Climate Change, Taxation and Equity: Instructions for Use

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El País, 10 February 2023

Climate change is not only a major failure of the economic system that will generate, as it is already doing, large net losses to our societies. It is also a distributional bomb slanted towards those who have less, both countries and individuals. The explanation is easy: countries and households that have contributed most to this problem are those with high economic capacities, as opposed to those that suffer the most because the capacity to adapt to climate change is also related to the availability of economic resources. Moreover, the essential climate mitigation policies have costs that in many cases are borne to a greater extent by those who have less. This is something we have known for some time, although we have an increasingly clearer and more precise picture of the direction and magnitude of these effects, as this newspaper has recently reported.

This has led some commentators and policy makers to advocate for the incorporation of taxes on personal wealth and on the windfall profits of the fossil conglomerate to the menu of climate mitigation policies. At first glance they are attractive proposals, focusing on groups with a clear responsibility for the problem, positive distributional effects and high revenue-raising capacity. However, it is necessary to explore more carefully the usefulness of these tax figures with this purpose to avoid formulating simple and popular solutions to complex problems that, by diverting interest and emphasis from other fundamental and priority fiscal instruments, might compromise the effectiveness of climate mitigation policies.

At this point, it is worth returning to the main conclusions of the recent Spanish white paper on tax reform which, despite paying a sizable attention to distributional issues, it does not include the preceding alternatives in its extensive list of environmental proposals. The white book underlies the central role of a number of taxes in promoting decarbonization, in coordination with other regulatory alternatives, mainly through charging fossil fuel consumption and the purchase and ownership of polluting equipment (e.g., vehicles). It also indicates that the possible regressive impacts of some of these taxes might be easily compensated by devoting part of their revenues, selectively and not related to emissions, to households with lower economic capacity. At the same time, redirecting the currently widespread subsidies for the replacement of polluting equipment to the poorest households would have positive equity impacts. Bear in mind that some of these taxes, such as those related to aviation or vehicles of large size and power, penalize wealthier households to a greater extent. Actually, a reduction of motor fuel subsidies (or the increase in their taxation) are generally progressive measures in developing countries. In addition, the very action of these taxes will contribute to the reduction of (ordinary or extraordinary) profits of the fossil industry and to facilitate the transition to a more sustainable business world. In sum, a good use of environmental taxation allows progress to be made on several objectives, climate and equity related, simultaneously.

This does not imply that wealth taxation should not play a relevant role in the fight against climate change, but for other reasons. Climate crises such as last summer's, with its immense impacts on the less well-off, and the recent agreement of a global fund based on the 'loss and damage' principle for developing countries, will require a huge volume of resources to facilitate adaptation and compensate the losers of climate change. A large part of these additional resources must come from our tax systems and it is unlikely that environmental taxes, especially if a large share of their revenues are used for distributional compensations, will be able to provide them. In this context, obtaining extra revenues must be guided by the principle of economic capacity, and here taxation on wealth and on large fortunes can and must play a relevant role.

An expert in technological solutions to decarbonization, Mark Jacobson (Stanford), has just published a book in which he points out that we do not need miracles but ambition to apply existing clean technologies without delay. Something similar is true in the fiscal area: we do not need to invent anything new or generate unnecessary confusion, but simply use existing taxes now to address, in a rigorous, transparent, and decisive way, two linked but different matters: the major challenges associated to climate mitigation and obtaining additional resources to deal with unequal climate-related impacts.

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