Public Hearing on Green Taxation
European Parliament: FISC Committee
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Dear Members of the European Parliament Subcommittee on tax Matters,

Thank you for the invitation to speak at this public hearing on Green Taxation. I cannot stress how important and how relevant it is to have a larger debate on the scope of the EU Energy Taxation Directive. The review of said Directive in light of the EU Green Deal provides the appropriate backdrop to correct the policy approach adopted when the Directive came into place in 2003.

An update of the policy is long overdue and is necessary, to better reflect the polluting potential and therefore the environmental impact of the covered energy products, remove harmful subsidies on fossil fuels, and extend the scope of the directive to also cover highly polluting energy sources such as coal, as well as the fuels employed in aviation and maritime transport.

My intervention today will therefore focus on three main points:

1. First of all, I will recount some of the history of the Energy Taxation Directive that proposed greater reliance on a carbon tax approach;
2. I will then highlight how the introduction of a carbon tax factor, or the conversion of the energy taxation directive into a carbon tax could be instrumental in fulfilling the EU 2030 Energy targets and the objective of the EU Green Deal to make the EU climate neutral by 2050; and
3. Finally, I will explain how the introduction of an explicit carbon price, via a carbon tax can ultimately simplify the administration of other environmental pricing systems such as the Carbon Border Adjustment Mechanism (CBAM).

Starting with the historical component, as you are probably aware of, prior to the adoption of the Energy Taxation Directive, there was a brief period between 1991 and 1993 when substantial debates took place on the policy approach that would be employed upon introduction of an instrument aiming to both reduce carbon dioxide emissions, and improve energy efficiency within the European territory.

In fact, on 14 October 1991, the European Commission published a Communication to the Council proposing a Community Strategy to limit Carbon Dioxide emissions and to improve energy Efficiency (1991 Communication). The initial Commission proposition, which got converted into the proposal for Council Directive Introducing a Tax on Carbon Dioxide Emission and Energy (1992), was for a hybrid tax, in which half the tax would take into account the energy component and the other half of the tax would take into account the carbon content of the product being taxed. According to that document, an energy tax would be more effective in encouraging energy efficiency, while a carbon tax would provide more specific incentives to reduce CO2 emissions. The justification for only a partial carbon tax was the need to protect the European companies’ competitive position in international markets. Additionally, a
full-on 100% carbon tax would put too much of a burden on coal (of which EU Member States were highly reliant on) and alleviate nuclear energy.

As you know, the 1992 Directive proposal was never adopted. I would nevertheless invite this Subcommittee to revisit the proposed 1992 Directive Introducing a Tax on Carbon Dioxide Emission and Energy, as the issues discussed therein are as current now as they were then. More central to the point is the fact that the proposal defends the application of a tax on the volume of carbon dioxide emitted on combustion of certain fossil fuel products. The application of a uniform carbon tax, whether centrally by the Commission or at Member State level, provides an important price signal for importers, producers, manufacturers and consumers alike, as to the environmental cost of doing business and of consuming energy products. Although an indirect carbon price may be derived from the application of energy taxes, the signal is never as clear as through the introduction of a carbon tax. That is because a carbon tax provides for an exact correlation between the carbon content of a fuel type and the carbon emissions it generates. Therefore, the carbon tax rate expressed by volume or weight units (such as litre of petrol or tonne of coal) will automatically inflict a higher price on the most carbon intensive fossil fuel by-product, thereby providing an economic incentive for the consumer to purchase the least carbon intensive product which, if the tax is absorbed into the price charged to the consumer, is also the cheapest product.

To illustrate, a carbon tax on fossil fuels would automatically create a price differentiation among diesel, gasoline, and natural gas. That is because diesel is more carbon-intensive than gasoline, which is more carbon-intensive than natural gas. Therefore, a carbon tax of $10 per ton of carbon would automatically affect diesel more than it would affect natural gas, creating a price incentive for consumers to purchase natural-gas-based products.

More importantly, the application of a carbon tax at the upstream level, that is, at the level of extraction or importation of crude oil or any of its by-products into a member state territory or the common territory of the EU, has the effect of allowing the carbon tax to impact the entire fuel value chain, all the way to the final consumer. That is a desired effect from an environmental standpoint, because the tax is capable of capturing the full polluting and carbon producing potential of the fossil fuel. It is also a desired design for administrative reasons. Employing a carbon tax at the upstream level would allow equalizing the carbon price employed by all member states, through a carbon price floor. This would provide uniformity to the many country led carbon tax regimes that exist within the EU.

From a policy perspective, and in line with the objectives perceived by the EU Green Deal, it would also allow for the EU to consider employing a Carbon border adjustment mechanism (or CBAM) in respect of the carbon tax – instead of focusing on the compatibility between the CBAM and the existing ETS.

This option would entail the application of an excise tax both domestically and at the border, where the excise tax takes the form of a genuine carbon tax. As such, the rate could vary according to the carbon intensity of the imported (or extracted) fossil product, hence providing the aforementioned economic incentive for producers and consumers to acquire the least carbon intensive fossil source of energy.

Furthermore, since this is a one time tax, applied either on import or on extraction, there would be no need to calculate the carbon footprint of the product before it enters the EU common market, because (i) the tax would be levied on a primary energy source that has not yet been subject to a conversion or transformation process; and (ii) the entire carbon emissions potential of the primary product is still
inbuilt into the fossil product and will only be released once it is subjected to a transformation process (such as production or manufacturing).

Therefore, this would also be the least complex option, capable of providing administrative simplicity, which is a positive feature considering such a tax would have to be employed by several member states concomitantly and in parallel to each other.

More importantly, and this is my last point, the application of a border carbon adjustment measure such as a CBAM in respect of an excise tax such as a carbon tax, has already been tested, and would probably be compatible with WTO rules, as is demonstrated in international trade law jurisprudence such as the case commonly referred to as US-Gasoline. In this case, the WTO panel concluded that a measure aiming to restrict the consumption of gasoline could be deemed to be a measure aimed at protecting human, animal and plant life or health. The same decision also concluded that clean air was an exhaustible natural resource, because it could be exhausted by pollutants such as those emitted through the consumption of gasoline. For this reason, it could also be considered justifiable under the public policy exception of the General Agreement on Trade and Tariffs. Therefore, there would be extensive grounds to conclude that the application of a CBAM in respect of a carbon tax would be admissible under the WTO rules, whereas there is not enough legal evidence to conclude that the same would apply towards a market-based approach such as an ETS.

The introduction of a carbon tax component into the Energy Tax Directive could thus substantively reduce the complexity of the proposed CBAM design, while at the same time providing, for the first time within the EU, a market wide carbon price, capable of equally burdening all producers and consumers irrespective of size or intensity in the use of energy resources. An important landmark that would be much needed to make the EU climate neutral by 2050.

In conclusion, adopting an explicit carbon tax denomination into the energy tax directive would lead to three very important effects. First, it would widen the scope and reach of the directive covering sectors that are currently either not covered or are subsidized. Second, it would allow the tax to inflict a burden that is proportionate to the polluting potential of the energy product, thus providing the right stimulus for consumers to change their consumption patterns in line with an emissions reduction pattern. Thirdly and finally, it would make it administratively easier and legally less challenging to employ an EU wide CBAM that would likewise not be restricted by a limited sectoral coverage, but rather have the capability of reaching and equalizing the carbon price paid by all businesses, industries and consumers within the EU.

These were the comments I had for the moment. I hope to have given you enough food for thought and look forward to answering any questions you might have.