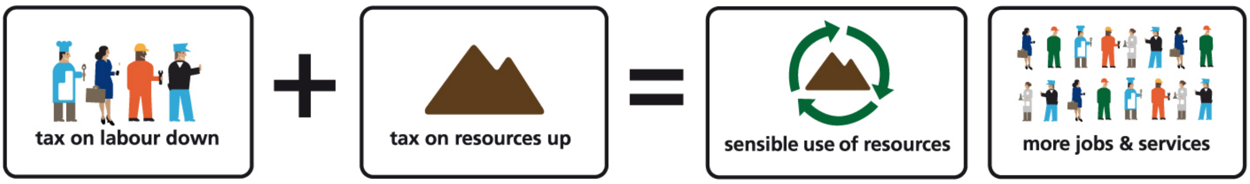
REPORT:

Tax shift boosts economic growth, creates jobs & cuts pollution across EU

The European Union and EU member states would benefit from higher economic growth, more jobs and a cleaner environment if governments shifted taxation from labour to pollution, the use of natural resources and consumption. By 2020, switching taxes from labour to pollution and resource use could increase GDP levels by 2%, create 6.6 million more jobs and cut carbon emissions by 8.2%.

These are the key findings of an extensive study 'New Era. New Plan. Europe. A fiscal strategy for an inclusive, circular economy' by the independent Dutch think tank The Ex'tax Project, in cooperation with Cambridge Econometrics, Trucost, Deloitte, EY, KPMG Meijburg & Co and PwC.

The study presents a tax shift scenario (see box) that matches EU aspirations to relieve the tax burden on labour in each of the 27 EU Member States under review. Cambridge Econometrics modelled the macro-economic effects of this scenario across the European Union using the E3ME model.



Impact across the board

Over the course of five years (2016-2020), the scenario shifts a cumulative € 1,716 billion of tax revenues from labour to natural resources and consumption (2015 prices). During this period, compared to baseline, the scenario saves 1,038 million tonnes of carbon, 219 billion cubic meters of water, 194 million tonnes of oil equivalents of energy resources (12 types of energy sources combined), and € 27.7 billion on the EU energy import bill.

Total value added in EU: € 1,100 billion over five years

Based on the modelling results, Trucost developed an Integrated Value Added Statement. The total value added of the scenario for the EU-27 is estimated at over € 1,100 billion over five years. In addition to the increase of € 842 billion in GDP (financial capital) across the EU-27 countries, € 260 billion in natural capital value will be added due to avoided air pollution impacts on health, avoided greenhouse gas emissions, avoided health and ecosystem impacts of land and water pollution, and water conservation. Over € 17 billion in social capital value will be added through improvements to health associated with reduced unemployment. The full benefits of reduced unemployment are likely much larger, including improvements in income security, economic inequality, poverty risk, social stability and cohesion.

The results in this study confirm that a tax shift from labour to natural resource use is a viable strategy to align fiscal systems with the goals of the Europe 2020 Strategy and the UN Sustainable Development Goals to increase employment, alleviate poverty, reduce harmful emissions and energy use and stimulate R&D.

The scenario

Based on the *Ex'tax Policy Toolkit*, the scenario applies 'the polluter pays' principles by introducing additional excise duties on fossil fuels and (for bulk users) taxes on carbon, water and electricity. It also includes a raise in VAT rates.

The combined revenues of these measures are assumed to lower the tax burden on labour.

Income tax and social contributions paid by employees and employers are reduced (without changing the social protection base). An investment in employment is made through a payroll tax credit for companies that effectively increase employment and a payroll tax credit for circular innovation. Finally, a 0% VAT rate is introduced for labour-intensive services (maintenance and repair).

Gaining momentum

In the past, many institutions such as the OECD, IMF, World Bank, European Parliament and ILO have called for a tax shift, and according to the European Commission it's a "winning strategy". The concept is gaining momentum for a number of reasons. There is, for example, an increasing knowledge base on the external costs of economic activities. Also, the world has seen a surge in support for climate action, which resulted in the Paris Climate Agreement being adopted by more than 190 countries. Across the globe, carbon-pricing systems are successfully being implemented. Finally, the role of business is changing as business leaders are now engaging actively in sustainability. In anticipation of effective carbon pricing by governments, more than 1,200 multinationals apply a shadow price on carbon -or plan to do so by 2018.

A shift in business opportunities

When 'the polluter pays' principles are applied, the cost of water, emissions, metals and minerals go up. The business case of resource-efficient technologies, renewable and biobased materials improves compared to resource-intensive and polluting technologies. Lower taxes on labour makes hiring people and applying manpower, craftsmanship and ingenuity more affordable. Business models can then shift to labour intensive business models, including services, maintenance, production and R&D.

A shift in financial incentives is needed to enable growth based on human capital (capacities and talents) instead of the extraction of natural resources. Such transformation requires a long-term vision on the role of tax and a pragmatic roadmap for implementation. This report contributes to both.

OECD Secretary-General Angel Gurría on the report:

"Tax reform can play an important role in greening growth. The evidence-driven simulations presented in this report of the Ex'tax Project suggest that shifting taxes from labour to consumption and natural resources will result in more growth, more employment, and a smaller environmental footprint. We have enough evidence to support green tax reform and concrete policy action."

The Ex'tax Project (et al.) (2016), New era. New plan. Europe. A fiscal strategy for an inclusive, circular economy. 226 pages. www.neweranewplan.com. Preface by Feike Sijbesma (CEO Royal DSM, Co-chair Carbon Pricing Leadership Coalition (CPLC) convened by the World Bank).

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