Appendix 1: The Taxshift Principles

A ‘taxshift’ entails an update of tax systems to address environmental challenges (such as climate disruption and resource supply risks) and social issues (such as underemployment and poverty) simultaneously. It focuses on opportunities to gradually increase taxes on resources and pollution while using the revenues to lower the tax burden on labour and invest in social impact.

A selection of quotes in support of applying such taxshift principles:

<table>
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<th>The European Green Deal:</th>
<th>World Business Council for Sustainable Development (WBCSD):</th>
<th>U.N. Secretary-General António Guterres:</th>
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<td>“At national level, the European Green Deal will create the context for broad-based tax reforms, removing subsidies for fossil fuels, shifting the tax burden from labour to pollution, and taking into account social considerations.”</td>
<td>“Shift the burden of taxation from “goods” (eg., employment) to “bads” (eg., pollution).”</td>
<td>“Solutions exist. First, let’s shift taxes from salaries to carbon. We should tax pollution, not people. Second, stop subsidizing fossil fuels.”</td>
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<td>OECD:</td>
<td>“[...] taxing economic &quot;bads&quot; (in this case carbon emissions) and using the revenues to reduce distorting taxes on economic &quot;goods&quot; (labour and capital) should increase the efficiency of the overall tax system. The increase in efficiency from broader tax reform has the potential to provide a double dividend, both improving environmental outcomes and increasing overall economic activity.”</td>
<td>IMF Managing Director Kristalina Georgieva:</td>
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<td>“Lowering taxes on labour and capital, in favour of taxing environmentally harmful consumption and production, can stimulate job creation and investment, improving economic efficiency.”</td>
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<td>“What we want to see is, very simply, to move the revenue raising objectives of governments from taxing people, taxing labour, to taxing pollution.”</td>
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Brief explanation:

Our current linear economy causes climate change and environmental damage (including biodiversity loss, soil contamination, plastic waste, air pollution and greenhouse gas emissions). To tackle these issues, we need to transform our economy to a circular system of closed loops in which raw materials, components and products lose their value as little as possible.

Companies are seeking to adopt circular practices, but many have found that the financial incentives in our tax systems are in fact curbing circular growth. Pollution and the use of natural resources are relatively tax-free. To illustrate, only 6% of tax revenues in EU Member States comes from ‘green’ (environmental) taxes. These taxes cover all uses of natural resources, including fuels, metals, minerals, water, air and soil; in addition to pollution and emissions of CO2 and other greenhouse gases.

At the same time, on average, EU-countries derive the majority (53%) of their tax revenue from labour, through income tax, payroll taxes and social security contributions. These directly erode net incomes, and on average, for every euro an employer pays in labour costs, only €0.61 ends up in the employee’s pocket. In addition, high labour taxes incentivise companies to minimise the use of human capacities, even if this means using more materials and fossil fuels, as resource use is taxed at low levels – and sometimes even subsidised.

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This system is a barrier to circular solutions, which tend to be more labour- and/or knowledge intensive. Also, they need to compete with products whose prices do not take into account the costs of externalities such as climate disruption and damage to health. Such external costs are borne by society at large rather than the polluter. Current tax systems therefore create an uneven playing field for circular products and services. The polluter doesn’t pay – the polluter gets paid. At the same time, labour taxes are a barrier to inclusive business models.

The taxshift is the proposal to shift taxation from labour to taxing pollution and resource use. Note that it’s not a proposal to increase taxation. Instead, the taxshift is about taxing more intelligently by aligning financial incentives with sustainable and social objectives of governments and businesses. Polluting activities will become less financially appealing, but circular and inclusive activities, on the other hand, become more financially viable. This would speed up the transition to a competitive circular economy while ensuring a socially just transition and well-functioning labour markets.

For more details, please refer to The Ex'tax Project (et al.) (June 2022), The Taxshift. An EU fiscal strategy to support the inclusive circular economy, and its country-by-country results.²