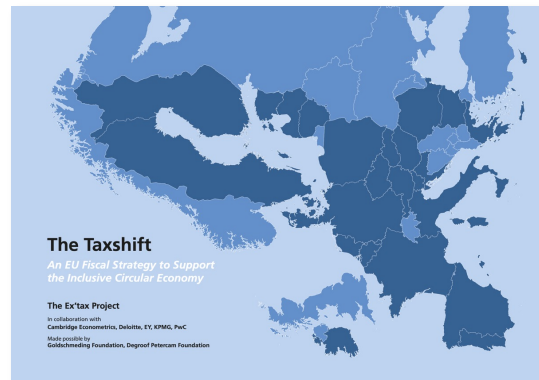


# The Taxshift

An EU fiscal strategy to support the inclusive circular economy

Country case study results:

## Latvia



KNOWLEDGE PARTNERS

FUNDING PARTNERS



# Introduction

At this pivotal moment in time, 'business as usual' is no longer an option. Saving energy and reducing fossil fuel import dependence are at the top of the EU agenda, as they are critical to solving both the energy crisis and the climate crisis. At the same time, governments are facing major socio-economic challenges including soaring inflation, rising poverty and social unrest. Integrated solutions will be needed, tackling environmental and socio-economic issues simultaneously.

A shift in financial incentives will be needed. For this purpose, the European Green Deal includes a commitment to shift the tax burden from labour to green taxes. The 'Taxshift' report presents a roadmap for such a rebalancing of the tax mix, both at national levels and in an EU context. It also assesses the impact of 20 exemplary taxshift measures that decrease the tax burden on labour while increasing taxation of resource use and pollution.

## The scenario

In the scenario under review, the burden for households is eased through a reduction in income tax and social contributions, and income support for the lowest income groups. For employers, various payroll tax credits are included. The necessary tax revenues are generated by introducing a kilometre charge, increasing VAT, taxing CO2 emissions and other harmful emissions from industry, aviation, shipping and agriculture, increasing excise duties on tobacco and a higher price on water, waste and the use of fossil fuels in chemical processes.

## Key results

Cambridge Econometrics used the E3ME model to assess the impacts. The modelling results indicate that in the scenario, GDP levels in the EU in 2025 are on average 1.6% higher. Employment levels are 3.0% higher than business as usual. At the same time, CO2 emissions have fallen by 7.1%.

Over the five-year period, EU Member States would jointly save €56 billion on their energy import bill.

## Income effects

Real incomes are higher than in the baseline and the results suggest a progressive impact, with more benefits (in relative terms) for lower income households.

This means that it is possible to design policy measures that address environmental issues (applying the Polluter Pays Principle) and social issues ('leaving no-one behind') simultaneously.

# The current tax mix is focused on labour taxes

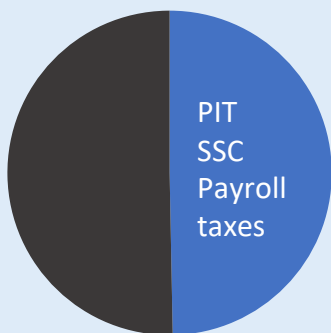
In the 27 Member States of the European Union, €5.4 trillion in tax revenues are collected each year. On average, 53% of tax revenues are based on labour taxes (including social security contributions). 6% of

tax revenues are green (environmental) taxes, mainly related to energy and transport. Pricing of pollution and resources covers just 0.2% of tax revenues. In Latvia, a similar tax mix applies:

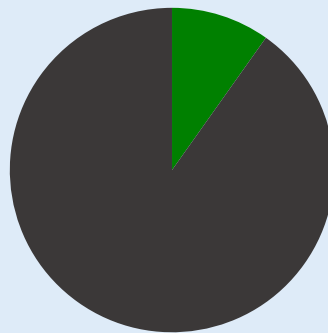


Latvia, share of total tax revenues, 2020:

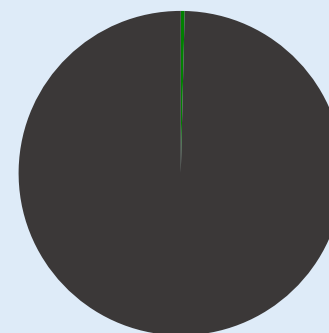
Labour taxes: 50%



Green taxes: 10%



Pollution & resources: 0.4%



**The Polluter Pays Principle is a guiding principle of the EU. It is not consistently applied.**

*Eurostat; Maastricht Treaty (1992): "the polluter should pay" Article 130R(2), EC Treaty, as amended by the Maastricht Treaty of 7 February 1992.*

# Support for the taxshift is growing

## The European Green Deal:

*“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.”*

## OECD:

*“Lowering taxes on labour and capital, in favour of taxing environmentally harmful consumption and production, can stimulate job creation and investment, improving economic efficiency.”*

## World Business Council for Sustainable Development (WBCSD):

*“Shift the burden of taxation from “goods” (eg., employment) to “bads” (eg., pollution).”*

## World Bank:

*“(…) taxing economic “bads” (in this case carbon emissions) and using the revenues to reduce distortionary taxes on economic “goods” (labor 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.”*

## U.N. Secretary-General António Guterres:

*“Solutions exist. First, let’s shift taxes from salaries to carbon. We should tax pollution, not people. Second, stop subsidizing fossil fuels.”*

## IMF Managing Director Kristalina Georgieva:

*“What we want to see is, very simply, to move the revenue raising objectives of governments from taxing people, taxing labour, to taxing pollution.”*

*United Nations (June 30, 2019), Secretary-General’s remarks to Climate Summit Preparatory Meeting. António Guterres. Abu Dhabi. Friends of Europe (September 16, 2020), In Conversation with Kristalina Georgieva (Managing Director of the IMF) on pursuing a green economic recovery. Video. (13:01). WBCSD (2021), Vision 2050: Time to transform.; World Bank (2019), Using Carbon Revenues. Partnership for Market Readiness Technical Note; No. 16. OECD (Sept 14, 2020), Policy Responses to Coronavirus (COVID-19) Making the green recovery work for jobs, income and growth. [https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal\\_en](https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en)*



# The scenario under review - Latvia

2025, difference to baseline, E3ME (2018 prices)



## Labour - €2,099 million

Households (60%)	Reduction in personal income tax (PIT) and Social Security Contributions	-856	41%
	Income support lowest two income quintiles (negative income tax)	-403	19%
Employers (40%)	Payroll Tax Credit (PTC) for new employment	-420	20%
	PTC generic	-168	8%
	PTC for reskilling	-126	6%
	PTC for circular innovation	-84	4%
	PTC Corporate Income Tax (CIT)	-42	2%
		<b>-2,099</b>	<b>100%</b>



## Natural resource use €2,099 million

Traffic (37%)	Kilometre charge	770	37%
Emissions (33%)	Industrial air pollution tax	366	17%
	Ammonia tax (agriculture)	210	10%
	Carbon tax (non-ETS sectors)	86	4%
	Carbon price floor (ETS sectors)	29	1%
VAT (6%)	VAT increase (reduced rate)	3	0%
	VAT increase (standard rate)	114	5%
Shipping (18%)	Marine transport tax	371	18%
Aviation (5%)	Aviation tax	103	5%
Use of resources (1%)	Water tax	15	1%
	Feedstock tax (non-energy use of fossil fuels)	5	0%
	Waste incineration and landfill tax	6	0%
Excise duties (1%)	Tobacco tax	23	1%
		<b>2,099</b>	<b>100%</b>

*In the modelling, the measures are phased in over a five-year period.*

*The scenario includes a selection of potential policy measure. For a broader overview of policy options, see: <https://ex-tax.com/taxshift>.*

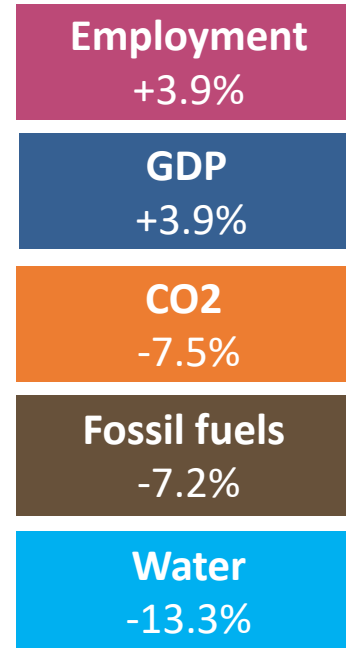
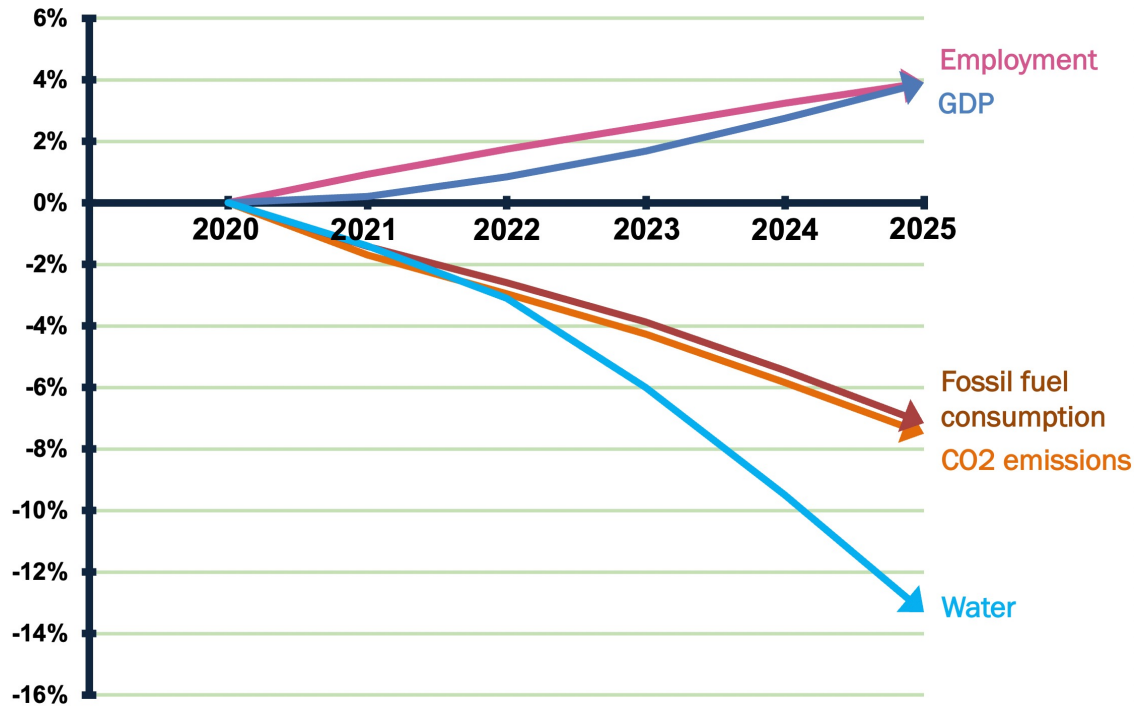
*For this country case study, the results have been updated based on EU and OECD baseline projections.*



# Modelling results - Latvia

2021-2025, difference to baseline, E3ME

In 2025

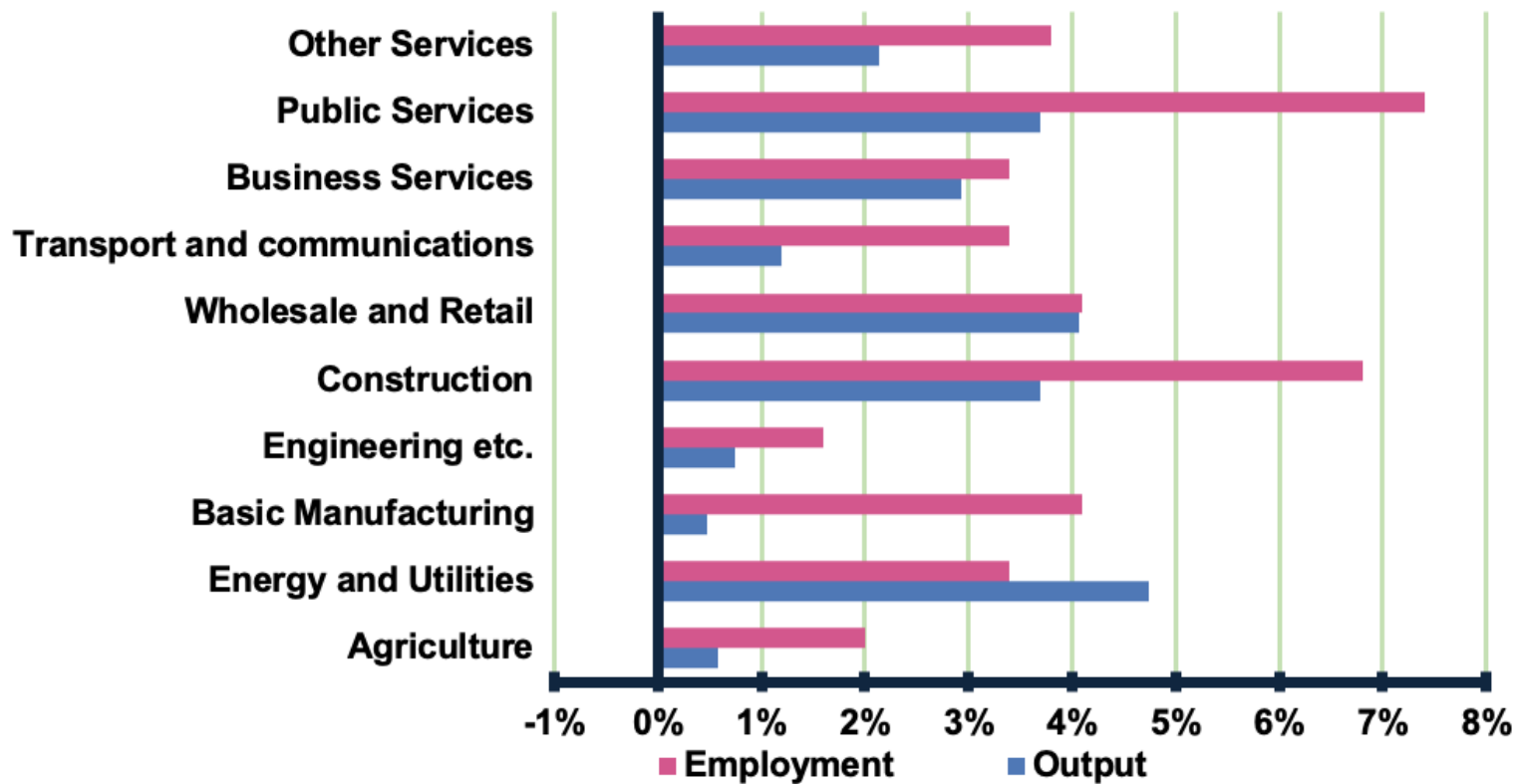


Real income	+7.7%
Consumption	+4.0%
Investment	+2.6%
Imports	-2.0%
Exports	-1.1%



# Results by sector - Latvia

2025, difference to baseline, E3ME



Overall result:  
35,000 more  
people in  
employment

Overall result:  
€1.5 billion  
more output



# Cumulative results - Latvia

2021-2025, difference to baseline, E3ME

Over a five-year period, the scenario would shift **€6.6 billion** in tax revenues in Latvia (non-discounted) with the following cumulative impacts:

- Adding **€2.8 billion** to GDP
- Adding **110 thousand person years of employment**
- Investing **€420 million** in infrastructure
- Saving **1.3 million tonnes** of carbon emissions
- Saving **€1.5 billion** on the energy import bill.

*The EU27 study is available at [www.ex-tax.com](http://www.ex-tax.com). This document presents the case study results for Latvia.*



# Income effects - Latvia

2025, difference to baseline, E3ME

<b>First quintile</b>	<b>9.8%</b>
<b>Second quintile</b>	<b>9.3%</b>
<b>Third quintile</b>	<b>4.9%</b>
<b>Fourth quintile</b>	<b>5.6%</b>
<b>Fifth quintile</b>	<b>6.7%</b>

- The lowest income quintiles increase their income **by 9.8% and 9.3% more than in the baseline.**
- The highest two income quintiles increase their income **by 5.6% and 6.7% more than in the baseline.**

Smart and social policy design can ensure progressive impacts with higher benefits (in relative terms) for lower income households. In practice, measures will be engineered to suit national circumstances, more detailed statistics and national goals.



# Relevance to Latvia

(selected data points)

## Social challenges

- **Unemployment:** 7.6%, youth unemployment: 14.8% (almost twice as high)
- **Unmet need for employment:** 105,000 (10.7% of the extended labour force)
- **At risk of poverty or social exclusion:** 439,000
- **Taxes on labour** as % of total taxation: 49.7%
- **The tax wedge:** 37.9%. The tax wedge is the difference between an employer's total wage costs and the employee's net wage.

## Environmental challenges

- **Share of energy from non-renewable sources:** 58%
- **The external costs of air pollution:** €1.9 billion per year
- **Waste generated:** 2.8 million tonnes per year
- **Food waste:** 75 kg per capita per year
- **Fossil fuel subsidies:** €125 million per year
- **Green taxes as a % of total taxation:** 9.8%.

EU Member States have committed to becoming the first carbon neutral continent and shifting to a regenerative circular economy by 2050. In addition, well-functioning labour markets and social security systems are a key objective of the European Union. The taxshift is an integrated approach to address environmental and social issues simultaneously.

*Sources Eurostat: most recent employment data August 2022 (or annual data 2021 if compared to youth unemployment); youth unemployment 2021; labour market slack/unmet need for employment Q2 2022; risk of poverty 2021; Tax rate on low wage earners: Tax wedge on labour costs 2021; share of energy from non-renewable resources 2020; total waste 2020, food waste 2018. Labour taxes & green taxes 2020. External costs of air pollution: European Commission/IEEP (2021). Fossil fuel subsidies: European Commission/Trinomics (2020).*

# Key EU steps towards an integrated fiscal strategy to accelerate the Green Deal objectives

## Step 1: Organisation

(2022-2023)

**Establishing an informal coalition composed of Member States committed to applying the Polluter Pays and Making Work Pay principles.**

The coalition fosters dialogue and develops proposals for coordinated taxshift policies in the EU.

**Developing an EU Policy Tracker:** mapping relevant tax policies under review in MS, as well as progress on policy implementation. Such public Tracker supports MS in coordinated action and fosters consistent policy making.

**Establishing an Expert Group on Tax Dynamics in Business** composed of CEOs, entrepreneurs, tax specialists and other financial experts. The group advises the Commission on how a taxshift might impact sustainable and social impact investment decisions, including the activities under the green EU taxonomy.

**Establishing an EU Taxshift Inter-Service Group composed of all relevant DGs.** The group focuses on dilemmas and progress on taxshift principles and integrating taxshift policies in EU programmes. It facilitates cooperation and in-depth research and debate on taxshift scenarios and opportunities.

## Step 2: Implementation

(2024-2025)

**Identify external costs and minimum tax rates for a broad range of resource uses,** including water, non-energy use of fossil fuels, industrial air pollution and NOx emissions from aviation and shipping.

**Issue recommendations on the use of revenues from new green taxes to lower labour taxes and make a positive social impact.** To support the internal market and effective social policies, ensure that labour tax competition is minimized.

**Develop guidelines and recommendations on shifting the tax burden,** including a coherent set of quantitative (country-specific) tax mix targets, to be used in the European Semester. Ultimately such targets are to be converted into binding obligations. If unanimous agreement remains unviable, a group of Member States could decide to move ahead under the enhanced cooperation procedure.

**Seek international cooperation through high-level tax diplomacy** (including within the UN, IMF, OECD and G20) to put the taxshift higher on the agenda and address potential border impacts outside the EU.

## Step 3: Adaptation

(2025-)

**From 2025 onwards,** tax systems will be subject to a continuous process of evaluation and adaptation to challenges that arise in the global economy, environment and labour market.

# Would you like to:

elaborate on the findings,  
request a presentation, or  
plan for a workshop on the findings with your team?

**Please contact:**



Ms. Femke Groothuis  
President

The Ex'tax Project  
[welcome@extax.nl](mailto:welcome@extax.nl)

