TAX 'BADS' NOT GOODS!

Time for a Green Tax Reform in Cyprus

By Theodoros Zachariadis

As a result of the recent financial crisis, European governments need to raise public revenue to maintain sustainable debt levels and reduce fiscal deficits. At the same time they are committed to implementing EU legislation. Furthermore, Member States are being asked to pursue the implementation of structural reforms and to consolidate their public finances as part of the 'Europe 2020' strategy which aims at generating 'smart, inclusive and sustainable growth'.

Until recently, environmental taxes had not been viewed as major revenue-raising options. It is becoming increasingly evident, however, that such taxes can be important components of a cost-effective fiscal consolidation strategy. Currently, European countries generate most of their revenues by levying taxes on labour and income. At the same time, revenues from taxes on activities that cause environmental degradation and the depletion of scarce natural resources (such as the consumption of electricity, fuels and water as well as the production of waste) account for a small fraction of government finances. This endangers economic growth and employment while rewarding the over-exploitation of natural resources. Environmental fiscal reform can correct this disparity by shifting the focus of government taxes: Instead of taxing 'goods' (such as from labour or income), governments should tax 'bads' (i.e. environmentally harmful and resource-depleting activities).

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Such reform can rely on market-based policy instruments like carbon taxes, emissions trading, water abstraction charges, levies on the production of waste, traffic congestion charges, etc. Another important element is the phasing out of environmentally harmful subsidies to fossil fuels; according to independent studies, governments across the G20 countries spend $88 billion every year subsidising the exploration of fossil fuels, whose combustion causes adverse health effects and may lead to serious climate change.

Several European countries have already introduced green tax reforms. Apart from saving energy and improving the environment, environmental taxes can produce better economic results than conventional taxes: Many studies and best practices show that, depending on how the additional public revenues generated from environmental taxation are used by the government, environmental fiscal reform may also be beneficial to economic growth.

The importance of environmental taxation is even more pronounced in countries that apply fiscal consolidation policies as part of broader structural reforms in their economies. To increase public revenues, governments often consider raising excise taxes on goods and services or increasing income tax rates. However, according to many economists and international organisations, environmental and natural resource taxes are among the most promising measures to improve public finances without being detrimental to economic growth. They can discourage polluting and resource-depleting activities and, at the same time, generate much needed public revenues – some of which may also be used for compensating vulnerable households that may suffer from the increase in environmental charges. This has been well documented by the European Commission, the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF). Moreover, a strong political consensus exists in Europe on the subject. For example, the European Parliament has recently expressed its support for such reforms: in November 2014, the Parliamentary Committee on Economic and Monetary Affairs urged the European Commission to proceed with legislative proposals that would increase environmental taxes and align tax policy with the objectives of the EU's energy and climate policy for 2030.

An international conference on this topic was held in Nicosia in June 2014, in the context of European "Green Week 2014". It was jointly organised by the European Commission Representation in Cyprus and the Cyprus University of Technology (CUT), in the framework of its EU-funded Jean Monnet project "European Energy and Environmental Policy at a Crossroads".

Speakers at the conference shed light on this topic from various angles – the fiscal and environmental effectiveness of such a reform, political acceptability, and equity concerns, i.e. whether such a tax reform hits low-income households more strongly and how such impacts can be alleviated. They provided an overview of environmental taxation in the European Union and policy initiatives of the European Commission towards strengthening the environmental tax base in EU member states. They explained the rationale of environmental fiscal reforms and provided examples of how these have been implemented in different countries, using Germany as the leading example, where such reform has helped reduce carbon emissions and has reportedly created a substantial number of new jobs. Another concrete example was described in detail: the implementation of a carbon tax in Ireland, during the period when a Troika-supervised economic adjustment programme was in place.

Cyprus is still faced with a serious financial and fiscal crisis. Therefore, this is the right time for national authorities to consider moving to a rigorous green tax reform. Lessons learnt from around Europe can provide valuable information to national policy makers. The fact that the governments of Italy and Portugal, amidst their own economic problems, are currently giving serious consideration to proceeding with environmental fiscal reform and have set up expert committees to provide the relevant recommendations shows that such reform is not a luxury; it can be a major component of an economic strategy to promote growth and environmental quality at the same time.

More information about the European experience on green tax reforms will be available in the December 2014 issue of the journal 'Cyprus Economic Policy Review', published by the University of Cyprus. It is freely available at http://www.ucy.ac.cy/erc/en/publications/cyprus-economic-policy-review. G

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