

Forum: Economic and Financial Committee (GA2)

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TOPIC 3: The question of green tax

I. Introduction to the Topic

According to the Organization for Economic Cooperation and Development (OECD), a green tax, or environmental tax, is a tax on “a physical unit that has a proven, negative, and specific impact on the environment”. Examples of green tax include taxes on fuel, carbon emission, and flights, all of which pose specific impacts that are proven to be negative for the environment. In recent years, a global rise in the implementation of a carbon tax has spurred greater interest in green taxes as a way to generate funding for combating climate change and promoting sustainable economic activities (Parry). However, difficulties in enforcing green taxes in developing countries and opposition from the private sector have prevented green taxes from playing a more major role in global climate change mitigation (Ibid.; Kings).

While green taxes can help reduce greenhouse gas emissions, they are much more welcomed in advanced economies, where consumers can bear the higher energy costs and the government has an effective tax system to help with monitoring polluters (Aldy and Stavins 155-157). However, given that developing countries emit 63% of global CO₂ emissions, the full potential of green taxes, which includes lower fiscal burden and lower economic intervention, will not be unlocked unless questions regarding their enforcement are resolved (Center for Global Development; “Environmentally Related Taxes in OECD Countries” 3).

II. Definition of Key Terms & Concepts

Fiscal policy: The use of government revenue collection and taxation to influence the economy (Econlib). Green taxes are part of a country’s fiscal policy as they raise government revenue from harmful activities to the environment and provide potential funding for environmental protection. All fiscal policies must work in cohesion to produce the intended

economic effects, hence, countries must consider the effects of a green tax on their economy and whether that is desirable to their current economic situation.

Incentive: In an economic sense, a reward or punishment that causes people to change their consumption or production behavior (WallStreetMojo). Green taxes are incentives that deter behaviors that negatively impact the environment, such as consuming single-use plastics, emitting carbon dioxide from manufacturing, and producing trash. Economic incentives such as taxation serve as an effective tool to make economic behaviors more environmentally friendly, as they promote action and innovation from producers and consumers to limit added costs from green taxes (Coria and Endo).

Negative externality: A cost borne by a third party as a result of an economic transaction (Pettinger). Economic activities that harm the environment create negative externalities as their impacts extend, beyond the producer and consumer, into stakeholders outside the transaction like the government and society. For example, a transaction in which an oil company provides petrol to a vehicle owner creates costs to the government, which has to manage worsened air pollution and climate change, and to society, because of health costs associated with air pollution.

Regressive tax: A tax imposed in a manner where the tax burden increases as income decreases (Tax Foundation). Regressive taxes are deemed unfair because poorer people have to pay a higher proportion of their income towards the tax than wealthier people. Some green taxes, like a fuel or flight tax, are regressive as the same flat fee is imposed on every consumer or producer, causing financial pressure on the most vulnerable sections of society (“Environmentally Related Taxes in OECD Countries” 29).

III. Key Stakeholders

Countries most affected by climate change: Out of the 10 most vulnerable countries to climate change according to the 2020 Climate Risk Index, 7 of them are developing countries (Iberdrola). Vulnerable countries receive more social, economic, and environmental damages and thus have a larger interest in the global regulation of environmentally-harmful economic activities. While they may confront different climate risks due to geographic reasons, developing countries generally lack the capacity to respond to them (Concern Worldwide). Furthermore, they cannot implement green taxes as flexibly as developed countries due to

inefficient tax systems, lower incomes, and dependence on non-renewable energy sources (Aldy and Stavins 156). Hence, developing countries that are highly vulnerable to climate change will likely request support from other countries and higher burden to be placed on developed countries.

Organization for Economic Cooperation and Development (OECD): While mainly consisting of developed, European countries, the OECD still exerts considerable influence over international green tax policy formulation as it has published research for many years regarding the use and effects of green taxes (“Green growth and taxation”). As a “policy forum”, it makes policy recommendations that are grounded in economic evaluations and thus reliable for use in discussions on implementing green taxes (“OECD Home”).

United Nations Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee): A subsidiary body of the Economic and Social Council, the UN Tax Committee advises on measures to strengthen national tax systems and promotes cooperation on transboundary taxation issues, including green tax (“About”). One of this committee’s aims is to employ taxation to generate funding for sustainable development, and this committee is further empowered by the UN Secretary-General to promote fairness through tax reforms (Hanif). It sees the ability of green taxes to foster sustainable development but also the potential to adapt them to countries at different levels of development (Ibid.).

Middle Eastern and Central Asian (ME&CA) countries: The Middle East and Central Asia represent the two regions with the lowest tax collection rates globally, meanwhile, they contain many large oil-producing countries, such as Saudi Arabia and Kazakhstan (Azour et al.; Anderson et al. 15). Thus, fossil fuel taxes (e.g. carbon tax) will be highly detrimental to ME&CA economies as energy costs will rise, producing inflation and lack of economic competitiveness (Anderson et al. 21). A paradoxical situation faces ME&CA countries as green taxes can help finance their ecological transition, however, their rising population and economic growth are still connected with fossil fuels production.

China: As the largest emitter of greenhouse gasses in the world, China plays an important role in limiting its environmental impact through green taxes (Wang et al.). Recognizing the long-term costs of environmental degradation on economic competitiveness, the Chinese government introduced a new Environmental Protection Tax in 2018, which imposed progressive tax levels based on emission level and strengthened financial and criminal penalties for infringements (Cicenia). However, the tax and pollution standards vary by

province to reflect each province's different economic needs, showing the important role economic considerations still play in formulating this new tax (Ibid.).

IV. Key Issues including Background Information

Regressive effects of green taxes: Some green taxes have the potential to affect poorer groups more than wealthier groups, especially if they are imposed as a flat rate and targeted towards essential goods like gas. For example, a 2018 impact assessment of a charge on single-use plastic bags in all retailers by the UK government shows small and medium-sized businesses incurring higher costs than large retailers due to economies of scale (Tvaruzek et al.).

Tax enforcement in developing countries: Since developing countries have less formalized tax systems, they will have more difficulty in tracking polluters and collecting taxes. On another note, tax collection also depends on the judicial system to adjudicate tax disputes, which is often weaker in developing countries. Lastly, enforcing certain green taxes, such as carbon tax, requires expensive technologies and technical expertise to record the pollution level and assign corresponding fees.

Lack of political acceptance: The uneven global adoption of green taxes highlights their lack of public support and political interest, notably in regions in development and reliant on non-renewable energy sources (Anderson et al. 21). Opposition to a green tax can arise from poor mitigation of its potential implications, such as its regressive effects and impacts on economic competitiveness ("The Political Economy of Environmentally Related Taxes" 21).

Emissions leakage: In a world where green taxes are applied unevenly, a green tax can incentivize manufacturers to relocate to other regions without strict environmental policies in order to save costs (Aldy and Stavins 156). This can negate the environmental gains resulting from a green tax by simply moving the emissions overseas, often to developing countries, which have lower capacity to create and enforce environmental regulations as well as raise funds for environmental protection.

Reduction in sectoral competitiveness: Green taxes can increase production costs and lower the export competitiveness of firms in countries where the green taxes are applied ("Environmentally Related Taxes in OECD Countries" 27). Countries with exports that are energy-intensive (e.g. manufacturing) are more highly impacted by green taxes than those

with labor-intensive exports (e.g. agriculture) (Ibid. 27). This reduction in competitiveness translates to several economic costs: lower GDP, and higher unemployment and inflation.

V. Timeline of Resolutions, Treaties, and Events

Date	Description of event
1920	British economist Arthur C. Pigou, who invented the concept of externalities in economics, wrote the book, <i>The Economics of Welfare</i> , in which he argued for environmental taxation on goods that increase the social cost over private cost (Hjöllund and Svendsen 20).
1927	Sweden created an energy tax on petrol, which was originally intended to raise government revenue, not to discourage environmental degradation (Jonsson et al.). Many other countries also established energy taxes for various fuels in this period.
1991	Sweden became the first country in the world to implement a carbon tax, imposed on fuels used for motors or heating. While it initially exempted fuels used in manufacturing, mining, and agriculture, the EU's Energy Taxation Directive later overturned this exemption on manufacturing activities (Ibid.).
December 11, 1997	The Kyoto Protocol was signed, setting greenhouse gas emission reduction targets for many developed countries and the foundation for emissions trading as a way to meet the emission reduction targets ("Kyoto Protocol to the United Nations Framework Convention on Climate Change").
October 31, 2003	The European Union promulgated Directive 2003/EC/96 (Energy Taxation Directive), in which it recognized energy taxation as a means of achieving Kyoto Protocol emissions reduction targets and set minimum taxation levels for fuels and electricity (EUR-Lex).
July 15, 2015	The Addis Ababa Action Agenda on Financing for Development (AAAA) was adopted by the UN, which emphasized international tax cooperation and committed to adjusting taxation to reduce the environmental impacts of fossil fuels ("Addis Ababa Action Agenda").
April 22, 2016	The Paris Agreement was signed by 195 countries. It specified that: 1) a voluntary mechanism be created to facilitate emissions trading between countries; and 2) emissions trading does not count as part of a country's nationally determined contribution towards cutting greenhouse gas emissions ("Paris Agreement").
October 19-28, 2021	In the 23rd session of the UN Tax Committee, the Committee decided to establish the Subcommittees on Environmental Taxation and Extractive Industries Taxation to further research on issues relating to green taxes, especially on carbon emissions and extracted natural resources (E/C.18/2021/4).

VI. Possible Challenges & Solutions

Progressive tax rates and tax shifting: To mitigate the regressive effects of some green taxes, governments should avoid flat taxes when they can. Higher incomes usually lead to more pollution due to higher consumption, therefore, governments should take advantage of this and set progressive tax rates based on different consumption levels (Branscombe). However, making green taxes progressive can cause high administrative costs and enforcement difficulties since there must be ways for sellers to determine consumers' incomes in order to charge the appropriate tax rate. An alternative to taxing consumption progressively is tax shifting, which means transferring the tax burden from one type of tax to another. A World Bank analysis showed that switching the income tax to an energy tax by 1% of GDP increases GDP growth, and energy taxes place less pressure on economic growth than an income tax (Estevão and Schoder). This is because while green taxes incentivize consumers and producers to adapt from environmentally-damaging behaviors, the income tax directly reduces individuals' disposable income, producing a domino effect that lowers spending and income throughout the economy.

Capacity-building policies for developing countries: An effective green tax design requires establishing a comprehensive process, from selecting resources or actions to tax and the tax rates to controlling the measurement of consumptions for the purpose of tax collection (Schlegelmilch and Joas 48). Common problems that developing countries face when enforcing green taxes are tax undercollection, inadequate tax rates, and taxpayer registration (Ibid. 48; "United Nations Handbook on Carbon Taxation in Developing Countries" 141-142). Tax undercollection arises from lack of oversight by the tax authority over resource consumption and emissions and can be amplified by the large informal economy in developing countries. Green tax rates should be commensurate with the external costs (negative externalities) from the consumption of environmentally harmful products (e.g. oil, timber). Lastly, for green taxes that focus on the production side, taxpayer registration is crucial to identifying polluters and verifying pollution reporting to ensure accurate tax collection.

Negotiation and communication with various stakeholders: As with any government policy, public engagement and communication are vital, but especially for green tax, engagements with various stakeholders are needed in order to resolve possible issues resulting from the tax and spread awareness on the importance of the green tax in addressing environmental problems. NGOs and advocacy groups play an important role in identifying problems that require regulation through green taxation, while businesses often participate in

policy design to ensure that the green tax is most acceptable to them (Watkins et al. 25). In addition, as countries prioritize adapting green taxes to their unique economic and social circumstances, engaging with various stakeholders throughout the policy formulation process makes green taxes more realistic and effective.

Regional green tax agreements: If green taxation is coordinated between countries at a regional or global scale, there will be less incentive for relocation, which would also ensure a reduction in environmental harm (“Environmentally Related Taxes in OECD Countries” 29). However, this effort will face opposition from countries in which business interests hold strong political influence or those that rely on non-renewable energy to export and power domestic economic activities. Agreements have been made at the regional level, such as the European Union’s Energy Taxation Directive, which specified green tax bases and minimum tax rates for all EU countries (KPMG).

Subsidies for private sector ecological transition: A stand-alone green tax, without support for industry to adopt alternative, more environmentally-friendly methods of production, will stagnate economic growth and increase inflation (Islam). Therefore, governments can consider providing subsidies to businesses to adjust their production and operations during a transition period before a green tax goes into effect. However, subsidies may not be helpful to decouple other sectors in the economy from polluting goods (e.g. oil, plastic), which could lessen the price pressure of green taxes on these goods. Hence, this also highlights the need to match green taxation with the technological readiness of a country.

VII. Recommendations for Resolution Writing including Research

The question of green tax will give ample opportunity for countries from various economic and political backgrounds to highlight their differences. Delegates will differ on both broad and specific questions: “Should there be a green tax?” “On which goods should a green tax be imposed?” “What support measures should be provided to countries where the implementation of green taxes would be highly disadvantageous?” While many high-income countries may support green taxes more eagerly, middle- and low-income countries may prioritize present economic concerns as their economies are still highly dependent on fossil fuels. Furthermore, there are questions regarding enforcement that can make resolutions on green tax harder to draft. Delegates should attend carefully to the technical aspects of green

tax implementation, such as measuring the social cost of polluting goods and reporting consumption or emissions. In addition, Middle Eastern countries, which traditionally have lower taxes, may object to green taxes for political purposes (Whitaker). To make green taxes work, delegates should seek ways to adapt them to different countries and recognize the prerequisites that allow green taxes to be effectively implemented.

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