Environmental Fiscal Reform: incentives and financial resources for SFM

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Summary:

According to the European Environment Agency, Environmental Tax Reform (ETR) is a reform of the national tax system where there is a shift of the burden of taxation from conventional taxes, for example on labor, to environmentally damaging activities, such as resource use or pollution. The burden of taxes should fall more on 'bads' than 'goods' so that appropriate signals are given to consumers and producers and the tax burdens across the economy are better distributed from a sustainable development perspective.The economic rationale is that welfare gains are generated by reducing taxes on labor or capital and increasing taxes on externalities and hence helping to avoid 'welfare-reducing' activities. A typical case is an increase in the tax on energy, and a simultaneous reduction in labor taxes or social security contributions. Environmental fiscal reform (EFR) is a broader approach, which focuses not just on shifting taxes and tax burdens, but also on reforming economically motivated subsidies, some of which are harmful to the environment and may have outlived their rationale.

EFR instruments include:

- Eco-taxes and environmental charges, levied for example on emissions (e.g., CO2, SO2), water effluent, water abstraction, energy (e.g., fuels, sulfur in fuels), transport (annual circulation, car registration/import/emission, motor size), landfill and/or incineration, resources (raw materials, minerals), environmentally harmful products (packaging material, tires, pesticides, batteries, etc.)
- Other fiscal instruments such as import duty differentiation, VAT rate differentiation, accelerated depreciation, etc.
- Emissions trading which can help ensure that a given overall emission target is met via allocation and trading of emission allowances
- Green subsidies, such as investment grants, soft loans, interest subsidies and equity finance for investment supporting the implementation of environmental policy, or, for catalyzing the uptake or mainstreaming of environmental technologies, etc.
- Reform of environmentally harmful subsides, e.g. subsidies that were introduced for other purposes than environmental policy but effectively counter-act environmental policy or support unsound environmental practices
- Green public procurement which can catalyze the mainstreaming of environmentally sound technologies and foster the environmental industry by including sustainability criteria in purchasing decisions
- Measures aimed at “greening” the yearly or longer term public budgeting processes, e.g., by including sustainability criteria in budget formulation
- In addition, measures aimed at greening commercial finance (e.g., financial products and services offered by commercial banks, insurance and leasing companies) may be included in EFR solutions

A number of these instruments can be used in the context of sustainable management of natural ecosystems, including for example:

- Environmental taxes and charges on emissions, effluent, natural resources, environmentally damaging products, etc.
- Fiscal instruments such as tax differentiation favoring certain eco-technologies
- Green subsidies supporting investments related to of sustainable management of natural ecosystems
- Reform of environmentally damaging subsidies (e.g., subsidies on pesticides and fertilizers leading to over-use and damage to ecosystems)
- User/entrance charges for protected areas
- Payments for ecosystem services
- Green commercial finance products, such as green bank accounts and investment funds

In many countries, revenues from environmental taxes and charges, including those mentioned above, are earmarked for public environmental expenditure schemes. The international benchmark for good practice in public environmental expenditure management is the OECD Council Recommendation No C(2006)84. These recommendations provide for useful checklists and principles in three key areas:

- Performance in terms of environmental effectiveness
- Performance in terms of fiscal prudence
- Performance in terms of management efficiency

Key recommendations:

- Consider SFM related finance and taxation in the wider context of environmental fiscal reform (EFR) and try to promote and include SFM related instruments into bigger EFR packages/solutions
- Introducing a public environmental expenditure scheme that includes SFM as one spending area (next to other, environmental spending areas) may be easier to justify and implementthan a scheme that focuses exclusively on SFM, e.g. a Forestry Fund
- The design and operationalization of a public environmental expenditure scheme focusing on (or including) SFM should be firmly based on good international practice, which is available as OECD Council Recommendation C(2006)84 on“Public Environmental Expenditure Management”.

Key words:environmental fiscal reform, environmental funds, environmental taxation, environmental finance, public environmental expenditure management