



## ENVIRONMENTAL TAXATION AND INEQUALITY

Our era is marked by two main challenges: the climate crisis and deepening inequality across the world.

These problems are linked and so are the solutions. We cannot confront the climate crisis without addressing inequality and we cannot confront inequality without addressing the climate crisis. Taxation, if used well, is a tool that can address both problems. Tax policies can either result in resources being shared more equally or allow them to be hoarded by the few. The latter has been the case up until now, with corporations and rich people paying less tax and workers and consumers paying more.<sup>1</sup> Tax policies can also deter polluting practices and incentivise environmental-friendly behaviours. Revenues from tax can be channelled into boosting social security systems or health services, helping to narrow the inequality gap, or into investing in environmentally friendly alternatives, helping to fight the climate crisis.

With the topic of environmental taxation growing in public debates and amongst policymakers, we must make sure any such policies are sustainable and address the gap between the rich and the poor. As the *gillet jaunes* movement showed to the world, environmental taxes can have negative social effects, a regressive impact and even undermine environmental efforts. Policymakers must take this into consideration when drafting environmental tax policies and adopt measures to avoid or compensate for any adverse social consequences.

### CLIMATE AND INEQUALITY

Climate and inequality are closely linked, in terms of responsibilities and consequences.

#### Responsibility is not evenly shared

The landmark Paris Agreement recognised that not all countries have contributed equally to the climate crisis. Low-income countries have a smaller historical carbon footprint as they contributed to a much lesser extent to global carbon emissions than early industrialised countries. The richest 10% of the world's population (around 630 million people) were responsible for over half (52%) of the total carbon emissions from 1990 to 2015, depleting the global carbon budget by nearly a third (31%) in those 25 years alone, according to a study from [Oxfam and the Stockholm Environment Institute](https://oxfam.org/en/research/publications/oxfam-and-the-stockholm-environment-institute).<sup>2</sup> On the other hand, the poorest 50% in the world (around 3.1 billion people) were responsible for just 7% of total carbon emissions and used a mere 4% of the available carbon budget. If we look at the super-

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<sup>1</sup> Oxfam estimated that between 2007 and 2017, Corporate Income Tax revenue from Corporate Income Tax and wealth taxes relative to GDP decreased by almost 10% and 1.3% respectively, while revenues on payroll taxes, Personal Income Tax and taxes on goods and services increased by 13%, 12.7% and 9.8% respectively. <https://oxfamlibrary.openrepository.com/bitstream/handle/10546/621149/bp-the-inequality-virus-250121-en.pdf> and <https://oxfamlibrary.openrepository.com/bitstream/handle/10546/621149/tb-inequality-virus-methodology-note-250121-en.pdf>

<sup>2</sup> The global carbon budget defines the maximum amount of cumulative emissions that can be added if the rise in average global temperature is to be kept below a certain level, such as the Paris Agreement's 1.5C goal, after which net emissions must be zero.



rich, the inequality is even more striking: the richest 1% of the world's population has consumed double the carbon emissions than those of the bottom 50%.

A similar picture can be found at the regional level. [In the EU](#), between 1990 and 2015, the richest 10% of EU citizens were responsible for over a quarter (27%) of EU emissions - the same amount as the poorest half of the EU population.

This uneven responsibility of carbon emissions cannot be ignored when considering who should bear the cost of reducing CO2 emissions.

### **Unequal consequences**

The impact of the climate crisis is much more devastating for those living in low- and middle-income countries. Within those countries, the poorest communities, in particularly women, are hit hardest. Poor communities tend to live in areas more affected by extreme weather with poorly built houses and no insurance, and many depend on activities which are particularly vulnerable to more extreme and erratic weather such as farming and fishing. [Across the continent of Africa, over 52 million people are at risk of going hungry because of drought, failed rains and flash floods](#). Women in these regions tend to work in sectors, such as growing food and collecting water and fuel which are made harder by the climate crisis, and, when forced to leave home, they are particularly vulnerable to violence and abuse. For example, [droughts in Somalia doubled the workload for women in Somalia - some had to travel up to 10 km a day in search of firewood and water](#).

### **IMPACT OF ENVIRONMENTAL TAXATION ON INEQUALITY**

The climate crisis is already hitting the poorest and most marginalized people the hardest, especially in low to middle-income countries, yet they are the least responsible for it. Still, taxes to combat the climate crisis can risk further widening the inequality gap between rich and poor countries, and the "haves" and "have nots".

Within a country, an environmental tax can have a negative effect on low-income households if there is an increase in the cost of products which are used more by low-income households. An example of this is the European Commission's recent proposal to expand the EU Emissions Trading System (ETS) to fuel for road transport and heating. While, in theory, the ETS is not a tax, in practice, it impacts consumers the same way, as additional costs to the company, stemming from the obligation to buy permits for gas emissions, are likely to be shifted onto the consumer. This affects poorer people to a greater extent as they spend a higher proportion of their budget on heating their homes compared to the well-off and often, cannot afford to pay for an energy efficiency upgrade. They also live in more peripheral areas with lower public transport supply. A tariff used to limit the consumption of polluting goods can therefore have a regressive impact, during a time where the [tax system has become already increasingly regressive](#).

At an international level, environmental taxes, like the carbon border tax, can have an impact on third countries and foster inequality, if no exemptions or compensations are made. A carbon border tax can result in a price increase on imports from low and middle-income countries. This has an impact on those countries' competitiveness, resulting in less exports, less jobs and less revenues. This can even undermine efforts in the third countries to invest in a green transition, if they do not receive any support to make their economy greener. In this sense, a carbon border tax risks disproportionately



shifting the burden of adjustment to poorer countries while reducing their capacity to tackle the climate crisis.

A recent proposal by the European Commission is a case in point. The Carbon Border Adjustment Mechanism (CBAM) proposed in July would require companies in certain sectors, who are importing goods into the EU, to buy a certificate reflecting the carbon emissions of the imported goods.<sup>3</sup> This measure will affect countries vulnerable to climate change including low-income countries like Mozambique and Zambia, who have not received an exemption.<sup>4</sup>

### **HOW CAN ENVIRONMENTAL TAXATION AND THE FIGHT AGAINST INEQUALITY RECONCILE?**

Any potential negative impacts of environmental taxation on equality can be addressed and reversed.

Environmental taxes with regressive impacts should be avoided in the first place. Carbon taxes could be applied at different rates for different sectors or groups, with the sectors relied on by the poorest having lower rates. Another option is to target carbon emissions from luxury consumption such as frequent or business class flights or highly polluting cars, like SUVs. Additionally, environmental taxes that target consumption, like a carbon tax, are more likely to have a regressive impact, while a tax on production or investments has a greater impact on companies and investors, rather than on the consumers. This shifts the responsibility of the transition to those most able to pay, and most responsible for the climate change.

If progressive environmental taxes are not possible, the regressive impact can be balanced out by other taxes or by redistribution mechanisms to compensate lower income groups for the increased costs. The current tax system for instance can become more progressive by increasing taxation on multinationals and on the wealthiest individuals, balancing out the regressive impact of the other taxes. Compensation is the direction chosen by the European Commission with the new Social Climate Fund. The Commission aims to mitigate the costs borne by those most exposed to increases in fossil fuel prices (due to the above-mentioned expansion of the ETS mechanism) and support the green transition. However, [questions remain whether the fund will work in practice](#) as it is small and not very accessible to the poorest.

Another aspect to consider when implementing an environmental tax, is to make alternatives available. For example, a good public transport system or better bike infrastructure can mitigate the impact of taxes on transport fuel. Tax cannot be the only solution, it must come with investments in the green transition.

What happens to the revenues from an environmental tax? While the main purpose of such a tax should be to reduce polluting practices, and not to collect revenue, any revenue could be channelled into green purposes or compensation measures. This could increase the acceptance of the tax as people can see the purpose of their taxes. The European Commission has partly applied this approach with its new “Fit for 55” package. Some of the revenue from the new ETS will support the energy transition in lower-income European countries and compensate those citizens who struggle to pay the tax. Yet, when it comes to the Carbon Border Adjustment Mechanism (CBAM), the European

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<sup>3</sup> The EC proposed to apply the CBAM to some pilot sectors: cement, iron, steel, aluminium, chemical fertilisers and electricity

<sup>4</sup> See this [IEEP study](#)



Commission used a different approach as they proposed to channel any revenues to the EU budget. This gives the perception of the measure as protectionist and unfair. In the context of the COVID-19 crisis, many governments in low to middle-income countries do not have the resources to support their own economies as the EU does. Yet, they are asked to contribute to Europe's recovery through the revenues collected from the new carbon tax.

Finally, both the design and implementation of an environmental tax are important. Conducting a comprehensive impact assessment can reveal the effect of environmental taxes on the poorest and on low to middle-income countries. This then allow governments to mitigate this impact. It is equally important to monitor and evaluate the social impact of the measure once in place. A transparent and clear communication on the tax will also increase the accountability and acceptance of the measure.

Environmental taxes and equality are not two irreconcilable concepts. On the contrary, environmental taxes can help the fight against inequality, within and amongst countries. This is possible if and when there is the political will and a recognition that the climate crisis and inequality are closely interlinked: we cannot address one without the other.

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