

Expert Opinion

Expert opinion by Robert Lönn, Magnus Nikkarinen and Petra Pettersson

Introduction

We represent Swedish trade and industry in the work of the committee, and we support its overall aim, which is to reduce the occurrence and dissemination of hazardous chemicals from clothing and footwear, and risk of exposure to those substances, in a cost-effective manner.

Given that the environment should be in focus, it is unfortunate that the terms of reference for the Inquiry limit it to presenting a proposed form of tax, instead of allowing it to impartially analyze alternative instruments that would potentially be a more effective means of achieving the intended environmental control. The choice of instrument is central to achievement of the environmental objectives in as cost-effective a way as possible, and it is therefore essential not to limit the choice of instruments without conducting a property study.

In some cases, a tax may be a suitable instrument if it is designed appropriately to target specific chemicals whose substitution is considered particularly urgent. Of the tax forms examined by the Inquiry, a tax based on defined categories of goods is preferable.¹ A delimited tax based on functional chemicals specifically added, for example, would produce a more efficacious tax structure, and would drive substitution more than a tax targeted on all clothing and footwear.

The tax here proposed represents an attempt to use a national instrument to meet international challenges. Effective environmental protection is best achieved at EU level. Homogenous statutory requirements and guidelines at European or global level are far better at achieving substitution of chemicals than are separate national regulations. Hazardous substances should preferably be banned. Introducing separate Swedish regulations may have the effect of creating barriers to trade and distorting competition.

Summary

We consider that the Inquiry's tax proposals should not be implemented for the following (and other) reasons.

- The proposals lack the necessary precision to constitute a cost-effective and acceptable instrument. If the tax is to operate in the interests of the environment, it sends the wrong signals by targeting all clothing and footwear, even though the Inquiry considers that 83.68 per cent of all such clothing contains none of the chemicals governed by the act. Under the proposal, all businesses will pay at least five per cent of full excise duty on clothing and footwear whether or not they contain chemicals.

¹ See section 10.5 of the report.

- The requirement under the terms of reference of the Inquiry that there be standard measurement methods or an equivalent method of measuring the chemicals to be taxed has not been met.
- The Inquiry has not been able to assess whether the tax is socio-economically justified, but considers that it will have a negative impact on competitiveness and employment in the industry.
- One failing of the Inquiry's proposal concerns its ability to create conditions for a circular economy. For instance, the act does not exclude goods going to waste incineration, which means that the products may be subject to double excise duties. Another example of the lack of circularity is that the tax construction proposed by the act means that second-hand goods will not be taxed. This is contrary to the Inquiry's remit not to adversely affect the conditions for trade in second-hand clothing and footwear, and hinders development of a circular economy.
- The design of the tax probably contravenes both EU regulations governing the single market and WTO trade regulations. It cannot be justified to design trade barriers on environment and health grounds when the lion's share of clothing and footwear does not contain the chemicals to be taxed.
- Our assessment is that the regulatory authorities will have limited capacity and ability to regulate and monitor. This concerns, *inter alia*, chemicals expertise in order to carry out relevant checks, as well as a lack of clear guidance in the legislation on testing methods and relevant thresholds. The limited ability of the authorities to collect tax from actors outside Sweden is also reason not to pursue the proposal.
- There are shortcomings in the selection of chemicals the Inquiry considers should be taxed. For instance, several of the chemicals in question will be doubly regulated, since they fall under other legislation. Moreover, the Inquiry's impact analysis is based on measurements that were taken more than eight years ago, and are therefore obsolete.
- The Inquiry gives no indications as to how and when it is to be ensured that the annexes are updated. In addition, the legislation should be reviewed within two years of entering into force, should that occur.

Comments on the Inquiry's proposals

The tax lacks the necessary precision

Assuming that a tax proposal is to be put forward by the Inquiry, it should have proposed a narrower, better targeted tax than the one proposed. Clear evidence that the tax is a blunt instrument may be found in the fact that over 83 per cent of the products covered by the tax do not contain any of the chemicals on which taxation of clothing and footwear is based. Moreover, all actors are obliged to prove the absence of various types of biocide, even though between 98 and 99 per cent of all clothing and footwear is not expected to contain any biocides.

Given the high proportion of enterprises that are not involved with the chemicals that the Inquiry has chosen to tax, it is of interest to recapitulate the report of the Chemicals Tax Inquiry report (SOU 2015:30). That inquiry chose not to propose a chemicals tax on clothing. "As the Inquiry sees it, the problem with this form of tax is that perhaps at least 90 per cent of all clothing does not contain hazardous chemicals. This means that many taxpayers would have to devote resources to documenting the chemical content in large numbers of garments that do not

contain any such chemicals.”² The reasons given by the Chemicals Tax Inquiry for not proposing a tax, or at least for limiting the scope of the tax, remain relevant.

In our view, the requirement made in the terms of reference for the Inquiry, i.e. that the tax be cost-effective and administratively simple, has not been met.

Fiscal design of the tax

A fundamental premise for an environmental tax is that it should drive substitution. This means that businesses pursuing substitution that have phased out harmful chemicals in the products covered by the act should not be taxed. Accordingly, it is unreasonable that the Inquiry nonetheless proposes that a full deduction should not be allowed for goods not containing any harmful chemicals.

Under the Inquiry’s proposal, five per cent of the original excise duty will always be payable, even if those involved have proved that the goods contain none of the listed chemicals. It is counter-productive and sends the wrong signal to tax someone who is actively working in the interests of the environment, and has phased out chemicals targeted by the tax. A purely fiscal tax constitutes an additional cost, jeopardising other environmental protection measures and investments. The fiscal portion of the tax is detrimental to confidence in, and acceptance of, the tax as an instrument of environmental policy. It is an important principle that a full deduction should be allowed for goods containing none of the listed chemicals. The tax will also have a marked impact on the profitability of the retail clothing industry. The industry has suffered from sharply falling operating margins, combined with stagnating clothing and footwear sales. It is also worth noting that the number of fashion stores fell by 27 per cent between 2011 and 2018. Imposition of a surcharge on this industry is very hard to justify in terms of cost-effectiveness. It will further reduce competitiveness, and result in business failures and job losses. In addition, there are a number of other political initiatives that will add to business costs. The main one is the planned producer responsibility for collection of textiles, which offers clear added value in terms of developing a more circular economy.

Absence of necessary standardised measuring methods

The Inquiry was charged with the task of particularly considering how the tax is to be monitored, and that administrative costs are to be kept as low as possible. It is clear from the Inquiry’s terms of reference that particular account should be taken of the administrative burden and costs borne by businesses. The terms of reference also state that it must be possible to measure the substances to be taxed using a standardised or equivalent method.

Several chemicals in the annexes do not have standardised testing methods; the concentration thresholds have been set low, in some cases so low that presence of the chemicals may be due to contamination rather than active use of additives. This may necessitate multiple tests to prove measuring uncertainties where different tests yield different outcomes. For example, the Inquiry states that standardised measuring methods or standard substances are not always available for PFAS, but has been informed that methods are being developed to measure total organic fluorine.³ The basis for a tax must be that there are objective measuring methods that businesses and agencies can use to ensure correct payment of tax. Where there are no general

² Swedish Government Official Report SOU 2015:30, p 249.

³ See section 11.7 of the present report.

measuring methods to check that the tax is correct, the substances in question cannot be covered by the tax. There is an obvious risk that the inability to perform checks will mean that business are obliged to pay a higher tax due to the difficulties in substantiating entitlement to deductions for chemicals for which there are no satisfactory measuring methods.

In our assessment, the regulatory authorities will have limited capacity and ability to regulate and monitor. This concerns, *inter alia*, chemicals expertise in order to carry out relevant checks, as well as a lack of clear guidance in the legislation on testing methods and relevant thresholds. The limited ability of the authorities to collect tax from actors outside Sweden is also reason not to pursue the proposal.

Uncertain health and environmental economic gains from the tax

It is evident from the impact analysis that the Inquiry has not been able to assess the health and environmental economic gains from avoiding harmful chemicals in clothing and footwear. As a result, the Inquiry considers that it cannot draw any conclusion as to whether the socio-economic costs of the tax are greater or less than the socio-economic gains.⁴ This lack of certainty about the effects of the tax should, in itself, suggest that it should not be implemented.

The proposal entails a heavy administrative burden for those reporting the tax, who must ensure they have satisfactory documentation supporting the right to a deduction. The impact analysis shows that the tax is an obstacle to freedom of movement, but can be justified on objective grounds for protection of human health and the environment. However, the question is whether there are grounds for restricting free movement of goods if there is no documentary evidence of the socio-economic gains produced by the tax.

Moreover, the impact analysis shows, among other things, that the tax is expected to result in approximately 700 job losses in the Swedish clothing and footwear industry, and to have the greatest adverse impact on women and low income earners. The risk is also that the number of job losses is a conservative figure, since the Inquiry's estimate is based on the assumption that businesses will fully cover the tax in the price charged to consumers. In a competitive market, it is not certain that a business can pass on the cost of the tax to consumers. This means that it will have a direct impact on business profitability, and adverse effects on employment.

All in all, there is cause to question whether there are reasons to introduce a tax whose health and socio-economic effects do not outweigh the negative consequences that a tax brings by worsening the legitimacy of the tax system, increasing the administrative burden for businesses, and causing job losses. This applies particularly if the majority of clothing and footwear items are taxed even though they do not contain the listed chemicals.

Exemption needed for goods sent to waste incineration

The Inquiry's proposal offers no exemption for goods that stock keepers send to waste incineration. We consider this to be unfortunate. The Swedish Environmental Code contains a "waste hierarchy", specifying the order in which waste is to be disposed of.⁵

⁴ See section 13.8.4.

⁵ See chapter 15, section 10, Swedish Environmental Code.

Furthermore, it is not an end in itself to send goods purchased to waste incineration, but it may be necessary if a consignment of clothing or footwear is found to contain chemicals rendering their sale inappropriate or unlawful. The risk of not having an exemption is that the clothing will instead be sent for recycling, with the result that the hazardous chemicals enter the recycling system. Another consequence of taxing goods sent to waste incineration is that those products may be subject to double excise duties, since goods that are incinerated are also subject to waste incineration tax as of 1 April 2020.

All things considered, there are rational reasons for not taxing clothing and footwear sent to waste incineration. Not allowing an exemption, as the Inquiry proposes, is counter-productive from an environmental viewpoint, and takes no account either of relevant environmental legislation or of the fact that waste incineration is already subject to a specific excise duty.

Worsened conditions for trade in second-hand clothing and footwear

The proposed taxation of second-hand clothing and footwear runs counter to the Inquiry's remit not to worsen the conditions for trade in second-hand goods. Under the Inquiry's proposal, a deduction is granted of 95 per cent of the full tax. Given that second-hand goods are generally cheaper than new ones, the consequence of this will be for the tax to take up a larger portion of the total price of taxable second-hand goods than is the case for taxable new goods. The effect of the Inquiry's proposal is to reduce the incentive to buy second-hand clothing and footwear, which is not in line with its remit. Additionally, the proposal counteracts the trend towards a more circular economy, since other laws, such as the increased requirement for collection of clothing and footwear, is intended to promote increased circulation. The tax is supposed to drive substitution. Substitution occurs when clothing and footwear are manufactured, not when second-hand goods are bought and sold.

Moreover, the Inquiry's proposal means that redesigned goods will be taxed as new clothes even though they are made from second-hand clothes, which is unfortunate, since redesign is a growing trend, and a way to increase the circular flow of clothing.

Restriction of free movement in the EU and of international trade

As with the proposed electronics tax, the Inquiry's proposal is that foreign sellers will also be liable to the tax. This means that they are to be subject to the same regulations.

It is very difficult to see that the design of the tax is consistent with EU regulations governing the single market, since the tax constitutes a trade barrier. The tax will also be very hard to justify from a global trade perspective. The Inquiry states that introduction of the tax can be justified, *inter alia*, by Article XX of the General Agreement on Tariffs and Trade (GATT), which provides that regulations restricting international trade may be introduced provided "[the measures are] necessary to protect human, animal or plant life or health". Since more than 83 per cent of all products that are proposed to be taxed do not contain any of the chemicals listed, the tax ought to be at odds with the intention of Article XX.

Finally, there is every reason to ask whether Sweden, as a small and export-dependent country, really wants to be at the vanguard of creating national taxes that place obstacles in the way of international trade. There is a risk that other countries will follow suit, and design their own national taxes that Sweden considers have an unscientific basis and impede our exports.

Failings in the selection of chemicals to be covered by the tax

The Inquiry has not taken sufficient account of information from industry experts when drawing up the annexes listing taxable chemicals.

It may be pointed out that certain listed substances are already banned under existing legislation. Evaluation of levels and concentrations has already been made, and should be followed, for example with regard to alkanes and SCCPs. In addition, there are regulations that overlap with other legislation, which creates a lack of clarity.

The Inquiry has also chosen to include a number of biocides in the annexes concerning all clothing and footwear, even though these chemicals are found only in a small proportion of all clothing and footwear. The Inquiry estimates that less than two per cent of all clothing and footwear contain biocides, but the figure is most likely lower. Requiring traders to prove the absence of biocides in all clothing and footwear is unacceptable, cost-driving and administratively burdensome. Moreover, the EU has a Biocides Regulation,⁶ and regulation of biocides should take place solely under that statute. Biocides should not be subject to any additional regulation, such as taxation.

Several chemicals in the annexes are already proposed to be covered by EU chemicals legislation (the REACH Regulation⁷), which is updated twice a year. This is one reason that the annexes to the act should be reviewed once or twice a year to ensure that double regulation does not occur, and that the chemicals listed in the annexes are relevant.

Several measurements in the document on which the impact analysis is based are over eight years old. A great deal has happened under REACH and the Biocides Regulation. Our knowledge of chemicals and chemicals management has increased enormously. Updated facts and current status must be obtained for correct impact analysis, and to be able to evaluate the effect of a law.

Plan for evaluation of the tax

In addition to updating the annexes, it is important that there be a plan to evaluate the environmental and fiscal impacts of the tax to ensure it has the desired effect. The Inquiry has proposed that an evaluation should be carried out after four years, but given the uncertain health and environmental gains from the tax, it is reasonable for it to be reviewed two years after its entry into force.

⁶ Regulation (EU) No 528/2012 of the European Parliament and of the Council of 22 May 2012 concerning the making available on the market and use of biocidal products.

⁷ Regulation (EC) No 1907/2006 of the European Parliament and of the Council of 18 December 2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), establishing a European Chemicals Agency, amending Directive 1999/45/EC and repealing Council Regulation (EEC) No 793/93 and Commission Regulation (EC) No 1488/94 as well as Council Directive 76/769/EEC and Commission Directives 91/155/EEC, 93/67/EEC, 93/105/EC and 2000/21/EC.

Proposed date of entry into force of the tax

The Inquiry has proposed that the act enter into force on 1 April 2021, and that the tax should be levied as from 1 July the same year. In view of the Inquiry's assessment that the EU, among others, should be notified of the proposal, and that the actors are not used to administering excise duties, entry into force should be postponed. A reasonable length of time should be given for transition, including adaptation of business systems and establishment of new procedures necessitated by the tax. The tax should therefore not be levied until 1 January 2022, at the earliest.

Conclusions

Lastly, it may be pointed out that during the course of its work, the Inquiry has taken the views of trade and industry into account to a very limited extent. The main impetus for the Inquiry instead appears to have been a desire to ensure additional tax revenue from the entire clothing and footwear industry, regardless of whether or not their products contain hazardous chemicals.

The Inquiry's proposals do not meet the general requirements under its terms of reference, viz., that the proposed tax should promote substitution, be cost-effective and administratively uncomplicated. The proposal should therefore not be remitted until this has been adjusted. If remittal nonetheless occurs without any adjustment, it should at least be deferred until after evaluation of the electronics tax has been completed, in autumn 2020.