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The use of consumption taxes to re-launch green tax reforms

Johan Albrecht *

Ghent University, Hoveniersberg 24, 9000 Ghent, Belgium

Abstract

Between 1995 and 2001, the share of green tax revenues in the EU-15 GDP slightly declined. This is a surprising evolution but there are, however, strong economic efficiency arguments to set environmental taxes at low levels, and hence below the Pigovian or marginal pollution damage level. This paper presents an alternative to re-launch the debate on green tax reform in Europe; consumption taxes that are differentiated according to the environmental impact of products. Given the long tradition of consumption taxes in Europe, this instrument requires less institutional innovations than emission taxes. We show that a pragmatic classification of products in a sustainable and hence low VAT category can strongly limit the economic costs of the tax reform while the price reduction for green products can limit undesirable distributional consequences.

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1. Introduction

In the latest decades many European governments declared to implement ambitious green tax reforms. Economic incentives make use of powerful market forces. Environmental taxes penalise the production and consumption of ‘bads’ while generating revenues that can offset existing taxes on ‘goods’ like labour. Higher prices for energy, wastes and environmental

* Tel.: +32 9 264 35 10; fax: +32 9 264 35 99.

E-mail address: johan.albrecht@ugent.be.

damages provide clear incentives for consumers and producers to search for technologies that can minimize or eliminate the environmental penalties. Compared to technical environmental regulation or the command-and-control approach, economic instruments can deliver static and dynamic efficiency gains (Royal Society, 2002; Tietenberg, 2003). An ecological tax reform is also the least bureaucratic, the least intrusive and arguably the most powerful instrument to make environmentally technologies more attractive (von Weizsäcker, Lovins, and Lovins, 1997). This paper deals with the modest progress in the use of environmental taxes in Europe. As an alternative to existing energy and pollution taxes, a scheme with environmentally differentiated consumption taxes is presented.

2. The use of environmental taxes

Most European countries have a long tradition with respect to environmental taxes. Between 1980 and 2001, total environmental tax revenues in the European Union (EU-15) increased from 55 billion Euro to 238 billion Euro. The share of environmental taxes in total revenues from taxes and social contributions increased from 5.8% in 1980 to 6.5% in 2001. Since 1980, the share of environmental taxes in GDP first increased from 2.2 to 2.8% in 1995, to slightly fall back to 2.7% in 2001 (Eurostat, 2003a). The importance of environmental tax revenues varies significantly across countries. Expressed as a share of GDP in 2001, environmental tax revenues are highest in Denmark (4.7%) and the Netherlands (3.8%). The relative importance of environmental taxes is lowest in France (2%) and Spain (2.2%).

Energy taxes are by far the most significant, representing more than three quarters of environmental tax receipts in 2001. Energy taxes are high in most European countries – up to 80% of the final price for leaded and unleaded petrol – but could not prevent that the price of most energy products was stable in real terms between 1985 and 1996 (EEA, 2001). Not surprisingly, the incentive from these energy taxes to save energy has been very modest. Transport taxes account for 21% of total tax revenues (Eurostat, 2003a). Despite the rhetoric about applying the Polluter Pays Principle (PPP), the relative importance of taxes on pollution and resource use has been more or less stable over the last 10 years.

Table 1 gives an overview of the composition and evolution of environmental tax revenues in Sweden between 1993 and 2004. In this pioneering country – Sweden is one of the few countries with taxes on carbon and sulphur dioxide and with a general tax on natural resources – the share of environmental taxes in GDP did fall from 3.1% in 1993 to 2.9% in 2004.

In Sweden, the energy-related environmental taxes amount to 88% of total environmental tax revenues. Table 1 shows that especially the tax on carbon dioxide emissions did lead to strongly increasing tax revenues. Revenues from general transportation taxes did fall back in the recent years.

The reduced share of environmental revenues in GDP suggests that environmental taxes only play a marginal role and that ambitious green taxation reforms have not yet been implemented. Environmental NGOs use this conclusion to ask for more ambitious green tax reforms. Environmental taxes can, however, be installed with the purpose to change behaviour or with the purpose to collect revenues. With the former or regulatory taxes, decision makers will be influenced in their ecologically relevant behaviour and this can

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