS). Plants covered by the ETS will be exempt from the CO₂ tax element, while still being liable to pay the energy tax. This creates a more level playing field between companies covered and not covered by ETS.
2. **The Directive changes the tax base of energy to unit of energy i.e. gigajoule**, thus relating minimum tax rates to the calorific content of each fuel, rather than to metric units as was previously the case, thus creating a level playing field between energy sources.
3. **The Directive prescribes that energy taxation shall be fuel neutral by mandating that from 2023 the same CO₂ and energy tax factors shall apply to all fuels.** The proposed structure will make energy taxation much more coherent and strengthen taxation as a tool to promote sustainable development. One consequence would be that coal could not be taxed at low or even at zero level, as is now often the case. A further consequence is that, due to its higher energy and carbon content, diesel will be taxed at a higher rate per litre than petrol.

Thanks to these elements, the Directive provides three important environmental tax incentives: to reduce CO₂ emissions, to save energy, and to switch to more energy efficient fuels and/or cleaner energy production technologies.

2. Specific GBE / EEB / T&E proposals

A. Set environmentally meaningful minimum tax rates

We are concerned that the minimum tax rates laid down in the Directive are not sufficiently high and that the adjustment mechanisms built into the Directive to increase these rates will not be sufficiently flexible.

Minimum rates and the impact of inflation

The proposed minimum tax rates are too low to have a significant incentive effect on environmentally damaging behaviour. As shown in the European Commission's own Impact Assessment³, the impact on employment is positive in all policy options – even those with higher tax rates – both in the EU as a whole and in all Member States, due to the effect of revenue recycling. Indeed, **the higher the additional revenues from energy taxes – i.e. the higher the minimum rate – the more favourable the economic impact.**

Since the entry into force of the current directive EC 2003/96, cumulative inflation has amounted to approximately 23%. This means that to keep minimum tax rates at the same nominal level, they should be increased by about 23% on 2004 levels. **If the revision sets out to increase minimum tax levels, then an increase of more than 23% is required – which is far higher than the slight increase currently proposed.**

³ The Commission's Impact Assessment on the Energy Tax Directive, http://www.europa-nu.nl/9353000/1/j4nvqs5kig27kof_j9vvikqpopjt8zm/vioo5lpp2puz.

While the proposed minimum rates are too low to make considerable difference, **the automatic amendments of the minimum energy tax in line with inflation every three years from 1 July 2016 are expected to help increase minimum tax rates, which is welcomed.**

Making adjustments to the proposed CO₂ tax rate

The proposal to link the CO₂ minimum tax level to the price of allowances in the ETS is too weak. The only requirement included is that the Commission examine the minimum level of the CO₂ tax every five years in a report to the Council. Changes will require a unanimous decision by the Member States in the Council.

Linking the CO₂ minimum tax level to the price of allowances in the ETS risks undermining the incentive effect of the minimum tax rate on CO₂. Thus far the ETS market has proven too shallow and too volatile to produce a sufficiently high carbon price. The revision proposal assumes that this situation will improve after permit auctioning, to be introduced from 2013. However, if more than 50% of permits are distributed free of charge, then the ETS will not produce a realistic and reliable set of prices.⁴ Thus, the price of EU ETS allowances is unlikely to provide a sensible basis for setting the CO₂ tax rate in non-ETS sectors.

The Commission's own Impact Assessment predicted that the proposed initial CO₂ tax rate of 20 Euros / ton will result in a 4% reduction of CO₂ emissions in non-ETS sectors by 2020. Such reductions as a result of the Energy Tax Directive are clearly insufficient. **The tax rate should be set so that – taking into account also other measures, especially the ETS and removal of environmentally harmful subsidies – total CO₂ emission reductions in the EU reach 30% by 2020.** Proper modelling already exists which shows the likely tax rate necessary to achieve this aim.⁵

A regular review of the minimum rate of CO₂ tax should take place every third year, not every 5 years as currently proposed. The Commission should be allowed to adjust the minimum CO₂ tax rate UPWARDS to bring it into line with the ETS market price, and the absolute minimum tax rate should be set at 20 Euros / ton. If agreement is not achievable on this, the Commission should be mandated to report and, if the development of the ETS market justifies, suggest an (upward) correction of the tax level to the Council.

As mentioned above, the CO₂ tax level proposed by the Commission is not predicted to deliver the EU emission reduction goal of 20% by 2020. However, conclusive and compelling evidence demonstrates that it would be both possible and profitable to meet a 30% reduction target, and the EU is indeed already committed to increasing the target to 30% should conditions be suitable in the future. **In this case, the CO₂ tax will contribute to meeting these increased levels of ambition. An automatic and flexible adjustment mechanism for the CO₂ tax rate could support the EU's efforts to meet a more ambitious EU emissions reduction target in the future.** While the Impact Assessment⁶ raises this issue, it is not mentioned in the proposal itself. In addition, in all scenarios investigated in the Impact Assessment⁷, the price on allowances by 2020 is above 20 Euros / ton, also demonstrating the need for quick revisions.

⁴ This concern is shared by Director General of Climate Action, Jos Delbeke, who has proposed that some allowances be "set aside" in view of concerns that the EU ETS will undermine the carbon price. Similarly, the UK government has set a floor price for carbon from 2013 in the UK, to ensure a minimum degree of certainty when making investment decisions.

⁵ See the petrE Report: Resource Productivity, Environmental Tax Reform and Sustainable Growth in Europe, Paul Ekins (Anglo-German Foundation for the Study of Industrial Society, 2009) <http://www.petre.org.uk/pdf/FinRepFin.pdf> (accessed on 01.06.2011).

⁶ Figures taken from the Commission's Impact Assessment on the Energy Tax Directive

⁷ Ibid.

B. No exemptions and higher minimum tax rates for domestic fuels

The proposal continues to allow Member States to exempt domestic use of fuels (art 15.1.a). However, 24% of GHG emissions in the EU-27 are attributable to private households, and energy saving potentials in the building sector are considerable and cost-effective. Exempting households from CO₂ tax will also put (existing or future) large-scale district heating systems – often an important environmental improvement – at a competitive disadvantage. **Hence, we call for the removal of the exemption clause for private households as well as the inclusion of higher proposed minimum tax rates for heating fuels in the Directive. These higher rates could be phased in over a relatively long period of time before the full rate be applied. This would give households time to adjust and respond to rising energy prices and for Member States to put measures in place to protect the most vulnerable.** At the same time, a gradual increase of tax rates would ensure that price incentives for crucial and relatively cheap energy saving measures in households are put in place. If the possibility exists to levy no tax at all on domestic use of fuels, then these valuable incentives are lost.

To put this in the context of the proposed revision: Energy related taxation for transport fuels is €9.6 per GJ (raised from €8.9GJ) while for heatingfuels (for electricity) it is €0.15 per GJ. While we support in principle different tax rates on stationary and mobile emissions sources, the current proposed tax rate on household fuels is 63 times lower than for transport – a difference which does not seem justified. Moreover, in the past, this difference has proven to be a strong incentive for tax evasion, as household fuel is illegally channelled for transport use. In some Member States, contraband trade results in more than €1bn in tax losses each year.

Arguments in favour of taxing household fuels

It is often argued that households should be exempt for social reasons – to avoid harming the poor. However, richer households are able to afford to pay higher taxes and should be subject to price incentives to reduce their CO₂ emissions and energy use. Otherwise, an important incentive to reduce CO₂ emissions and energy use is lost. For fairness reasons as well it is important not to exempt all households. Rich households consume more energy than poor households, and thus receive more indirect tax subsidies than the poor, if all households are exempt. It is more progressive and socially just to tax all domestic fuel use for heating purposes and use some of the revenue raised to help protect those who are on low incomes and especially vulnerable, or allocate revenues to renovation schemes for social housing or the homes of those in fuel poverty. In some Member States, higher heating costs are offset through higher social welfare payments or additional social measures. Member States should be obliged to report back to the Commission on steps they are taking to protect those on low incomes.

Compulsory taxation of fuels for heating purposes would – with the right use of the revenues – have multiple benefits for society:

- It will increase private economic incentives for building renovation, since the private economic value of the energy saved will be increased,
- In turn, this would create local jobs in the construction sector where unemployment is high,
- It will generate additional revenues for governments, since richer households required to pay the tax will not necessarily have to be reimbursed. On the other hand, if a reform is revenue neutral, additional positive impacts on employment and on the economy as a result of reduced distortions are to be expected (the so-called double dividend),
- Increasing taxation on fuels for heating purposes for households, if revenues are used to protect the vulnerable, will not have a negative impact on poor households or those in fuel poverty,

- Increasing taxation for fuels for heating purposes in industry will increase the burden of taxation on each industry by a very small amount, and will create incentives for industry to exploit its potential to make energy efficiency savings – and in so-doing, increase competitiveness and reduce costs for the vast majority of industries.

C. Transport fuels - higher rates on diesel to be welcomed, fuel tourism remains an issue

New tax levels on petrol and diesel a step in the right direction

New research from Transport & Environment shows that, in relation to energy content, average fuel tax in Europe has declined in real terms by 10 cents a litre since 1999, attributable to a failure to correct for inflation – a problem which this revision of the Directive corrects – and also due to a shift from petrol to (lower taxed) diesel.⁸ **Thus, we welcome the proposal to increase the minimum diesel tax rate** – which will be a consequence of the introduction of a fuel neutral taxation, mandatory from 2023 – **but we also call for an earlier introduction, preferably in 2018 but no later than 2020.** The clause on fuel neutrality in the revision means that taxation per litre of diesel will be roughly 10% higher than petrol (diesel has a proportionally higher energy and carbon content than petrol). However, it is left to the Member States to set these taxes above the minimum. **Provisions should be included to make sure that the difference between diesel and petrol taxes is evened out by increasing the diesel tax and not by lowering the petrol tax.**

The car industry has claimed this measure will make it impossible to reach the 95 g/km fleet average CO₂ emission for 2020, as laid down in the cars & CO₂ regulation. In fact, fuel taxes have surprisingly little influence on the petrol/diesel car split.⁹

The problem of fuel tourism remains unsolved

Transport fuels can be bought in one country and consumed in another. A working EU-wide regulation in this field is decisive for the achievement of the overall EU climate goals. A major obstacle for the EU to achieve its climate and energy policy goals is that present legislation allows for some countries to attract fuel tax revenues from neighbouring countries by applying lower tax rates, particularly on diesel, thereby restricting the possibility for their neighbours to use fuel taxes as a means of reducing emissions or energy use in their environmental policy. The European Commission has highlighted this problem on many occasions. The proposal slightly improves the situation, but **minimum tax rates are too low to solve the problem of “fuel tourism”.**

The Directive should make it possible or even compulsory to levy a special tax on fuels brought into the EU in the tanks of motor vehicles from those non-EU countries where the fuel price is less than the fuel price in the EU country concerned. This tax should be high enough to prevent fuel tourism and fuel smuggling from non-EU countries into the EU.

⁸ <http://www.transportenvironment.org/News/2011/4/Fuel-taxes-down-10-cents-in-10-years/>

⁹ Data from the T&E “Briefing: Transport fuels and the Energy Tax Directive” shows that there is no correlation between relative taxation of diesel and petrol and diesel cars sales. In the UK, for example, where diesel and petrol are taxed at the same rate, almost 50% of new car sales are for diesel cars. For more information see www.transportenvironment.org/Publications/prep_hand_out/lid/633 (accessed 26 May 2011).

D. Include biofuels

The proposal includes exemptions for all biomass used for heating and electricity, as well as for biofuels and bioliquids that comply with the sustainability criteria in the Renewable Energy Directive. This regulation has several weaknesses:

- Biomass used for heating and electricity are exempt from the sustainability criteria laid down in the Renewable Energy Directive. This means Member States may use fuels that actually increase the climate impact while still complying with the Directive. This risk is aggravated by a complete and unconditional exemption from the CO₂ tax for biomass-based fuels that comply with the sustainability criteria.
- **For biofuels and bioliquids there should be no mandatory exemptions.** Instead, all exemptions should be made optional.
- **The energy tax on biofuels and bioliquids should be introduced from 2020, not 2023.**
- The exemption from the CO₂ tax is currently limited to fuels that comply with the sustainability criteria in the Renewable Energy Directive. **We suggest that this exemption should be further limited according to the Directive 2009/28/EC¹⁰ on the CO₂ emission savings.** This would mean that the CO₂ tax exemption for biofuels and bioliquids which provide greenhouse gas savings of at least 35% should be valid only until the end of 2016. From 2017, the limit should be 50% and from 2018 onwards it should be 60%.

E. Include aviation and shipping

The proposal leaves the tax ban for aviation and shipping fuels untouched. There is no justification whatsoever for this ban. Indeed, a strong majority of the Member States as well as the Commission agreed that the ban should be removed as soon as possible when the present ETD was adopted in 2003.

The Council should take the opportunity of the revision of the ETD to end the tax ban for aviation and shipping fuels. The low incentive effect of the inclusion of greenhouse gas emissions from aviation in the ETS from 2012 – which has been estimated to be equivalent to 1.2 cents per litre of kerosene – does not justify an exemption from energy taxation and prevents the creation of a level playing field between different transport modes.¹¹

F. Inclusion of nuclear fuels in energy taxation

The Energy Tax Directive revision does not address the issue of nuclear fuels or their exemption from the energy component of the proposed tax. Yet the externalities associated with the use of nuclear power, the potential risk implicitly carried by the Member States in the event of a nuclear accident, and the requirement for a level playing field between different energy sources, all justify the **inclusion of a minimum tax rate on nuclear fuel rods in the Directive.** This minimum tax rate

¹⁰ The greenhouse gas emission saving from the use of biofuels and bioliquids taken into account for the purposes referred to in points (a), (b) and (c) of paragraph 1 shall be at least 35%. With effect from 1 January 2017, the greenhouse gas emission saving from the use of biofuels and bioliquids taken into account for the purposes referred to in points (a), (b) and (c) of paragraph 1 shall be at least 50 %. From 1 January 2018 that greenhouse gas emission saving shall be at least 60 % for biofuels and bioliquids produced in installations in which production started on or after 1 January 2017.

¹¹ If the estimated costs of inclusion in the ETS to aviation are calculated per litre of fuel used, then the equivalent rate of tax would amount to 1.2 cents per litre (Financial Times 07.04.2011).

should correspond with the financial advantage enjoyed by nuclear power as a result of increased electricity prices resulting from the EU Emission Trading Scheme.

G. No further / special exemptions

There should be no special exemptions for the nine Eastern Member States. Exemptions from environmental taxation result in poorer environmental outcomes and mainly subsidise wealthy consumers. The impact from such exemptions may include increased GHG emissions, slower rates of economic development, a slower transition to low-carbon economy, and potentially higher rates of unemployment in these countries, and consequently in the EU as a whole. If there are concerns regarding the impact of tax rates on poorer or vulnerable households, any impacts can be mitigated by the means described above under point B.

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