



Forum European Union – Latin America and the Caribbean

Fiscal policy and an environmentally sustainable economy in the context of climate change

10 and 11 November 2010, Berlin

Recommendations

Convened by	Federal Ministry for Economic Cooperation and Development (BMZ), Germany The United Nations Economic Commission for Latin America and the Caribbean (ECLAC/CEPAL), Santiago de Chile Ministry of Foreign Affairs, Chile
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1. Introduction

Leading policy- and decision-makers from the worlds of politics, business and industry, and civil society in the Latin American and Caribbean regions and the European Union (EU) came together in Berlin on 10 and 11 November 2010 to exchange ideas on the objectives and instruments of fiscal policy and their implications for the challenge of climate change and the aspiration to achieve an environmentally-sustainable economy. The immediate aims were to provide specialist input for the design of suitable fiscal policy approaches and to enhance the quality of fiscal policies with environmental implications.

The EU-LAC Forum on fiscal policy and an environmentally-sustainable economy in the context of climate change builds on the existing strategic partnership between the European Union and the Latin American and Caribbean region and marks a further step in the process of exchanges on fiscal policy that commenced in Berlin in March 2008 and continued in Montevideo in May 2009. It also forms part of the preparations for the summit of European, Latin American and Caribbean heads of state and government for the UN Climate Conference (COP16) to be held in Cancún, Mexico, in December 2010, the UN Climate Conference (COP17) scheduled for December 2011 in Durban, South Africa, and the EU-LAC summit of heads of state and government planned for the first half of 2012 in the Chilean capital Santiago.

2. Addressing climate change while improving public finances through fiscal policy: government obligations

The rate of progress of climate change means that prompt action and large-scale investment in energy-efficient, environmentally-benign technologies are required. For this reason, notwithstanding the economic and financial crisis, the international community must not only deploy substantial resources, but also, and in particular, offer the right incentives to steer development towards low-carbon societies. No individual state can succeed in achieving this objective without the involvement of the commercial and industrial sectors and of civil society.

Addressing climate change presents the established routines of governments and parliaments with a whole series of challenges. Long-term trends in society and the long-term impacts of policy measures must be identified and taken into consideration. Policies must be coordinated across a large number of departments, as the necessary transformation of approaches to the environment cannot become a reality without an integrated, overarching programme applicable in every sphere of state action – an overall philosophy that must also take account of a country's aspirations for social justice and economic development.

2.1. Re-orientation of strategic goals for a sustainable economy, bearing in mind payoffs between affordability and climate protection, and incentives from policy choices and economic distortions.

2.2. Review of administrative and governance structures and decision-making processes to increase stakeholder involvement and ensure greater acceptance of critical transformations

- (1) Involving private-sector actors who can contribute to protection of the environment and climate with their technical and financial resources – through, for example, dialogue with private financial institutions with a view to promoting ecologically-responsible investment
- (2) Creating appropriate conditions for a commitment on the part of industry, with particular emphasis on early announcement of policy measures owing to the crucial importance of long-term planning security for relevant actors.
- (3) Increasing public expenditure efficiency, as deficits in important socio-political and environmental tasks are attributable not only to inadequate investment by the state but also, and more importantly, to the ineffectiveness and lack of relevance of the measures applied.

2.3. The design of appropriate fiscal policy instruments requiring long-term planning processes and evaluation systems based on country-specific criteria. This requires the establishment of an independent body for evaluating the instruments deployed and their outcomes.

3. Fiscal policy instruments with climate and environmental implications

Numerous approaches, in addition to a wealth of instruments and measures of various kinds were proposed, which now need to be developed from a theoretical perspective to assess their practical value. The summary below does not claim to provide an exhaustive account of the different approaches and solutions that are proposed, but rather outlines some suggestions and is intended as a basis for future debate amongst the relevant actors.

3.1. Multi-sectoral approaches

3.1.1. Use of international funding mechanisms to encourage the countries of Latin America to adopt climate protection measures

- (1) Mechanisms for forest carbon storage (REDD)
- (2) Development of Nationally Appropriate Mitigation Measures (NAMAs)
- (3) Investment in capacity building for monitoring and evaluation

3.1.2. Achieving integrated fiscal reform: widening the tax base and establishing a fairer tax system

- (1) Securing a proportionate distribution of the tax burden by improving the balance between direct and indirect taxes
- (2) Reduction of income-tax allowances for high earners
- (3) Reduction in value-added tax and/or greater modulation of VAT rates (higher for luxury goods and lower for basic necessities)
- (4) Abolition of exemptions and special treatment in both direct and indirect taxation – e.g. exemption of certain sectors from VAT

- (5) Introduction of specific incentives for small- and medium-sized enterprises and investors, to ensure that the tax reform does not induce firms to take refuge in the informal economy causing the part of the flow of foreign investment to dry up
- (6) Development of approaches to the funding of social security through direct taxation, thus reducing the cost advantages enjoyed by firms in the informal sector
- (7) Restructuring, modernization, and competence and capacity building for tax authorities
- (8) Enhancing the transparency of fiscal systems so that tax collection principles are readily-comprehensible as is the logic behind the use made of the tax collected
- (9) Programmes for the most vulnerable groups in society, which barely benefit from these measures, either because their income is below the tax threshold or because their earnings originate from the informal sector, and which do not benefit from the reduction in value-added tax because the goods and services they use are obtained from the informal sector

3.1.3. Influencing knowledge and values amongst actors by suasional methods/techniques ('moral suasion')

- (1) Information, training, raising awareness about the issue
- (2) Introduction of new terms for taxes in line with the principles behind "tax psychology", with a view to securing greater public acceptance of measures

3.1.4. Establishing mechanisms for coordination and exchange of views

Formal and informal dialogue and discussion (working groups, round tables, task forces, etc.) involving all actors – government, private sector, academic partners and NGOs – at municipal, regional, national and international level

3.2. Energy/energy efficiency and industry, construction and tourism

3.2.1. Review and restructuring of the various different tax, incentive and certification systems

'Green Tax', review incentives through the Renewable Energy Act and emissions trading certificates so as to limit fiscal effects and eliminate mis-allocation

3.2.2. Promoting technology transfer, technology cooperation and partnerships in order to create local value chains with potential benefits for all parties

- (1) Increasing state incentives for and cooperation in research
- (2) Seeking innovative forms of cooperation through joint ventures or public-private partnerships
- (3) Increasing adaptability, empowering actors to understand technologies, and providing knowledge transfer with particular emphasis on education
- (4) Accelerating technology transfer by means of climate funds using public resources contributed by the governments of industrialized nations, thus enabling poorer countries to deploy climate-related and environmental technologies earlier.
- (5) Reducing customs duties on climate-related and environmental technologies so as to achieve faster market penetration

3.2.3. Reducing consumption of energy and resources and increasing efficiency through economic incentives (fiscal and market-based instruments)

- (1) Emissions trading
- (2) Environmental taxes and duties (with the aim not only of benefiting the environment but also of increasing tax revenues): kerosene tax, CO₂ tax
- (3) Removal of fossil fuel subsidies in favour of greater incentives for renewables
- (4) Support for energy storage and transport technologies
- (5) Abolition of import duty on renewable energies
- (6) Support for biofuels (especially second-generation: wood, grasses etc.)
- (7) Incentives for innovative low-tech inventions (e.g. grassroots inventions)
- (8) Technology bonus for innovative technologies
- (9) Incentives for making buildings more energy efficient: providing existing buildings with better insulation and more energy-efficient equipment and systems
- (10) Removal of subsidies for establishing industrial, commercial and transport facilities on virgin land

3.2.4. Allocation of savings achieved by removing subsidies for the most energy-intensive sectors to measures that achieve positive benefits, with the aim of gaining public acceptance for these measures and off-setting job losses due to the removal of subsidies

- (1) Re-training of workers in industries affected by removal of subsidies
- (2) Off-setting the adverse effects of indirect fuel taxation (e.g. on low-income groups) by short-term compensatory mechanisms
- (3) Introduction of new subsidies to off-set or mitigate adverse effects

3.3. Agriculture, forestry and water resources management

3.3.1. Changing the principles behind taxation in international trade

Countries that export solid and liquid biofuels should be able to impose export tax on their products, to be recognized by importing countries so as to avoid double taxation

3.3.2. In the short term: implementation of measures with direct implications for tax revenues

- (1) Introduction of differential prices for agricultural water use to reflect actual production costs
- (2) Removal of farm subsidies

3.3.3. In the long term: cost-benefit analysis of environmental projects covering not only fiscal and economic impact but also environmental and social effects

3.3.4. Direct incentives for green technologies and environmental projects through bilateral conditional debt remission agreements

- (1) Consultation and participation of affected communities (e.g. national park residents)
- (2) Provision of alternative sources of employment and income to cushion income loss due to restrictions and/or prohibitions (on logging or hunting)

3.4. Transport, infrastructure and megacities

3.4.1. Using demand management to increase the cost of private motorized transport while incentivizing the shift to public transport

- (1) Taxing motor fuel and using the resulting revenue to off-set social disparities; conditional cash transfers (CCTs) could be used to compensate for redistributive mechanisms
- (2) Use of road pricing or city centre congestion charging as instruments for avoiding congestion, controlling traffic levels and flows, and reducing noise and other environmental pollution; the revenue could be used to fund public expenditure such as budget deficits or consumption-related public spending, ring-fenced funding of public expenditure such as highway infrastructure projects or support for alternatives to private motorized transport (e.g. public transport or cycling), as well as indirect or direct monetary reimbursement
- (3) Introduction of pay-as-you-drive systems and insurance schemes with premiums charged partly according to mileage or driving style

3.4.2. Improving local public transport

- (1) Increasing the attraction of public transport facilities by better matching of supply and demand
- (2) Improvement and more efficient use of existing infrastructure
- (3) Investment in new transport capacity: supplementing local bus services with additional public transport facilities such as underground, metropolitan and suburban railways and trams

3.4.3. Designing measures to change attitudes and behaviour among relevant actors

Raising awareness of the problem of increasing traffic levels and their effects; this calls for various educational activities to draw attention to the concept of sustainable transport facilities and to secure social acceptance for the introduction of fiscal measures

3.4.4. Exploiting megacity densification to introduce sustainable trends, economic attitudes and patterns of behaviour

Urban development and planning have an enormous potential for sustainability. Densification of city centres is an important factor in sustainable development of the lived environment and can contribute to limiting urban sprawl.

3.4.5. Securing better outcomes through improved governance

- (1) Establishment of strategic infrastructure management systems for long-term planning
- (2) Improved coordination of individual levels of urban administration and establishment of clear command hierarchies, as well as integrated urban management approaches
- (3) Enhancing the efficiency of administrative bodies by reducing their number and by clearly delimiting their responsibilities, so as to avoid duplication and to facilitate strategic planning
- (4) Creating administrative structures that cater to the needs not only of the core city but also of the conurbation as a whole, while also taking account of the interactions between individual infrastructure fields

3.4.6. A more direct response to local issues, and, in particular, the needs of disadvantaged social groups, through increased transparency and greater responsibility for city management

- (1) Making local officials responsible for more areas of administration while at the same time increasing their accountability to residents and/or electors
- (2) Provision of full information on the application of financial resources
- (3) Direct involvement of the public in determining city budget allocations