
Introductory statement
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The recent acceleration of inflation and the climate crisis raise the question of public policies and their capacity to protect citizens. The question is key given that GIEC scientists anticipate in the next three decades a higher frequency of shocks driven by climate change (GIEC, 2021). However, the current political governance of the most EU countries involves a non-standard policy mix characterized by a common currency, country-specific budget and tax policies and tiny fiscal transfers that are not intended to be permanent. In sum, monetary policy runs at the federal level for euro area member countries while tax policies are still mostly in national governments’ control. Obviously, euro area Treasuries are not autonomous since their budget position is under the surveillance of the European Semester. This is unfortunately not optimal from an economic point of view, but it is the political status quo which derives from a historical construction. In this context, I will answer the question on the role of tax policy at a national level because this is the appropriate level of political governance. My first point concerns inflation and underlines that at best tax policy can help absorb shocks but not control inflation. In my second point, I agree that tax policy is central in the climate crisis, and I call for a rehaul under a democratic control. I will focus on corporate sector taxes based on my own research.

1) Tax policy is not the first best to fight against inflation, but it can help absorbing the detrimental effects of inflation on households’ welfare.

In the policy mix which combines tax and monetary policies, the latter implemented by the Central bank has the mandate to fight against inflation, i.e. to try and curb faster rising prices.\(^1\) In turn, tax policy can help absorbing the effects of inflation. In fact the main negative effects of inflation on households is a decline of their real income: in most European countries, nominal wages are not indexed to inflation and social income are weakly indexed; this lack of indexation may imply that households’ income grow slower than prices and that people end up with an income that buys less goods and services. According to ECB, nominal wages have increased by a bit more than 6% since the fourth quarter 2019 i.e. before the pandemic but given inflation it means that real wages have fallen by almost 4% in the same period and are expected to fall further in the coming months.\(^2\)

Governments have implemented economic measures to marginally improve the households’ income. It is however a political choice rather than a standard process of the policy mix.

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\(^1\) By tightening the financing conditions for households and for firms, the central bank intends to slow down the economic activity and bring it down closer to its equilibrium trend. By curbing the economic activity, demand should slow down, and prices decline.

\(^2\) Wage developments and their determinants since the start of the pandemic, Katalin Bodnár, Eduardo Gonçalves, Lucyna Górnicka and Gerrit Koester. ECB Economic Bulletin, Issue 8/2022
The decline of real income is certainly not homogeneous across all income levels: for example, in France, the bottom 50% of the population consumes 100% of their income whereas the top 10% consumes 60% and saves 40% of their income. It implies that in their daily life, the bottom 50% suffers $1/0.6 = 1.67$ times more from consumer goods inflation than the top 10%. This fact requests targeted tax responses. The hardest hit income levels should get the largest tax support. This is a matter of government spendings efficiency and of social justice. Yet, some governments have implemented cross-income tax support such as subsidizing the price of gas for every citizen. This is not efficient because the demand of high-income households is less elastic to prices than low-income households. This means that higher prices do not affect their demand and therefore the government subsidy could have been avoided; and it runs against the general interest of reducing the consumption of fossil fuels. In this sense, a subsidy on public transportation may be more efficient and is carbon reduction compatible. The reason why it may be more efficient is if the distribution of public transportation users is biased towards middle- and low-income households. More generally, any tax support to absorb the effects of inflation should meet the following criteria: 1) is it targeted towards the bottom of income distribution? 2) is it compatible with the climate change mitigation objective?

2) Tax policy is the first best to fight the climate crisis but to do so, a rehaul is needed

Tax policy can contribute operating the transition towards a carbon-neutral production system. To do so, economists generally recommend distributing strong government support to help develop low carbon technologies. In fact, the market alone cannot generate good innovation because today high-carbon technologies are still more productive than clean technologies. For example, machines that run on gas or oil are produced faster than machines that run on renewable energy. Therefore, private corporate efforts to develop clean technologies are bound to be insufficient since the private benefits are less than the benefits to the community. The amount of money spent on these activities will be too small compared to the level that would be socially efficient. This reasoning justifies targeted government support to redirect innovation toward clean technologies. According to this model and recent patent data, a combination of subsidies and a sufficiently high carbon tax would reverse the equilibrium and steer firms in the right direction, towards clean technologies. However, this reasoning does not take into account existing government support, which is primarily targeted at carbon-intensive sectors. In fact, in general, government support is somewhat neutral to the sectoral structure of the economy. In carbon-intensive economies such as our developed economies, it is not surprising that tax subsidies primarily benefit carbon-intensive sectors. This is not surprising from a pre-climate crisis perspective, but it should no longer be the case. For example, in France: the amount of money that the government has dedicated to support the corporate sector has doubled over the last 45 years (in % of GDP) to reach 8.5% of GDP on average since 2010, i.e. 190 Billions Eur per year (Fig. 1). The French government thus annually distributes almost 200 billion in budgetary and fiscal aid to companies each year, most of which goes to carbon-intensive sectors. The budget for the ecological transition is capped at 37 billion euros. An interesting feature of the French scheme is that only a quarter of government support is budgetary in the form of subsidies, the rest being fiscal and social in the form of tax and social contributions reductions. For example, the largest French corporate tax credit has a cost of

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Euros 20 billion (0.7% of GDP) and is distributed regardless of the sector but on payroll criteria.\(^4\) An implication is the lack of data transparency because only budget support is recorded in the national account while tax and social contributions reductions are losses and hence not recorded as spendings. This implies that tax and social contribution cuts are not directly visible in the national accounts, which probably diminishes the attention they receive in the public spendings debate.

In sum, beyond the amounts of green fiscal support, it is key to reduce the proportion of non-green government support distributed to carbon intensive sectors. A solution could consist in conditioning EU-level transfers for green transition to the amount of government support to carbon-intensive sectors. It would give an EU leverage to tilt the sectoral composition of government support. To do so, the European Parliament could require the disclosure of all government support including subsidy, tax reduction and social contribution reduction.

In conclusion, tax policy is a key element to protect citizens against shocks. I have emphasized the heterogeneity across income groups, a fact that requires targeted tax policy instead of cross-income measures. In addition, it is key to select government support to the corporate sector upon carbon emission, an area where the EU political governance could help. I have left apart household taxes for the sake of time and lack of personal research. Obviously, a common tax on top income at the EU level is justified by the level of carbon emission of this income group and would help collecting common resources at the EU level.

Fig. 1 Government support to firms and households in Franc over 1995-2021 (as a % of GDP)

\[\text{Source: INSEE, budget laws and social security laws since 1995. Delatte (2023)}\]^5

\(^4\) Note that this tax credit has been turned into a social contribution reduction in 2019.

\(^5\) *L’Etat droit dans le Mur*, Anne-Laure Delatte, Fayard, 2023