European
Circular Economy
Stakeholder Platform

# European Circular Economy Stakeholder Platform (ECESP) Coordination Group

## Leadership Group on Economic incentives

## Orientation paper

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# Background

Low-carbon circular business models are hampered by many obstacles, including three structural and systemic ones: lack of demand for low-carbon circular products and innovative products, services and practices; lack of transparency throughout the value chain; and lack of access to finance. In December 2019, the EU adopted a Sustainable Finance Rulebook (“Taxonomy”) concerning climate investments, which is scheduled to come into effect as of 2021. Then, in 2020, the European Commission presented the European Green Deal (EGD) and the new Circular Economy Action Plan (CEAP). While the taxonomy is set to allocate more investments to financing climate solutions, avoid greenwashing and increase the transparency of financial markets -- thereby targeting two out of the three major hurdles to the circular economy --, the CEAP is hoped to solve the first and largest barrier: the lack of demand for circular products and services. At the same time, we are facing a shortfall of the effectiveness of the EU Non-Financial Reporting Directive (NFRD) which has targeted public-interest companies (>500 employees).

# Contribution of Economic Incentive Policies to the Circular Economy

Notwithstanding their excellent intentions, the policy instruments set out in the EGD and CEAP seem insufficient to meet their own ambitions. Economic incentives play a crucial role in steering the market demand towards circular choices as they are able to solve a major market failure in our current economy: external costs along the value chain resulting from placing products on the market are not included in the price. Capturing these impacts through "true pricing" will make circular products and services cheaper and linear ones more expensive.

Without economic incentive policies, there will be no real push towards a wider adoption of the circular economy. Circular solutions will stay niche products and services until strong market forces are created. Incentive policies will also ensure that the significant investments in Green Recovery bring economic returns and contribute to the transition to a new economy. The Taxonomy cannot accomplish that by itself, as it is just laying foundations of the new economic boundaries.

The ecological and fiscal transition can only be achieved if it is fair at the same time, integrating the requirement of social justice. This is a sine qua non condition for the acceptability of the transition, which has been confirmed by recent events relating to the carbon tax in France. Acceptability depends on predictability and progressivity too, in order to enable stakeholders to anticipate and prepare for the transition.
Also, existing economic incentives remain focused on the energy and waste sectors. Taxation on incoming resources plays an extremely limited role. In France, a tonne of outgoing materials (waste) is taxed twenty-six times more than a tonne of incoming materials on average. Taxation of materials incorporated into the productive process offers an important potential for accelerating the transition to a circular economy. This involves directly taxing inputs related to the extraction of virgin natural resources, as well as the import of certain polluting materials, in order to reduce the pressure they exert on the environment.
The price signal given would encourage a low use of virgin natural resources and would favour the preservation of the value of materials and the use of raw materials from recycling rather than extraction. In the long term, the improvement in material productivity should be accompanied by a reduction in dependence on raw material imports, and by extension by an increase in the competitiveness of European companies and the creation of local jobs.

This Leadership Group (LG) wants to elaborate on the following types of incentives, each of which has a specific potential for increasing the demand for circular solutions as well as specific policy trajectories and challenges:

| Economic incentive | Increase demand for circular products and services by: | Policy challenges |
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| 1. Green and Circular Public Procurement | Simple tender criteria to contain mandatory circular performance criteria besides price (green public procurement or GPP) | implement the EGD and CEAP actions |
| 2. Extended Producer Responsibility (EPR) incorporating all external costs in the price of specific product groups | Incentivising the production and consumption of circular products by modulating EPR fees according to sustainability criteria, which is, in turn, reflected in the higher cost that the producers have to bear for end-of-life management of those products that are waste intensive, thus rewarding eco-friendly design choices.<br>Explore possible taxation schemes, for example on the baseline of virgin resources use (rather than only plastic being not recycled, or | Implement harmonised eco-modulated fees in EPR schemes for all waste-intensive product groups<br><br>Needs to be considered in integration/in a dynamic approach with possible modulation of EPR, if related to hazardous waste generation. |

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| | single use material) or pollution generated (link to $CO_2$ pricing but not only, for example hazardous substances contents/hazardous waste generation). | |
| 3. A tax shift from labour to resources | Adding a high tax on resource-intensive products and services while reducing the taxation of labour<br>Determine circularity criteria in each product / service / process<br>Visual circularity labelling mechanism (similar to the energy efficiency label) | Launch an enhanced cooperation initiative by at least 9 member states |
| 4. No or low VAT for circular products and services across EU | Nudging consumers and businesses towards circular solutions – establish timeframe | Switch to majority voting on certain tax matters in the Council |
| 5. $CO_2$ pricing | Making materials and products with high, embedded carbon more expensive by either the EU-ETS, taxes or other measures; target the supply chains – e.g. major consumer supply chains to set 3rd party certified baseline by 2021) and targets to come into force from 2022. Where possible try to capture overall carbon footprint, linked to fossil fuel use or not (extraction, other materials and waste burning...etc). | Agree on at least 55% $CO_2$ reduction by 2030; the aim is to encourage local / regional supply chains and logistics rather than across the world (encourage seasonal products) |
| 6. Investigate possibility to add mandatory recycled content for specific product groups | Measure to boost demand for recyclates. Inclusion in the Single Use Plastic (SUP) Directive showed immediate effects on prices of R-PET, that were no longer driven by (lower) virgin PET prices. | Agree on a minimum percentage of recycled content for specific product groups in line or exceeding the requirements of the SUP Directive 2019/904 Art.6 |
| 7. Investigate demand side incentives, beyond GPP | - Voucher schemes for the most vulnerable/less wealthy citizens (to possibly overcome their lack of access to circular services/products),<br>- Levies on advertising, with higher fees for high $CO_2$/high impact products (the benchmark could be established based on PEF average or other type of LCAs)<br>- Mandatory inclusion of sustainable procurement (= in line with GPP criteria) for private businesses having to report on sustainability, and making it a criteria to report on for non-financial reporting<br>- Create a level playing field with | Investigate effects and integrate with the body of law under development |

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| | public authorities for services that are both public and private: Why should a public school respect GPP, when a private school could derogate, why should a public hospital comply with GPP, when a private clinic could derogate? | |

## Strategy

This LG on Economic Incentives will work on *how* to realise economic incentives that will create a strong *market* for circular products and services by increasing the demand for them. We will build on existing knowledge, networks and initiatives. As a concrete first step, the LG will prepare a Workshop on the topic for the ECESP Stakeholder Conference 2020.

More specifically, connected to these seven instruments, this LG will discuss:

- Possible strategies to overcome identified policy challenges, with a focus on the practical and member state level. Some questions at EU level are: Where do we stand? E.g., how can we come to an overview of the net EU public incentives per year towards and away from the circular economy? Who can help us to add up all circular public incentives (EU-ETS rights bought, all EPR fees modulated according to sustainability criteria, value of circular public procurement contracts signed, VAT reductions for circular products and services, etc.) while subtracting all linear public incentives, like fossil fuels subsidies or tax exemptions? Is it feasible to launch an enhanced cooperation initiative by at least 9 members to introduce, step by step, jointly, a tax shift from labour to resources? Which countries might be interested? How can the proposal for amending the EU VAT Directive on VAT rates, which was adopted by the Parliament but has stranded in the Council, be brought back to life? How could we best keep track of the implementation of minimum EPR requirements according to the Waste Framework Directive and how can we move onto harmonised EPR legislation with eco-modulation? What enabling conditions would be required for fee modulation by EPR schemes to be effective? (e.g. innovation; essential requirements for packaging; etc.).
- Relations between these instruments, e.g. the VAT, is also part of the tax shift. Instruments can reinforce each other, and “double taxing” needs to be avoided. Can there be an acceleration of tax harmonisation at EU level?
- Tax evasion, which is hindering the transition for SMEs by distorting the level playing field for multinationals
- Introduce a transfer price mechanism which is linked to public ESG (non-financial) disclosures which will tax the profit before the transfer based on a carbon-cost rate. E.g. if a product has different costs within the group companies, profit based in a country with low ESG performance (carbon associated to the product is not internalised in the market price) will have a carbon tax before it can be transferred
- The need for more social support for the required tax reforms.
- How to correct for the current low price of virgin versus recycled plastics due to the low oil price
- The EU’s own resources as an opportunity for implementing effective incentives; e.g. the value of a “plastic tax” and similar instruments for the circular economy – N.B. the current proposal in Council is not really a tax, it would rather be considered a national contribution to the EU budget.
- Single use plastic fee to be collected within affected regions
- Base the scoring of grants on a requirement of at least 10% green procurement by the company applying
- Other ways to implement economic incentives, e.g. in new investment (circular investment) and as well for promoting new circular economy business models.
- The need that imported products are subject to the same requirements as goods that are produced in the EU (requirements related to $CO_2$ emissions, to recycled content, to reduced production of hazardous waste/phasing out of chemical substances, to emissions control, etc).

- Cooperation between science and industry focusing on the application of circular economy solutions, both in projects supported from EU funds, i.e. by including circular models into new innovative and breakthrough solutions, and focusing on productivity and zero-waste solutions.
- Related topics such as special dedicated projects, subsidies, taxation on waste, waste to landfill, and investment

## Synergies with Leadership Group members' work

Economic incentives are part of sustainable finance which is an overarching means able to transform our current linear economy, including its mechanisms to steer demand to circular products and services, regardless of the sector. Therefore, the Economic Incentives Policies Leadership Group synergises with all other Leadership Groups in the following ways:

- Consumer/Retail Leadership Group: Making circular products and services cheaper and linear ones more expensive will automatically shift consumer's demand towards circularity. Retail has to adjust to a shift in supply in order to meet the demand. This entails bureaucratic changes and modifications in the supply chain. Synergising both Leadership Groups is of two-fold benefit: on the one hand, the insights from the Consumer/Retail Leadership Group can be used to sharpen the recommended economic incentives, making them more effective, on the other hand, practical suggestions for consumer and retail might become more specific through input from the Economic Incentives Leadership Group.
- Textiles Leadership Group: the outcomes of this group can feed into the Textiles Group and vice versa. Textiles are likely to become the first end-consumer sector turning circular. Applying the right economic incentives will accelerate the transition of consumer behaviour and industry and will, if successful, serve as model for circular transition.
- Cities Leadership Group: Circular Procurement is crucial to create circular cities. Likewise, cities and regions have been pushing for EPR for years as an important tool to accelerate waste recycling and prevention. In addition, city taxes can play a role to accelerate local and regional circularity. So the outcomes of both groups can reinforce one another.
- Investigate potential links to the other working group on Circular Economy Roadmaps, inherently linked with the economic incentives (for example in France, the circular economy roadmap mention a reduced VAT rate on circular products).