OECD's Current Tax Agenda

APRIL 2011

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Green Growth and Climate Change: Taxation and Tradable Permits

Green growth and climate change are global challenges. All countries share the challenge of finding policy instruments that can reduce pollution.

Environmentally-related taxes and emission trading schemes are among the most effective policy instruments: they increase the cost of greenhouse gas emissions and encourage the businesses and households who can most easily change their behaviour to do so (achieving abatement at least resource cost), and they also spur innovation and promote the adoption of climate-friendly technologies. Auctioned emission permits or carbon taxes may also contribute much-needed revenues that can help governments to rebuild sound public finances after the financial and economic crisis.

The CTPA is actively involved in providing countries with analyses of the efficacy of different policy tools to promote green growth and slow and contain

Hosts and speakers at the international seminar on environmental taxation organised by China and the OECD in collaboration, Beijing, 26-27 October 2010 climate change. Over recent years, a series of studies have been undertaken to analyse how taxes on energy and pollution can address environmental problems. In addition new projects are examining how features of tax systems may effectively promote the production and consumption of fossil fuels, and reviewing the tax treatment of tradable permits to identify whether this risks impeding the efficient operation of a tradable permits regime.

Collaboration with emerging economies

Environmental taxation was first embraced by advanced economies. But in recent years it has risen on the political agenda of a number of emerging economies, notably in densely populated Asia. Living standards have risen rapidly in these emerging economies over the past decades, and hundreds of millions of people have been lifted out of poverty. But for progress in living standards and quality of life to continue within the constraints set by natural resources and the environment, economic growth has to take a greener direction.

> *" One of the most powerful and efficient approaches to encourage green innovation is to reform our tax systems. I am not speaking about higher taxes; I am speaking about shifting the composition of taxes: using environmental taxes more to create green incentives, perhaps while cutting taxes on corporate and personal income where it matters most for investment, entrepreneurship, employment and growth."*
>
> *Angel Gurría, OECD Secretary-General, presenting the Taxation Innovation and the Environment book in at the Global Green Growth Conference in Copenhagen on 8 November 2010*

These issues are part of an ongoing dialogue between the OECD and emerging economies on how taxes and tradable permits can be used to achieve environmental goals sharing and adapting OECD experience to the special circumstances in each country. In October, an international seminar was held in Beijing. Chinese experts described the energy taxes and environmental charges that are currently applied in China. Experts from OECD countries, the European Union and South Africa shared their experience concerning energy and energy-related taxes, including taxes on sulfur oxides and nitrous oxides that cause smog, as well as taxes on water and waste. Among the challenges for both the OECD and emerging economies are to refine the administration of environmental taxes, bring tax rates closer to levels that match the environmental damage and ensure they apply consistently to all sources of pollution.

Taxation, Innovation and the Environment

Solving the world's environmental problems could take a significant toll on economic growth if only today's technologies are available. However, innovation – the creation and adoption of new technologies and know-how – provides a means to achieve local and global environmental goals at significantly lower costs. Innovation is also a major driver of economic growth.

As one of the first major reports under the OECD Green Growth Strategy, *Taxation Innovation and the Environment* was released in October 2010.

It explores the relationship between environmentally related taxation and innovation which is critical to understanding the full impacts of this policy instrument.

An example: Sweden was among the first countries to seriously address pollution from Nitrous Oxides that cause smog. Back in 1992 a charge was introduced and after just a couple of years, emissions fell by a third. Power plants used a variety of different technologies depending on what the best fit was – and the least costly – for their particular context. New technical solutions also emerged, and a number of patents were taken out by Swedish companies. If, instead, Sweden had mandated the use of specific technologies, it would not have given room for innovation – the scope for green growth would have been limited. In this sense shifting part of the tax burden onto pollution aligns with the logic of business: it creates market demand for entrepreneurs to develop and sell new smarter and cleaner technologies and promotes green growth.

Aside from Sweden, the report draws on case studies that cover Japan, Korea, Spain, Switzerland, the United Kingdom, Israel and others.

Angel Gurría, OECD Secretary-General, at the Global Green Growth Conference in Copenhagen, 8 November 2010, speaking about the role of tax policies in spurring green innovation and growth.

Putting a Price on Greenhouse Gas Emissions is Crucial

To limit climate change, emissions of greenhouse gases must be reduced. Carbon dioxide (coming mainly from the burning of fossil fuels) accounts for over 80% of greenhouse gas emissions, while methane (coming mainly from agriculture and waste disposal) accounts for close to 10% of greenhouse gas emissions, measured in CO_2-equivalent terms.

Reducing emissions is a global challenge. No matter where emissions happen, or who generates them, they have a broadly similar effect on the concentration of greenhouse gases in the atmosphere. Moreover, because emissions stay in the atmosphere for some 50 years or so, it makes little material difference when they occur. Correspondingly, the sooner serious abatement efforts start, the better. Moving towards similar disincentives for all types of greenhouse gas emissions will be essential.

Households and businesses are sensitive to prices. Whether in the form of taxes or emission permits under cap-and-trade schemes, putting a price on greenhouse gas emissions creates strong incentives to shift towards cleaner methods of production or transport, and encourages households to invest in energy saving and to switch their spending toward more environment-friendly products. They have a choice about how and when to do so; and this should enable them to seek out optimal solutions instead of having to comply with, for example, specific technology standards set out in rigid regulations. Innovation could also be nurtured in other ways but by making emitters 'pay' for the damage they are doing to the planet, other incentives will be reinforced. Putting a price on greenhouse gas emissions is crucial.

A number of countries are adopting and expanding cap-and-trade schemes, but taxes are still needed to ensure incentives for emission reductions in areas where cap-and-trade schemes cannot realistically be applied. Cap-and-trade schemes are generally being used to address CO_2 emissions for large-scale industrial emitters and electricity generation. Current schemes typically do not cover some important sources of greenhouse gas emissions such as waste, agriculture, and transportation. Yet, transportation alone constitutes a fifth or more of total CO_2 emissions. Hence, taxes on fuel will form an essential component of the overall strategy.

While the instruments used may be different, achieving economy-wide abatement at the lowest cost implies that the aim should be to move towards similar incentives for all types of greenhouse gas abatement.

Successfully addressing the threat of climate change requires a comprehensive strategy for all sources of emissions. Current approaches in many OECD countries, by contrast, provide significant concessions that undermine achieving an ambitious target at the lowest possible cost. Aviation, shipping, agriculture, and energy-intensive industries are routinely subject to reduced tax burdens and, in some cases, are completely exempted or payments are refunded.

The G20 mandate on fossil fuel subsidies

At the Pittsburgh Summit in September 2009, G20 Leaders agreed to phase out subsidies that encourage wasteful fossil fuel consumption. The G20 also asked the OECD, together with the International Energy Agency, the World Bank and OPEC, to produce a report analysing the scope of such subsidies, and subsequent G20 meetings have asked for this work to continue. For OECD countries a large part of these subsidies take the form of tax expenditures related to oil extraction, coal mining, processing of fuels or the use of fossil fuels either by businesses or final consumers.

Starting from work undertaken by the CFA's Working Party 2, the OECD is now looking into methodologies for assessing how features of the tax systems may promote production and consumption of fossil fuels. A key aim is to help countries achieve reductions in green house gas emissions at least resource cost.

The Tax Treatment of Tradable Permits

Tradable permits will be used increasingly by countries, notably to curb CO^2 emissions. Tax experts need to pay attention to such developments: it is easier to establish solutions to tax issues while tradable permit markets are still being developed before the amounts at stake become high and countries' positions more entrenched.

The CFA is reviewing the tax treatment of permits in member countries, to identify whether there could be impediments to the efficient operation of a permits regime (particularly through international interactions of tax regimes) and consider appropriate responses. ■

Key Publications

- Taxation, Innovation and the Environment, October 2010.
- Green Growth Strategy Synthesis report (forthcoming)
- Taxation and Green Growth (forthcoming)
- Environmentally Related Taxes and Tradable Permit Systems in Practice, June 2008.
- The Political Economy of Environmentally Related Taxes, June 2006, ISBN: 978-92-64-02552-3

Tax and the Environment on the Web

- *www.oecd.org/env/taxes*

- **Did you know**…Recent OECD analysis found that, if the proper mix of policies and instruments to price carbon is put in place to reduce emissions by 20% in developed countries by 2020, this could raise the equivalent of up to 2% of their GDP?

Want to Know More?

Key Links

Consumption tax	*www.oecd.org/ctp/ct*
Dispute resolution	*www.oecd.org/ctp/dr*
Exchange of information	*www.oecd.org/ctp/eoi*
Harmful tax practices	*www.oecd.org/ctp/htp*
Global Forum on transparency and exchange of information for tax purposes	*www.oecd.org/tax/transparency*
OECD tax database	*www.oecd.org/ctp/taxdatabase*
Partnerships with non-OECD economies	*www.oecd.org/tax/globalrelations*
Tax administration	*www.oecd.org/ctp/ta*
Tax crimes and money laundering	*www.oecd.org/ctp/taxcrimes*
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Transfer pricing	*www.oecd.org/ctp/tp*
Tax treaties	*www.oecd.org/ctp/tt*
Tax treatment of bribes	*www.oecd.org/ctp/ttb*

Key Publications

- Revenue Statistics 1995-2009 (2010 edition)
- Taxation, Innovation and the Environment (2010)
- OECD Tax Policy Studies No.19: Choosing a Broad Base – Low Rate Approach to Taxation (2010)
- OECD Tax Policy Studies No. 20: Tax Policy Reform and Economic Growth (2010)
- Model Tax Convention on Income and Capital (2010)
- Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2010 update)

- Taxing Wages (2010)
- Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues
- Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series 2010
- Global Forum on Transparency and Exchange of Information for Tax Purposes, 18 Peer Review Reports

Key Events in 2011

- Tax and Crime: A Whole-of-Government Approach in Fighting Financial Crime, Oslo, 21-23 March 2011
- Second Plenary Meeting of the informal Task Force on Tax and Development, Paris, 11-12 April 2011
- 11th Annual U.S. & Europe Tax Planning Strategies Conference, Paris, 14-15 April 2011
- Global Forum on Transparency and Exchange of Information for Tax Purposes, Bermuda, 31 May – 1 June 2011
- OECD-USCIB Tax Conference, Washington, 6-7 June 2011
- High Level Seminar: Current Issues in Transfer Pricing – Delhi, India, 13-14 June 2011
- OECD 50th Anniversary: High Level Tax Reform Conference, Paris, 30 June 2011
- 16th Annual Tax Treaty Meeting, Paris, 15-16 September 2011
- First Annual Transfer Pricing Meeting, Paris, 3-4 November 2011
- Fifth ITD Global Conference on Inequality, 5-7 December 2011
- Seventh Forum on Tax Administration, Argentina, 18-19 January 2012

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