

## **Environmental Fiscal Reforms in Europe and their Prospects for Cyprus – Some Introductory Remarks**

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As a result of the recent economic 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 implement EU legislation. Member States are asked to pursue the implementation of structural reforms and to consolidate public finances as part of the 'Europe 2020' strategy which aims at generating 'smart, inclusive and sustainable growth'.

Among different policies, environmental taxes were not viewed until recently as major revenue-raising options. It becomes increasingly evident, however, that such taxes can be important ingredients 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, activities causing environmental degradation and depletion of scarce natural resources (such as consumption of electricity, fuels and water as well as production of waste) account for a small fraction of government finances. This endangers economic growth and employment while rewarding over-exploitation of natural resources. Environmental fiscal reform can correct this disparity by shifting the focus of government taxes from labour/income to environmentally harmful and resource-depleting activities.

Such a reform can rely on market-based policy instruments such as carbon taxes, emissions trading, water abstraction charges, levies on the production of waste, traffic congestion charges etc. Another important element is 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 (Bast et al., 2014).

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Several European countries have already introduced such policy instruments. 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 whether and how the additional public revenues generated from environmental taxation are recycled in the economy, an environmental fiscal reform may also be beneficial for 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, independent studies and international organizations, 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 e.g. by the European Commission (2011); the Organisation for Economic Cooperation and Development (Hagemann, 2012); and the International Monetary Fund (Parry et al., 2014). Moreover, the European Parliament has recently expressed its support for such reforms: The Parliament’s Committee on Economic and Monetary Affairs urged in November 2014 the European Commission to proceed with legislative proposals that would increase environmental taxes and align tax policy with the objectives of the EU energy and climate policy for 2030<sup>1</sup>.

An international conference on this topic took place in Nicosia in June 2014, as a satellite event of the European “Green Week 2014”. It was jointly organized by the European Commission Representation in Cyprus and the Cyprus University of Technology, in the frame of its EU-funded Jean Monnet project “European Energy and Environmental Policy at a Crossroads”. In this conference, the European experience from such reforms was presented, examples from other countries in crisis were provided, and national experts presented their thoughts about the potential effects of such reforms on economic activity and household welfare.

This article is followed by three short papers written by speakers in that conference, which shed light on this topic from numerous viewpoints – the

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<sup>1</sup> See <http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-541.536&format=PDF&language=EN&secondRef=01> (last accessed 17 November 2014).

fiscal and environmental effectiveness of such a reform, its political acceptability and the equity concerns. Manfred Rosenstock provides 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. Kai Schlegelmilch explains the rationale of environmental fiscal reforms and provides examples of how this has been implemented in different countries, using Germany as the leading example, where such a reform helped decrease carbon emissions and has reportedly created a substantial number of new jobs. Finally, Louise Dunne describes a concrete example of such a reform – the implementation of a carbon tax in Ireland – during a period that a Troika-supervised economic adjustment programme was in effect.

Cyprus is one of the Eurozone countries faced with a serious financial and fiscal crisis. Therefore, this is the right time for national authorities to consider moving to a rigorous environmental fiscal reform. The articles that follow provide basic guidance as to how to implement such a reform. Despite some particularities of Cyprus (mainly associated with distributional aspects of energy expenditures that may be different from those of other European countries), the 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 considering seriously to proceed with an environmental fiscal reform and have set up expert committees to provide relevant recommendations shows that such a reform is not a luxury; it can be a major ingredient of an economic strategy to promote growth and environmental quality at the same time.

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