CONSUMER PERSPECTIVE ON THE REFORM OF THE EU ENERGY TAXATION DIRECTIVE

Position paper of the Federation of German Consumer Organisations (vzbv)

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1. ABOUT THE FEDERATION OF GERMAN CONSUMER ORGANISATIONS

The Federation of German Consumer Organisations (Verbraucherzentrale Bundesverband e.V. – vzbv; www.vzbv.de) is the umbrella organisation for more than 40 consumer organisations throughout Germany and represents the interests of German consumers vis-à-vis policymakers, the private sector and in public.

2. INTRODUCTION

On 11 December 2019, the European Commission adopted its Communication on a European Green Deal. The European Commission plans to make Europe the first climate neutral continent in the world by 2050 and to reduce greenhouse gases emissions by at least 55 percent by 2030. In order to achieve this goal, the European Commission will come forward with a package of legislative proposals in 2021. The revision of the EU Energy Taxation Directive (ETD)[1] forms part of this package to deliver on climate neutrality by 2050.

The ETD lays down the basic rules for the taxation of energy products used as motor or heating fuel and of electricity in the EU single market. The current ETD was adopted in 2003 and has not been updated since, even though energy markets and technologies as well as the EU's ambition to combat climate heating have evolved considerably since then.

Well-designed fiscal instruments can be an essential policy option to complement the existing climate and energy regulatory framework and accelerate the transition towards a carbon-neutral economy. In a free market economy, producers pass on the price of energy of a product or service to the consumer. The taxation or subsidisation of energy products is therefore of immense importance to consumers as those fiscal decisions amplify or weaken the effect that the price of a product has on a consumer's purchasing decision. As the European Commission wants to use the ETD as a tool to decrease greenhouse gas emissions, it is to be expected that any forthcoming reform proposal will try to steer consumers' behaviour with the help of price signals to adopt less CO_2-intensive consumption patterns. Policy makers should strive to make any ETD reform as consumer-friendly as possible as it will be the consumer who pays the costs in the end.

The European Commission's legislative proposal to align the ETD with the European Green Deal should therefore address four key priorities.

3. CONSUMER PRIORITIES FOR ENERGY TAXATION

3.1 Tax on negative externalities

The European Commission wants to align the ETD with its climate and energy priorities laid down in the European Green Deal. Currently, energy products are taxed according to their consumed volume (e.g. per kWh/per m^3) instead of their effects on the climate or the environment. In its review of the current ETD[2], the European Commission found that taxes on energy products are incoherent. It found strong divergences between min-

[1] Energy Taxation Directive 2003/96

[2] European Commission, Evaluation of the Energy Taxation Directive, 12/09/2019: https://ec.europa.eu/taxation_customs/news/commission-report-evaluation-energy-taxation-directive%C2%A0_en, 13/10/2020

imum tax rates on electricity and those on heating fuel or gasoline, which distort the effect of price signals to consumers and investors alike in terms of making climate-friendly decisions.

In vzbv's view, the ETD should tax energy products according to their negative climate externalities such as greenhouse gases emissions. Such an approach would follow the polluter-pays principle[3]. Internalising negative externalities such as the CO_2-emissions in the price would make the "true costs" of a product more visible to consumers, which in turn can help to guide consumers' consumption choices. Products with high carbon content would become more expensive compared to more climate-friendly alternatives. This would provide much needed guidance for consumers as the sustainable consumption choice would become more competitive. Manufacturers would receive a price signal as well, which they need for their investment decisions in climate-friendly production facilities, triggering a chain effect that could lead to more sustainable product choices for consumers.

TAX ON NEGATIVE EXTERNALITIES

The European Commission should revise the ETD in order to support the transition towards climate neutrality. It should base the minimum tax rate of an energy product on the cost of their climate-averse externalities such as greenhouse gases emissions.

3.2 Fair distribution of costs and an end to fossil subsidies

Producers will pass on the energy costs to consumers in their final products. Therefore, higher energy taxes for products with a higher carbon content will mean higher prices for consumers concerning these products. In order to gain consumers' acceptance of such taxation and the higher prices for climate-unfriendly products, it is important that policy-makers distribute the costs for safeguarding public goods such as a healthy climate amongst all actors in order to ensure that the costs are distributed fairly.

Currently, however, industrial production benefits from both direct and implicit fossil fuel subsidies[4]. This undermines both the climate objectives and the fair distribution of costs in society. According to a study by the Overseas Development Institute, Germany alone provided fiscal support worth 33.3 billion euros per year in support of combustion engine vehicles, a capacity mechanism including coal-fired power plants, aviation, shipping, petrol and diesel[5]. The number also includes tax exemptions for the industrial sector, which constitute implicit subsidies and lead to a disproportionate burden on consumers who have to fill any arising gaps in the financing of public goods.

Therefore, policy-makers should abolish all direct fossil fuel subsidies as well as fiscal exemptions for industry, including the tax exemptions for kerosene in the aviation sector. Such an approach would distribute the costs of saving the climate and preserving the environment more equally and consumers would be more willing to accept higher costs[6].

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[3] Article 191 TFEU

[4] Example: state aid for capacity mechanisms, which include coal-fired power plants is allowed until 2025. Cf. OECD, 2019, p.3: https://www.oecd.org/fossil-fuels/publication/OECD-IEA-G20-Fossil-Fuel-Subsidies-Reform-Update-2019.pdf, 13/10/2020

[5] ODI, 2020, Phase-out 2020: monitoring Europe's fossil fuel subsidies, p.2: https://www.odi.org/sites/odi.org.uk/files/resource-documents/11778.pdf, 13/10/2020

[6] vzbv, 2019: https://www.vzbv.de/pressemitteilung/verbraucher-sehen-chance-im-klimaschutz, 13/10/2020

FAIR DISTRIBUTION OF COSTS AND AN END TO FOSSIL SUBSIDIES

Policy-makers should abolish all direct fossil fuel subsidies as well as fiscal exemptions for industry, including the tax exemptions for kerosene in the aviation sector.

3.3 Revenue: ex-ante assessment of social impact and compensation measures

Introducing carbon emission adjusted energy taxation could potentially have strong social impacts. Firstly, carbon-adjusted energy taxes will increase the price of heating fuels and gasoline for households, possibly making them unaffordable for some consumers. Secondly, fossil fuel based electricity production (e.g. gas-fuelled power plants) will become more expensive and this cost will be passed on by manufacturers of products to consumers. Thirdly, manufacturers will have to compensate the lack of subsidies through higher product prices for consumers.

If consumers cannot afford the fuel anymore, mobility might decrease or some households might struggle with paying their heating bill in winter. Therefore, public authorities should carefully consider the impact that a tax on negative externalities and an end to fossil subsidies would have on consumers, especially low-income households, before introducing any such measure.

It is important that, once the impact has been assessed, the European Commission starts a dialogue with Member States on how to use the additional available revenue generated from the carbon-adjusted energy taxation and the saved fossil subsidies. vzbv recommends that the additional revenue should be used to benefit consumers as they will be burdened with additional costs. Member States should be required to develop strategies on how to mitigate the aforementioned undesirable social effects in order to prevent a repeat of the “Yellow Vest” experience observed in France. Such accompanying social measures are necessary for the broad acceptance of climate policy, especially when those policies put an additional burden on consumers. They are also an opportunity to compensate economically disadvantaged consumers for their proportionally higher financial contribution as well as reward those who choose to adapt to a climate-friendlier lifestyle. For instance, in Germany, the introduction of a national carbon price is accompanied by financial measures for low-income households, investments in public transport and a reduction of the price of electricity for all consumers.

A direct financial compensation to households at Member State level via a lump-sum payment could also alleviate the financial burden of carbon-adjusted energy taxation, while ensuring that a price on negative externalities develops the desired steering effect away from products with high carbon content[7].

REVENUE USAGE

Policy-makers should carefully consider the impact that a carbon-adjusted energy taxation would have on consumers, especially low-income households, before introducing any such measure. The revenue as well as the saved fossil subsidies should be fully used to benefit consumers as they will be burdened with additional costs.

[7] German Council of Economic Experts, 2019, Setting out for a new climate policy: https://www.sachverstaendigenrat-wirtschaft.de/en/special-report-2019.html, 13/10/2020

3.4 Dynamic taxation

The European Commission should reflect upon taxing electricity ad valorem (as a percentage of the market price) instead of a per-unit (kWh) basis. Such an approach would make price signals for consumers more effective and thus stimulate behavioural changes. It could incentivise consumers' participation in demand-response schemes and energy efficiency schemes as the amplified price signals promise higher rewards for those who participate. Especially flexible consumers who own electric cars or use electric heating systems could benefit from stronger price signals that reward their flexibility. This could help to promote other public policies such as the take-up of electric vehicles and electrification of heating services.

However, the European Commission should consider that low-income households have less flexibility and therefore less capacity to participate in demand-response schemes. Low-income households rarely own electric cars or heat pumps and generally consume less electricity than affluent households. They are also more dependent on an immediate supply of electricity as they use it for essential services such as heating, cooking, washing, rather than leisure activities.

The European Commission should also be mindful that energy taxes have a regressive effect on consumers, meaning low-income households suffer more from higher taxes than affluent households since the usage of energy services is unavoidable for low-income households.

Therefore, an option that the European Commission should assess is a scenario in which taxes on electricity are only partially based on an ad valorem calculation. In such a scenario, a fixed per unit tax (per kWh) would be accompanied by a percentage-based tax, which would be based on the market price (+/- x percent of market price). Such an approach would lead to a more manageable corridor of final prices, which would protect consumers from price shocks. As with the introduction of a carbon-adjusted energy taxation system, social measures should accompany the introduction of dynamic electricity taxation elements. Such measures should aim at enabling less affluent households to participate in demand-response schemes and adjust their energy consumption. Member States should ensure that social measures prevent economic hardships for energy-poor consumers or those that cannot participate in demand-response schemes.

DYNAMIC TAXATION ELEMENTS

Dynamic energy taxation does not benefit all households. Some households do not have the flexibility to participate in demand-response schemes. A combination of fixed and variable energy taxation could alleviate price shocks. Social measures for low-income households and inflexible households should accompany the introduction of dynamic taxation elements.