

ENVIRONMENTALLY RELATED TAXES IN OECD COUNTRIES: ISSUES AND STRATEGIES

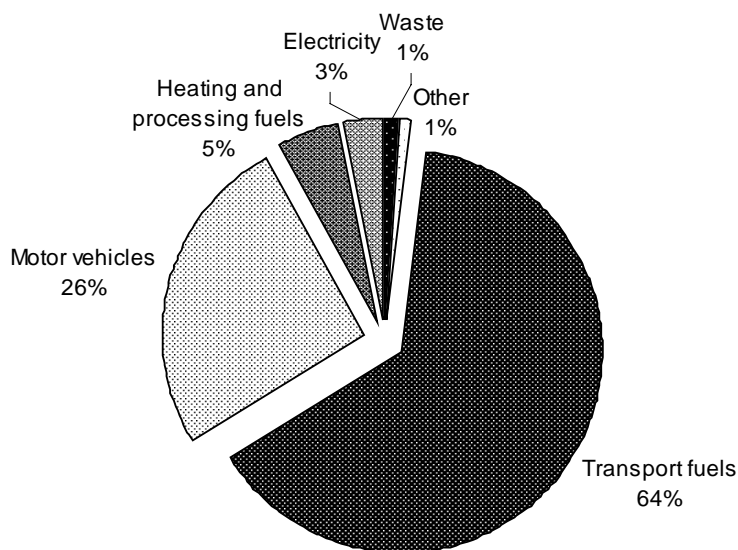
EXECUTIVE SUMMARY

Over the last couple of decades, economic instruments have been playing a growing role in environmental policies of OECD countries. A distinctive feature is the increasing use of environmentally related taxes, defined as any taxes levied on environmentally relevant tax-bases, such as emissions to air or water, energy sources, motor vehicles, waste, etc.

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The revenue from environmentally related taxes averages roughly 2% of GDP in OECD Member countries. Taxes on the purchase or use of motor vehicles and fuels, including taxes on petrol and diesel, generate most of the revenues. In some countries taxes are also used to address a broad spectrum of other environmental problems. Nevertheless, there is scope for expanding the use of environmentally related taxes in most OECD countries, although many chose to do so in a revenue-neutral manner.

**Share of different tax-bases in total revenue raised by environmentally related taxes
21 OECD Member countries, 1995**



Green Tax Reform

An increasing number of countries are implementing comprehensive green tax reforms, and others are contemplating doing so. Green tax reforms can include restructuring existing taxes to reflect the polluting characteristics of the different products or activities, the introduction of new taxes – e.g. on water use, water pollution, waste, certain chemicals – and the removal of environmentally harmful tax exemptions and subsidies. Due notice should, however, be given to the non-environmental – e.g. social or economic – objectives these provisions were meant to serve.

The tax revenues can alleviate a budget deficit, contribute to a budget surplus, or finance discretionary increases in government expenditures. The revenues can also provide room for reductions in other taxes to reduce market distortions, address competitiveness concerns, or to increase the public acceptance of environmental taxes.

There is growing evidence of the environmental effectiveness of green tax reform.

In the context of the Joint Meetings of Tax and Environment Experts, OECD fiscal and environment experts have prepared a report on *Environmentally Related Taxation in OECD Countries: Issues and Strategies* (2001). The report documents the growing evidence of the environmental effectiveness of environmentally related taxes. The responsiveness of demand to changes in prices, for example of energy, is often significantly higher in the long run than in the short run, implying that a consistent long-term implementation of environmentally related taxes could reduce energy consumption and improve the environment.

Perceived impacts on sectoral competitiveness and on low-income households are important obstacles to implementation...

The report also addresses a number of obstacles to the implementation of environmentally related taxes, such as the perceived competitiveness implications for the most affected – and generally most polluting – industrial sectors, possible negative impacts on low-income households and fears that administrative costs could be significant.

...but measures can be taken to address these concerns.

Several complementary options to build acceptance for policy reform exist, including identifying, simply and clearly, the objectives behind an environmentally related tax, disseminating information about the need to address the environmental problems, and allowing sufficient time for public hearings or other forms of consultation. This could include the creation of “green tax commissions” and inter-ministerial working parties.

Some environmentally related taxes can impact more on low-income households than on others, or can increase regional income disparities. However, a complete assessment of the distributional effects of a tax should include the secondary impact of any compensation payments, reductions in other taxes, and the induced employment effects. It should also take into account the distribution of environmental benefits resulting from the tax. While exemptions and rate reductions that defeat the environmental purpose of the taxes should be avoided, where there are significant negative distribution impacts of a tax reform, these can generally be avoided through proper design of compensatory measures and revenue recycling schemes.

Industries are granted a large number of exemptions and rebates to environmental taxes...

To date, environmentally related taxes have not been identified as causing significant reductions in the competitiveness of any sector. This is consistent with OECD and other research on economic performance that shows that it is largely skills and investments that determine sectoral competitiveness. The finding is also not surprising given the numerous forms of exemptions and rebates currently granted to business. Indeed, the OECD/EU database on environmentally related taxes indicates that such taxes are levied almost exclusively on households and the transport sector (for further information see <http://www.oecd.org/env/tax-database/>)

... which reduce their environmental effectiveness.

Blanket exemptions for polluting products along with rebates for heavy polluting industries can significantly reduce the effectiveness of the taxes in curbing pollution and reduce incentives for developing and introducing new environmentally friendly technologies.

When addressing sectoral competitiveness concerns, countries can allow desirable structural change to take place – gradually, ...

The report suggests ways to better address sectoral competitiveness concerns. Countries would benefit from better integration of environmentally motivated reforms with broader fiscal reforms. Possible negative impacts on the competitiveness of some sectors from the environmentally related part of a broader reform might thus be reduced. It should also be kept in mind that while some sectors may face a net loss in competitiveness due to an environmentally motivated tax reform, other – often more environmentally benign sectors – could generally improve their competitiveness. Countries may wish to allow such desirable structural changes to gradually take place.

...pre-announce phase-outs of tax exemptions, and recycle part of the revenues back to industry, while maintaining the environmental incentives.

In general, such restructuring would be facilitated if the introduction of new taxes and tax rate increases is announced well in advance, and if existing rebates and exemptions are phased-out gradually. Where exemptions and rebates are currently given, countries could remove these and channel part of the revenues back to the industries in question – but in such a way that the environmental incentives are maintained at the margin.

The negative environmental effects of exemptions and rate reductions can also be limited by ensuring that firms that are currently exempted or benefit from reduced tax rates sign up to stringent mitigation measures. In some countries, there is also scope for improving the design of tax provisions to ensure that any remaining exemptions and refund mechanisms are properly targeted to achieve their stated objectives.

International co-operation can facilitate concerted policies that reduce unwanted competitiveness impacts.

Countries concerned with competitiveness implications of adjusting taxes on a unilateral basis could also consider possible concerted policy options and changes, decided and implemented at the national level, but within a framework which provides for a multilateral dialogue. The OECD provides a unique forum to facilitate such policy discussions, and the competitiveness issue figure prominently in the recently renewed mandate of the Joint Meetings of Tax and Environment Experts.

To purchase *Environmentally Related Taxes in OECD Countries: Issues and Strategies*, and other OECD publications, visit the OECD Online Bookshop at <http://www.oecd.org/bookshop> or send an email to sales@oecd.org
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