Chapter 27
Environmental Tax Policy Reforms in the European Union

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ABSTRACT

This chapter provides an overview of the environmental tax policy system in the European Union. The different kinds of environmental taxes, their quantitative use in the member states as well as the factors that influence the potential for tax reforms are explained. Reference is also made as to how environmental fiscal reforms can contribute to a Green Economy. The principles and the motivational factors for an Environmental Fiscal Reform (EFR) are explained. The experiences and the practices of European and Asian countries are presented and policy lessons learnt are drawn. Finally the chapter concludes by referring to the environmental fiscal reform prospects.

INTRODUCTION

Early in the 1990s a political discussion about the adoption and the increased use of environmental taxation in Europe started. Since then, a number of environmental tax reforms (ETR) were introduced. The Scandinavian countries introduced ETR for preventing the environment from pollution, making the living environment healthier, improving living conditions and increasing economic efficiency. For achieving economic efficiency, it is necessary to adapt the EU economic structures to the environmental reforms. This need for structural change is one of the key points underlined in the European Commission´s 2020 strategy. Making the ETR an important part of the EUs strategy underpins the need that the ETR must be implemented by the EU Member States and any environmental-harmful subsidies (EHS) must be removed. Currently, the share of the environmental taxes in the total taxes and the social security contributions is limited to 6.1%. Around 75% of these taxes are from taxes on energy and transport. Very few EU Member States obtain significant revenues from taxes on resources such as water, waste, landfill, or pollution.

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Environmental taxes are not intensively used in EU, due to the fact that there is already a high tax burden which leads to a resistance against further increases. Also, there are concerns about the distributional and competitiveness impacts of these taxes (OECD, 2006). Concerning their distributional impacts, there is a feeling that poorer households might suffer proportionately more, especially in case of taxes on water or heating energy (or electricity) consumption. Concerns their competitiveness impacts the energy-intensive sectors will be worse off through an ETR. The governments also worry that these industries will be relocated in other countries if they are environmentally taxed. However, labour-intensive sectors with low energy consumption are likely to benefit from an ETR. Thus, further increases in environmental taxes are not encouraged. Nevertheless the factors mentioned that do not encourage ETR, a number of governments have approached this issue as follows:

1. ETR is concomitantly reduced by the tax burden on labour with low income. This helps with the distributional and competitiveness concerns and revenue is recycled.
2. Tax reductions or exemptions are made in order to help energy intensive companies and sectors. Derogations as a policy, however, have weakened the financial incentive to reduce energy, resource consumption or pollution. So, in order to limit this effect, compensation can be applied in a digressive way for a given period in order to maintain incentives.
3. Revenues from environmental taxes are used to finance environmental spending or investments on energy saving.

Thus, if tax exemptions are limited, the efficiency of the tax system will be improved. Also harmonization within the European Union is necessary and each EU member country has to take into consideration its industrial structure when deciding tax rates. There are EU countries with heavy industries that cause high pollution levels whereas there are countries with light industries and very low pollution levels.

ENVIRONMENTAL TAXES IN TRANSPORT, POLLUTION AND NATURAL RESOURCES

Taxes on transport are the second in rank biggest group of environmental taxes. As a tax base, vehicle taxation is a supplementary instrument that supports ETR. Transport is at one hand a substantial source of revenue and on the other a growing source of carbon dioxide emissions, air pollution, noise and congestion.

In 2005, the Commission had made a proposal to introduce a Carbon Dioxide element on car taxation. At the beginning, Taxes on Carbon Dioxide could make up one quarter of revenues and later half of revenues (European Commission, 2005). By the year 2014, already eleven Member States had a Carbon Dioxide element in their registration tax. Regarding annual circulation taxes twelve Member States have a Carbon Dioxide element (ACEA, 2014).

Taxes on, water abstraction and consumption (and also waste water discharges) and on, waste generation (including specific packaging-waste taxes and those on types of waste management, such as taxes on land-filling or incineration),[1] are two most commonly applied taxes.

The Water Framework Directive (European Union, 2000), obliges Member States to restructure water pricing in order to ensure that the allocation of costs is in line with the polluter-pays principle in order to give incentives for an efficient use of water. Thus, all water users (i.e., households, industries