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**Article**

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Margit Schratzenstaller

## Elements of a European Green Fiscal Policy

The European Green Deal, the core project of the current European Commission, envisages a green transition in the EU, which aims at making the 27 EU member states climate-neutral by 2050 and at reducing greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels in a first step. Since it began in February 2022, Russia's war of aggression against Ukraine has been intensifying the urgency of the green transition, which would make Europe independent of fossil fuels imported from third countries and secure an affordable energy supply. Such an ambitious green transition requires a comprehensive "green fiscal policy" as one element of a broad mix of measures at the EU level to complement and reinforce member states' initiatives to green national public finances. A European green fiscal policy rests on four pillars, which are partly elements of the Fit for 55 package<sup>1</sup> aiming at achieving the goals of the European Green Deal (see Figure 1): the greening of revenues, the greening of EU expenditure, the greening of EU governance and European green bonds. Green implementation mechanisms can initiate and facilitate greening initiatives in a systematic way in the four green fiscal policy pillars.

### Four pillars of greening EU fiscal policy

#### Greening of revenues at EU level

The first pillar of a European green fiscal policy is the greening of revenues at the EU level, which comprises two interrelated elements: carbon pricing and green own resources to finance the EU budget. Carbon pricing at the EU level includes the EU Emissions Trading System (EU ETS), the EU Carbon Border Adjustment Mechanism (CBAM), the EU Energy Tax Directive (EU ETD) and potential green EU levies. As part of the Fit for 55 package, the current EU ETS 1 covering industry and energy generation will be supplemented by a new EU ETS 2 for the build-

ing and the transport sector as of 2027. The EU CBAM was introduced in October 2023 starting with a transition phase and will be effective as a carbon pricing instrument as of 2026. The revision of the EU ETD, another measure of the Fit for 55 package, is still pending.

The coordinated implementation of further green levies in EU member states has not found its way onto the European agenda yet.

Currently, the lion's share of EU revenues are national contributions from member states (see Figure 2). In 2022, the VAT-based own resource contributed 8% of overall revenue including other revenue (€19.7 billion), the GNI-based own resource 42.4% (€103.9 billion) and the plastic own resource 2.6% (€6.3 billion). The share of custom duties, which since the end of the sugar quota system are the only remaining traditional own resource, amounts to 10.5% (€25.9 billion). The remaining revenues stem from other revenue and the balance carried over from the previous year.<sup>2</sup>

It is obvious that the EU system of own resources in its current form contributes in a very limited extent only to central EU objectives and policies (Schratenstaller et al., 2017, 2022). Recently, the need to repay NextGenerationEU (NGEU) debt, newly emerging potential genuine own resources and mounting long-term challenges for the EU (e.g. climate, digital and demographic change) have provided new impulses to the long-standing debate about a fundamental reform of the EU revenue system.

Green own resources appear as particularly relevant in this context, as they would strengthen the link between EU revenues and EU spending and thus coherence between EU budget policies addressing climate change. The EU ETS, the EU CBAM and green EU levies offer themselves as green own resources.

The Interinstitutional Agreement accompanying the agreement of 2020 on the multiannual financial framework (MFF) and NGEU (which together form the European COVID-19 Recovery Plan) includes a roadmap for the stepwise introduction of new own resources as of 2021,

<sup>1</sup> See Tagliapietra (2021) for an overview of the 13 elements of the Fit for 55 package.

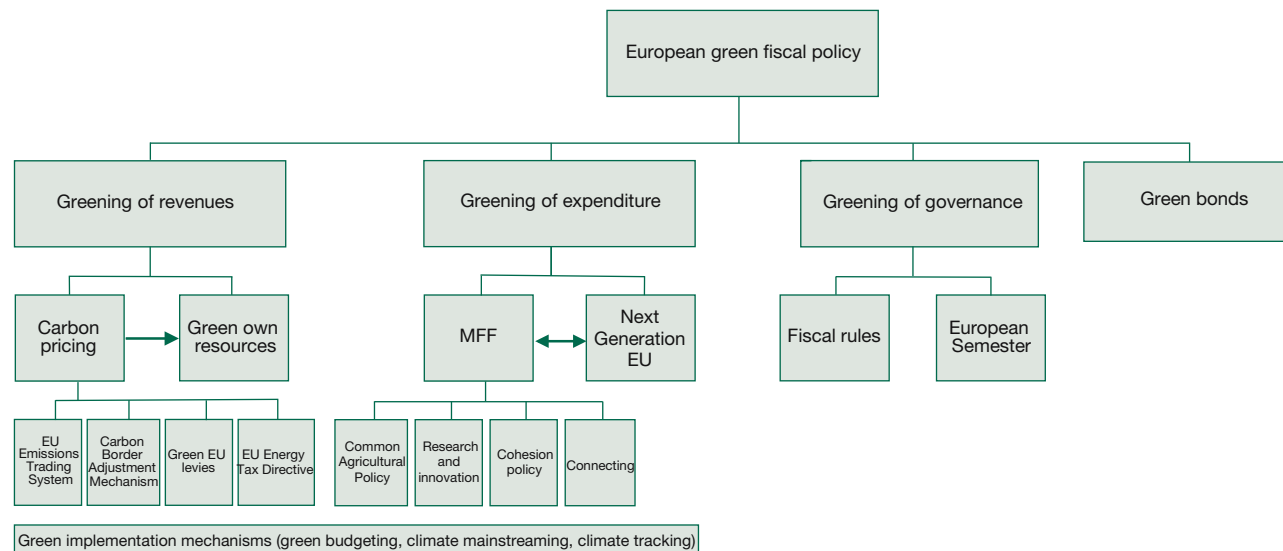
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<sup>2</sup> The volume of other revenue has been increasing markedly since 2021, as grants and loans provided to member states through NGEU are financed through EU debt, which also constitutes other revenue of the EU; however, this effect is only temporary.

Figure 1  
The green transition: Pillars of a green fiscal policy in the EU



Source: Enhanced version from Schratzenstaller (2022).

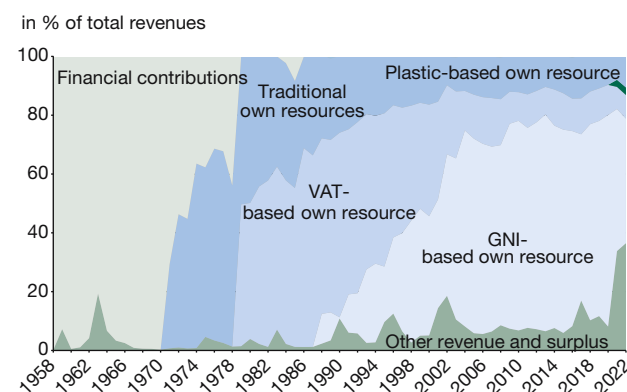
which, inter alia, comprise green own resources. As a first step, a contribution based on the non-recycled plastic packaging waste was introduced as a new own resource in January 2021. At 2.6%, its contribution to EU revenues is rather modest, and it is expected to fall over the medium run, with non-recycled plastic waste decreasing. Moreover, the Commission put forward a proposal for a first basket of new own resources, comprising, inter alia, new own resources based on revenues from the EU ETS and the EU CBAM with a view to their introduction in 2023 (Schratenstaller et al., 2022), which, however, has not been agreed on. As part of the MFF midterm review, the Commission released an adjusted first basket of new own resources in June 2023 to be introduced in 2024 (European Commission, 2023a).

This adjusted first basket includes an ETS-based own resource: 30% of all revenues from ETS 1 and ETS 2 shall be dedicated as EU revenues, with expected revenues for the EU of annually €7 billion as of 2024 and €19 billion as of 2028. In addition, a CBAM-based own resource is proposed: 75% of the revenues from the EU CBAM applying a carbon price from imports from third countries not applying carbon pricing to cement, steel and iron, aluminium, fertiliser, and electricity, with expected revenues for the EU of €1.5 billion per year as of 2028.

The revenues from the EU ETS and CBAM are particularly suitable as own resources to finance EU expenditure (Fuest and Pisani-Ferry, 2020): they stem from

Union policies and can thus be considered genuine own resources of the EU. Moreover, they would not exist without EU-wide coordination, and emissions as the base of these revenues cannot be attributed properly to particular member states because of their cross-border nature. Moreover, they could be introduced without treaty changes (Schratenstaller et al., 2022), and they

Figure 2  
Composition of EU revenues in a long-term perspective, 1958 to 2022, including other revenue<sup>1</sup>



Note: <sup>1</sup> Other revenue includes taxes on the salaries of EU staff, contributions from non-EU countries to certain EU programmes, remaining UK contributions, fines and EU borrowings.

Source: European Commission (2023b), own representation.

would shift the burden from financing the EU budget from the general population to polluters. They should be introduced as soon as possible and complemented by additional green own resources options based on further green levies introduced in a coordinated way in EU member states, particularly those that are hard to implement effectively on a bilateral level. Promising candidates are taxes on cryptocurrencies, which are increasingly criticised due to their negative climate impact (Baer et al., 2023) or on aviation (Krenek and Schratzenstaller, 2017).<sup>3</sup> Statistical own resources similar to the plastic own resource (which is based on the amount of non-recycled plastic waste in member states) are also of interest, for example based on biowaste. They contain incentives to introduce measures at the member state level to decrease the respective environmentally harmful base (Büttner, 2023). New green own resources should – in addition to servicing NGEU debt – also be used to replace a part of current national contributions to the EU budget (Schratzenstaller, 2021). This would allow a reduction of the member states' national contribution and thus tax cuts at member state level, enabling a supranational green tax shift.

The greening of member states' tax systems would be supported by the revision of the EU ETD, which originally was envisaged for 2023, but is still pending. Accordingly, energy taxation shall be based on the energy content of the energy sources. Energy tax rates are to be increased stepwise between 2023 and 2033 and regularly adjusted for inflation. Moreover, sustainable energy sources shall be taxed at lower rates than non-sustainable ones.

### Greening of EU expenditure

The second pillar of greening European fiscal policy is the greening of EU expenditure. The centerpiece of spending at the EU level is the EU budget in the narrower sense, i.e. the MFF 2021-2027. In addition, there is the COVID-19 Recovery Package NGEU, which was adopted in 2020 and is implemented as a temporary facility between 2021 and 2026.

The MFF is explicitly being used as an instrument of climate protection since the 2014-2020 programming period, by introducing climate mainstreaming – including a target of 20% of all expenditure for climate protection spending. The European Recovery Plan (i.e. the MFF and NGEU), provides for a climate mainstreaming target of 30% of total expenditure for the current MFF period. In

addition, the do-no-significant-harm (DNSH) principle applies, according to which EU expenditure should not violate environmental targets. The climate protection target is supplemented by a biodiversity target, according to which in 2024, 5% of MFF expenditure is to be dedicated to the promotion of biodiversity, and another 10% in both 2026 and 2027.

The potential of the MFF to make an increasing contribution to climate protection is not being fully realised, however. According to the European Court of Auditors (2022), the actual contribution of the Common Agricultural Policy (CAP) in particular, but also of cohesion and infrastructure funding to the EU's climate targets in the last MFF period 2014-2020, was significantly below the stated values. At around 13%, the share of climate expenditure as a part of total expenditure fell significantly short of the climate mainstreaming target of 20%.

The CAP and cohesion policy are still dominating the current MFF, each accounting for about 30% of the total MFF volume. The European Court of Auditors (2022) expressed particular doubts as to whether the CAP, which is supposed to make the greatest contribution to climate protection, can actually achieve the targeted 40% climate protection expenditure. At the same time, the large volume of the CAP and cohesion policy severely constrains other areas of expenditure that could make important contributions to climate protection. This applies in particular to the Connecting Europe Facility (CEF), which among other things, finances cross-border infrastructure for transport and energy supply, whose share of expenditure has stagnated in comparison to the previous MFF. It also applies to the Horizon Europe research framework programme, whose share of expenditure has only slightly increased. Strengthening the impact of the MFF regarding the green transformation requires a reduction in the expenditure share of the CAP in particular in order to free up more funds for the CEF and the research framework programme (and here in particular for green research). In addition, the CAP and cohesion policy must be even more closely linked to climate targets.

### Greening of EU governance

The green transformation is associated with challenges for EU governance, in particular with regard to fiscal rules (Pekanov and Schratzenstaller, forthcoming) and the European Semester.

To achieve the objectives of the European Green Deal, the European Commission (2021) estimates a green investment gap for the current decade of €520 billion per year (3.7% of 2019 GDP) compared to the previous

<sup>3</sup> See Schratzenstaller et al. (2022) for a more detailed discussion of potential green own resources.

decade. A significant part of this green investment gap needs to be covered by the private sector. In face of its remarkable size, the remainder of the green investment gap will need to be financed by the EU and EU member states (Claeys and Tagliapietra, 2020; European Commission, 2022a). Hereby the existing EU fiscal framework acts as a constraint to the expansion of (debt-financed) green public investment at the member state level (Bénassy-Quéré, 2022). The proposal for the reform of the EU fiscal framework put forward by the Commission and currently negotiated at the EU level does not explicitly account for the increasingly pressing need for investment in climate protection and climate change adaptation measures. The current discussion should therefore seriously consider options to green the EU fiscal framework, e.g. a green golden rule, country-specific recommendations for green public investment via the European Semester, or an EU Climate Fund (Pekanov and Schratzenstaller, forthcoming).

The European Semester, which serves to coordinate economic, fiscal, labour and social policy within the EU, has been expanded in recent years from a relatively narrow focus on budgetary and economic policy to other policy areas. Currently, environmental aspects are primarily taken into account by monitoring the implementation of national recovery and resilience plans as part of the European Semester. Further steps in the ongoing efforts at the EU level towards greening the European Semester may include a regular monitoring of the development of the green investment gap, of environmentally harmful subsidies, and of a labour market policy adapted to the requirements of the green transformation (Simon et al., 2022).

### EU green bonds

Green bonds are the fourth pillar of a European green fiscal policy. NGEU contains a commitment from the Commission to raise up to 30% (about €250 billion) of the funds borrowed on capital markets to finance NGEU via NGEU green bonds, making the EU the largest green bond issuer (Christie et al., 2021). Projects financed through the Recovery and Resilience Facility (RRF), as the core of NGEU, can be financed through NGEU green bonds if they contribute to climate and environmental objectives (such as biodiversity) and comply with the DNSH principle. This ensures that measures financed via green bonds support environmental objectives and do not significantly harm other environmental objectives.<sup>4</sup> The Commission has established the independently

evaluated NGEU Green Bond framework<sup>5</sup> setting out the conditions for green bonds, which refer to the green expenditure categories for which green bonds proceeds may be used as well as the evaluation and selection, the tracking, and the impact reporting on the projects that may be financed through green bonds.

In a recent report, the European Court of Auditors (2023) criticises the fact that the Commission, in some cases, considered activities that do not meet the EU Taxonomy criteria to determine the contribution of RRF investments and reforms to the green transition. This implies that some share of green NGEU bond proceeds are not used according to the EU Taxonomy and the upcoming EU green bonds standard.<sup>6</sup> In addition, Commission reporting up until now does not include the actual amount of expenditure financed through NGEU green bonds aligned with the EU Taxonomy. Therefore, a stricter implementation of the NGEU Green Bond framework is called for. Generally, with increasing popularity of green bonds, the adoption of an official European green bond standard aligned with the Taxonomy currently under negotiation should be accelerated.

### Conclusions

The greening of European fiscal policy can be expected to provide a powerful lever to support the European climate targets at the EU and member state level. To support and facilitate as well as to coordinate the greening of the four pillars of a European green fiscal policy outlined in this contribution, implementation mechanisms are required. These can build on existing institutional structures and mechanisms, in particular climate mainstreaming, green budgeting, or climate tracking. However, they need to be focused and strengthened to reinforce their effectiveness (Levarlet et al., 2022), and they should be embedded in the ongoing efforts to strengthen the EU budget's impact orientation. Moreover, greening efforts need a broader focus beyond climate change, considering also other important environmental problems, such as biodiversity loss. Not least, the greening of European fiscal policy needs to be accompanied by a comprehensive overall just transition strategy to avoid undesirable distributional effects and to secure public acceptance.

<sup>4</sup> See Levarlet et al. (2022) for details.

<sup>5</sup> [https://commission.europa.eu/strategy-and-policy/eu-budget/eu-borrower-investor-relations/nextgenerationeu-green-bonds\\_en](https://commission.europa.eu/strategy-and-policy/eu-budget/eu-borrower-investor-relations/nextgenerationeu-green-bonds_en).

<sup>6</sup> See Spinaci (2023) for a brief overview of the current status quo regarding an official European green bond standard.

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