HANDBOOK

NGO Guidelines for promoting National Reforms of Environmentally Harmful Subsidies (EHS)

PUBLICATION BY THE EUROPEAN ENVIRONMENTAL BUREAU
WITH THE ASSISTANCE OF ITS WORKING GROUP ENVIRONMENTAL TAX REFORM

DECEMBER 2004

EEB PUBLICATION NUMBER 2004/015

The European Environmental Bureau (EEB)

The EEB is a federation of over 140 environmental citizens' organisations based in all EU Member States and most Accession Countries, as well as in a few neighbouring countries. These organisations range from local and national, to European and international. The aim of the EEB is to protect and improve the environment of Europe and to enable the citizens of Europe to play their part in achieving that goal.

The EEB office in Brussels was established in 1974 to provide a focal point for its Members to monitor and respond to the emerging EU environmental policy. It has an information service, runs working groups of EEB Members, produces position papers on topics that are, or should be, on the EU agenda, and it represents the Membership in discussions with the Commission, the European Parliament and the Council.
It closely co-ordinates EU-oriented activities with its Members at the national levels, and also closely follows the EU enlargement process and some pan-European issues.

Editor responsible John Hontelez

European Environmental Bureau (EEB)
Boulevard de Waterloo 34 | B-1000 Brussels | Belgium
Tel.: +32 2 289 1090 | **Fax:** +32 2 289 1099
E-mail: eeb@eeb.org
Websites: www.eeb.org, www.ecotax.net,
www.chemicalreaction.org, www.participate.org

AN INTERNATIONAL NON-PROFIT ASSOCIATION
ASSOCIATION INTERNATIONALE SANS BUT LUCRATIF

The EEB gratefully acknowledges financial support from the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety.

Copied on 100% recycled chlorine-free paper.

NGO Guidelines for promoting National Reforms of Environmentally Harmful Subsidies (EHS)

Publication by the European Environmental Bureau
with the assistance of its Working Group Environmental Tax Reform

Dec 2004

EEB publication number 2004/015

The European Environmental Bureau (EEB)

The EEB is a federation of over 140 environmental citizens' organisations based in all EU Member States and most Accession Countries, as well as in a few neighbouring countries. These organisations range from local and national, to European and international. The aim of the EEB is to protect and improve the environment of Europe and to enable the citizens of Europe to play their part in achieving that goal.

The EEB office in Brussels was established in 1974 to provide a focal point for its Members to monitor and respond to the emerging EU environmental policy. It has an information service, runs working groups of EEB Members, produces position papers on topics that are, or should be, on the EU agenda, and it represents the Membership in discussions with the Commission, the European Parliament and the Council. It closely co-ordinates EU-oriented activities with its Members at the national levels, and also closely follows the EU enlargement process and some pan-European issues.

Editor responsible: John Hontelez

European Environmental Bureau (EEB)

Boulevard de Waterloo 34

B-1000 Brussels

Tel.: +32 2 289 1090

Fax: +32 2 289 1099

E-mail: eeb@eeb.org

Websites: www.eeb.org, www.ecotax.net,

an international non-profit association

association international sans but lucratif

The EEB gratefully acknowledges financial support from the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety

Copied on recycled chlorine-free paper.

Contents

1. Introduction and Foreword

For the past ten years or more, there has been a growing awareness that "environmentally harmful subsidies" (EHS) are the worst of both worlds. They hurt the environment, while at the same time they quite often do not serve our welfare in a more general sense. As a prominent newspaper put it: "the no-win madness of perverse subsidies".[1]

Despite this growing awareness, little progress has been made to abolish EHS or to redesign them in such a way that negative environmental effects are avoided while upholding societal gains in other areas. The guilty parties are – in our view – governmental indolence and the pressure from those who profit from subsidies. There are, of course, always short term beneficiaries.

This is reason enough for environmental NGOs to enter the arena and forward a strong case for phasing out EHS – as some have already done in recent years. This publication is intended to stimulate and assist environmental NGOs in achieving their objectives. It offers:

- definitions and general figures, arguments for and against, and political diagnosis (ch.2)
- suggestions for NGO activities, ranging from agenda setting to influencing policies; identification and evaluating EHS is part of this (ch.3)
- suggested reading (ch.4)
- examples of NGO activities and experiences (annex 2-5)

This document was written by Jan de Vries, from Stichting Natuur en Milieu in The Netherlands, with the help of the EEB-working group on environmental fiscal reform. We thank all members who contributed, and especially the Clean Air Action Group Hungary (CAAG) for their extensive input.

The European Environmental Bureau established an NGO working group on Environmental Fiscal Reform in 2001. The EEB has a dedicated website (www.ecotax.net), and has published reports and position papers on the issues. The EEB also organises seminars in order to raise NGO awareness and capacity-build, increasing their ability to push for national action on environmental fiscal reforms. One such seminar on environmentally harmful subsidies was held in November 2003, and in September 2004 the EEB joined its member, the Clean Air Action Group, in Hungary for a Conference on the same topic. This publication is the result of intensive preparatory work. In February 2005 the European Environmental Bureau will publish its political demands for a reform of environmentally harmful subsidies; This will be addressed to Member States and EU Institutions to support them in their efforts to implement the Lisbon and Gothenburg Agendas' effective and coherent policies to achieve sustainable development.

Jan de Vries, SNM, The Netherlands
Karoly Kiss, CAAG - Clean Air Action Group, Hungary
Stefan Scheuer, EEB, Brussels

[1] Norman Myers and Crispin Tickell, *The no-win madness of perverse subsidies,* Financial Times; 28-07-2003.

2. EHS – why talk about them?

What are we talking about?
The OECD defines a subsidy as "any measure that keeps prices for consumers below market levels, or for producers above market levels". This includes hidden subsidies, for example, when regulations for an environmentally more harmful sector are much less strict than for a less harmful one. To give one illustration, safety regulations prove to be much stricter for rail freight than for road freight transportation.

Strictly speaking, non-internalisation of external costs is not included in the OECD definition as mentioned above. This is included in a broader definition, as another form of an implicit subsidy. The definition may then be reworded: "any measure that keeps prices for consumers below environmentally correct market prices, or for producers above these prices." In fact, the OECD applies this broader definition to several EHS-reports (see ch. 4).
An external cost arises when the social or economic activities of one group of persons have an impact on another group and when that impact is not fully accounted, or compensated for, by the first group. Or more simply, an external cost arises when the user does not pay the full value of the product or service he or she uses.

Not all subsidies are environmentally harmful. A specific definition of EHS is – again – given by the OECD: "… all kinds of financial supports and regulations that are put in place to enhance the competitiveness of certain products, processes or regions, and that, together with the prevailing taxation regime, (unintentionally) discriminate against sound environmental practices." [2]
In this publication we follow the above definition, which we interpret more or less broadly.(see the menus in chapter 3)

Subsidies are widespread. See table 1 for a recent estimate of relatively easy detectable subsidies (hidden subsidies, subsidies to services like transport, tourism, or energy services, non-internalisation of external effects which are exempted or underestimated).
Such estimates typically show subsidy levels to be around 5 per cent of GDP. At first sight, this might not look very impressive. But remember that the level of subsidies is much higher for the producers or consumers concerned. One example: two-thirds of the support for agriculture goes to producers, representing 31 per cent of the value of farm receipts. Obviously, such subsidy levels influence the decisions made by farmers ! However, subsidy levels are much higher if one includes the environmental costs which are not paid for by the users. For example, a recent OECD-study estimated that the external cost of transport in Central and Eastern European countries equals 14% of their GDP

Table 1. **Typical recent estimate of environmentally relevant subsidies**
(billions of US dollars a year, late 1990s); Source: OECD, 2004b

Sector	OECD countries	Non-OECD countries	Total
Agriculture	335	65	400
Water	15	45	60
Energy	80	160	240
Forestry	5	30	35

[2] OECD: 1998, *Improving the environment through reducing subsidies* (3 vol), Part 1, p.7

Fisheries	10	10	20
Other sectors	280	30	310
Total	725	340	1065
(per cent GDP)	(3.4)	(6,3)	(4)

Pros and cons

There are many reasons why governments subsidise certain economic activities or products. These include correction of market failures (when the market is deemed unable to price correctly, or in a socially acceptable way, basic needs such as water, food or energy), protection of national production and employment, regional development, reduction of dependence on foreign imports, access to services or goods for all, technological innovation, stimulation of economic growth etc… There is a very important driving force for this - lobbying by powerful interest groups.[3]

Subsidies may or may not serve their primary objective. Even when they do, the granting of subsidies has disadvantages which should not be forgotten: for example the fact that someone, usually the taxpayer, has to pay the subsidy given to certain categories of producers or consumers. More important in our context is another undesirable effect. Subsidies which are intended to contribute to a certain objective may at the same time hamper other objectives, such as the recovery and preservation of environmental quality. Such subsidies with perverse environmental effects need to be reformed, replaced by other policy tools or abolished.

There is convincing evidence that environmentally harmful subsidies are prominent in a number of sectors: agriculture, fossil fuels, road transport, water, forestry, fisheries, land use and the construction industry. Of course, these sectors are closely interrelated and also have links with other sectors. Removal of such subsidies may even offer a "win-win" scenario: improving the environment and simultaneously increasing economic efficiency. Subsidy removal increases government revenues (or lessens outlays). The decrease of public financial debt is an important issue in all countries, but particularly so in the accession countries where imbalanced central budgets threaten economic stability. A further positive economic effect arises from subsidy removal, as subsidies that are conditional on the development of a specific mode of production discourage producers from choosing cleaner methods. Furthermore, subsidies tend to impede technological development or innovation (lock-in effect), especially those that shelter industries that are no longer economically viable.

On the other hand, there are also beneficial subsides, as seen from an environmental perspective. Of course, such subsidies may hamper other political objectives and for that reason may need to be reframed or replaced by other policy instruments. For example, in most cases the application of the polluter pays principle is preferable to subsidising industries in order to lower their emissions. But subsidies may be a viable tool, especially when innovation and development of new environmental technologies is at stake. For example feed-in-tariffs in the renewable energy sector appear to be an effective tool towards improving their attractiveness as an alternative to fossil fuels. Such tariffs can act as fiscal incentives to

[3] In September 2003 the Clean Air Action Group of Hungary, together with the EEB, organised a conference on EFR in Budapest. A former Finance Minister of Hungary also participated. When asked why the government subsidises activities which are clearly harmful not only from an environmental, but also a purely economic viewpoint, his reply was the following: "Find out how many times the representatives of industries and companies visited various ministries, and you will have the answer…"

achieve environmental objectives, as well as mitigating social impacts in sectors such as the domestic one.

Political perspective
The focus in these guidelines is on environmentally harmful subsidies, with a view to fiscal and budgetary reform: redesigning, replacing or removing EHS may contribute to an economically and environmentally sound fiscal and budgetary system.

In general terms, political chances for the reform of EHS are positive. Most international institutions, such as the OECD, recognise the majority of subsidies as being obsolete, wasteful and inefficient. During the last 3 years the OECD has performed an extensive program to identify EHS, analyse their effects and support governments in reducing them. To mention just one result: the OECD estimates that removing coal producer grants and price supports (including market entry barriers) could save 100 million tonnes of CO_2 per year by 2010 in OECD countries, and also reduce acid gas emissions. (see the following chapter for further discussion of OECD findings and recommendations)

The aim of phasing out EHS has also reached international agreements like the Kyoto protocol, as well as EU policy making. The 2001 Göteborg European Summit called for a "progressive removal of harmful subsidies" by 2010. The Sixth Environmental Action Programme (2002) demands a reform of "subsidies that have considerable negative effects on the environment and are incompatible with sustainable development". In mid-2004 the EU Environment Council asked the Commission to develop new initiatives. Furthermore, the High Level Group, chaired by former Dutch Prime Minister Kok, which advised the EU on revitalisation of the so-called Lisbon Strategy, stressed the importance of subsidy reforms (Autumn 2004).

It is fair to say that during the last decade, progress has been made in removing subsidies. Examples include the lowering of state support for EU steel production (from more than 2 Billion USD in 1995 to 3.5 Million in 2000), the removal of direct social allowances and cross subsidies for electricity and gas in many Central and Eastern European countries (e.g. in Czech Republic these amounted to almost 3 billion USD during 1994-1998), and even the modest reduction of agricultural subsidies (from nearly 40 per cent of the value of farm receipts in OECD countries in the late 1980s to 31per cent in 2002). But it is also fair to say that trade distortions and budgetary problems, not environmental harm, were the main drivers for these changes. Positive environmental effects only emerged as by-products.

This implies that a systematic evaluation of EHS might still reveal substantial new opportunities for environmental improvement and win-win solutions by eliminating or redesigning them. Some EU Member States have already produced such inventories (e.g. Czech Republic, The Netherlands, Germany), mostly based on a rather strict EHS-definition. However, up until now, no Member State has embarked on a comprehensive action plan to remove, replace or redesign them. Nevertheless, the examples mentioned above illustrate that major changes within a few years are possible.

In Feb 2005 the EEB will present its demands to EU governments and institutions to have EHS reforms incorporated into the implementation of the Lisbon Agenda

3. Suggestions for NGO activity

Choose your limitation
EHS can be defined very broadly, embracing virtually all factors which prevent (in the words of German MP Prof. Ernst-Ulrich von Weizsäcker) „prices from telling the (ecological) truth". EHS can also be defined more strictly; for example as explicit (financial) support plus fiscal facilities. Several intermediate definitions also exist. In practice a decision should be made on whether to include or exclude certain forms of EHS from the following list:

– ***Direct and indirect state subsidies**:* grants from the state budget, allowances from state funds, preferential credits, relief or reduction of taxes and liabilities, etc.

– ***Use of undervalued natural resources**:* cases where natural resources are valued at an unrealistically low level, and so the users of such resources obtain hidden subsidies (e.g. in land use or mining).

– ***Non-internalised environmental damage**[1]:* all cases where the consequences of an environment-polluting or damaging activity are borne by others, i.e. where *external* costs are incurred, as if the polluter was granted a subsidy corresponding to the extent of the negative externalities.

– ***Publicly funded infra-structural developments which are harmful to the environment**:* cases when economic policy does not take into account the environmental damage ensuing from infra-structural projects (e.g. motorways or regional waste dumping sites).

The decision as to which limitation is preferable is highly dependent on political circumstances In other words, which limitation gives the best chance for the elimination of EHS ? For instance, there are EU Member States where intense discussions already exist on how to internalise external (environmental) effects in the fiscal system. Pleading for internalisation under the heading of EHS would not add much to this discussion. So, it seems wise to choose a really focussed approach towards harmful subsidies in a strict sense, like the first category mentioned above.
In other Member States the discussion about greening the tax system is less developed or less promising eg. in several Central and Eastern European countries. Instead questions about budget deficits and budgetary reform might be crucial. Here it might be more promising to choose a broad approach, calling for attention from traditionally minded economic policy-makers to all categories of EHS.

Besides such strategic considerations, there are of course other relevant aspects. For instance, some types of EHS are easy to identify while others are not; some are already controversial, others are yet undisputed; etc... The message here is : *Choose your limitation!*

Identification and evaluation
EHS are a complex matter. Eliminating or redesigning them is often difficult, for political and other reasons. NGO expertise and capacities are typically scarce. So, we recommend that NGOs first tackle obvious (direct or fiscal) subsidies that have a clear and significant impact on the environment. A direct link between the subsidy and output[4] levels is an important criterion, as is a direct link between the subsidy and inputs that affect the environment (energy, raw materials).

Examples for obvious environmentally harmful subsidies are:
- direct subsidies for road construction
- production support to intensive agriculture
- subsidies for fossil fuels
- tax exemptions for air travel
- allowances for commuters
- tax deductions for commuting

Starting from subsidies which are easily detectable and the removal of which clearly benefits the environment, NGOs could gradually move towards more hidden and complex ones. As well as widening the scope in this way, it may also be attractive or even necessary to stimulate researchers and/or governmental institutions to investigate EHS. NGOs could then rely on their results, communicate them, formulate action plans and lobby for better alternatives. After all, carrying out research is not the core business of NGOs.

In all cases – focussing on a single subsidy or taking a broader approach, carrying out one's own research or relying on outside sources – it is important to distinguish between identification of *potential* harmful subsidies and evaluation of their real environmental impact. Identification results in a description of the "where, what and how" of a subsidy that might cause environmental damage

Identification:
– *Where* - which sectors or consumer categories profit from this (explicit or hidden) subsidy?
– *What form does it take?* (see categories mentioned above)
– *How* - through what mechanism is it granted (economic policy, income taxation, etc)?

Also, in a broader investigation, these three dimensions are helpful in drawing up an inventory. In terms of the first dimension, the importance of EHS in different sectors emerges. The second cross-section (the form the subsidy takes) highlights the fields where a change of attitude may be needed. Lastly, from an analysis of the third dimension (mechanisms), conclusions can be drawn regarding the areas where existing regulations should be evaluated.

The next step is to evaluate the environmental impact of a subsidy which has been identified as potentially harmful. For most subsidies this is not self evident, even in seemingly clear cases. Take for example state support for coal mining. Given the fact that most environmental damage results from coal *burning*, and not - in many cases, at least - from the mining as such,

[4] Outputs that are considered to damage the environment, or the production process of which damages the environment.

the environmental gains from eliminating this state support will be small *if* it only leads to substituting domestic with imported coal.
The essential question then is whether the removal of a specific subsidy does indeed lead to improvement of the environment. The OECD recently produced a so-called *checklist*, which offers a feasible method for answering this question (see Annex 1). This checklist essentially consists of three yes/no options, after description of the subsidy concerned:

- *First: is the existing regulation of the relevant environmental problem effective ?*
  If the answer is 'yes', the removal of the subsidy will be futile and significant environmental results will not be attained. If the answer is 'no', then the next choice follows.
- *Second:* are *environmentally more favourable alternatives (production sectors or methods, consumer goods etc.) available or not ?*
  If 'not', because environment-friendly alternatives do not exist, then again subsidy removal will be futile. If the answer is 'yes', the third choice is relevant.
- *Third: does the subsidy increase the extent of the environmentally harmful activity or not?*
  If 'not', e.g. if demand is inelastic to price changes, if the subsidy is not directly related to production or if the beneficiary has a monopoly position, withdrawal of the subsidy will not result in environmental improvement. If 'yes', there is a strong environmental argument for subsidy elimination or redesign.

This OECD checklist has been developed as a guiding instrument for governments. Quite often NGOs choose a wider perspective than actual policy objectives, because these are mostly short term oriented, based on political compromises et cetera. Therefore we add two considerations:
- Regarding the first choice: the criterion "environmental policy effectiveness" should not only refer to existing policy objectives, but also to the long term ecological carrying capacity.
- Regarding the second choice: the availability of environment friendly alternatives is often disputable. It depends on a lot of economic (market and prices), technological, social and other conditions. The time span we think in can also make an alternative realistic or unrealistic. We should assume a simplified approach, including alternatives which are viable in the short *or* longer term. eg. energy saving and renewables are alternatives to fossil fuel extraction, organic farming is an environmentally friendly substitute for intensive agriculture, public transportation an alternative to car use, combined transportation to road haulage, natural materials to synthetics, root zone sewage treatment in rural areas to the traditional sewage treatment, etc. Finally, in most cases there is also the option of just consuming less.

Strategy and tactics
For any campaign to be effective, it is important to define its precise political goal. Roughly speaking, we can differentiate between three options:

a. raise the issue. While the removal of EHS is hardly an issue for national politicians, what *is* of primary importance is awareness raising about their detrimental effects. Making noise about one or a few very obvious examples of EHS seems the best strategy here. Show its stupidity! Make it a scandal! Demand transparency!
b. broaden the policy case. Once the existence of EHS and the attractiveness of removing or redesigning them is recognised, the moment has arrived to proceed towards political support for an economy wide reappraisal of explicit and implicit subsidy schemes - for annual subsidy publications, for correcting prices to internalise external effects, etc

c. show alternatives. Policy making has something to do with 'the art of the possible' – it's what *can* be changed, not what *should* be changed that motivates politicians. So it may help a lot if attractive alternatives to existing EHS are developed and propagated.

As has been said, it depends on political situations which strategic goal should be preferred. Also never forget, it also depends on NGO resources, including NGO capabilities, their ability to mobilise supportive journalists and researchers or to stimulate official research, independent publicity, action from political parties, etc….

Coalition building is another dimension of strategy and tactics which is worth mentioning separately. Whether EHS are maintained, withdrawn or redesigned will almost certainly have other impacts besides environmental ones, positively or negatively. We can, for example, think of health effects, social effects, economic effects such as jobs and profitability, for the population at large or for certain groups or sectors. It proves helpful to analyse these effects, as far as possible, in order to identify potential opponents and potential allies. NGOs that address these issues properly may be able to build broader coalitions in favour of EHS elimination. Sometimes it may also be attractive for NGOs to join the bandwagon of subsidy reform, even if the primary incentive is not environmental but social and economic impacts.

In short, NGO campaigns on harmful subsidies could be developed as follows:

1. ***Identify*** harmful subsidy/ies and their environmental impact. The effect of removal or redesign on the environment must be clear and significant.

2. ***Analyse*** the overall setting – social, economic, health aspects. Recognize counter arguments, opponents and potential allies; choose your political target; propose alternatives with better overall impacts; invest in potential allies like unions, social NGOs, economic sectors.

3. Develop ***lobbying and publicity*** including media action, public awareness raising, pressure on parliaments, government, local authorities, political parties and opponents of subsidy reform.

4. ***Co-ordinate*** with other NGOs, nationally and internationally (EU), in order to exchange experiences, to mutually reinforce national activities, and to strengthen European involvement.

4. Further Reading

Beers, Kees van and André de Moor (2001): *Public subsidies and public failures: how subsidies distort trade, equity and the environment and how to reform them.* Edward Elgar, Cheltenham, UK.

Myers, Norman and Jennifer Kent (2001): *Perverse subsidies: how tax dollars can undercut the environment and the economy.* Island Press, Washington DC.

OECD (1998): *Improving the environment through reducing subsidies (three volumes).* OECD, Paris.

OECD (2003): *Environmentally harmful subsidies: Policy issues and challenges.* OECD, Paris.

OECD (2004a): *Synthesis report on environmentally harmful subsidies.* OECD, Paris

OECD (2004b): *Environmentally harmful subsidies and international instruments.* OECD, Paris.

Explanation:
We selected two internationally renowned sources of facts and analyses of harmful subsidies worldwide. These books by Van Beers/de Moor and Myers/Kent contain numerous references to other reports, which have both a national and international focus (except of course publications from the last few years).

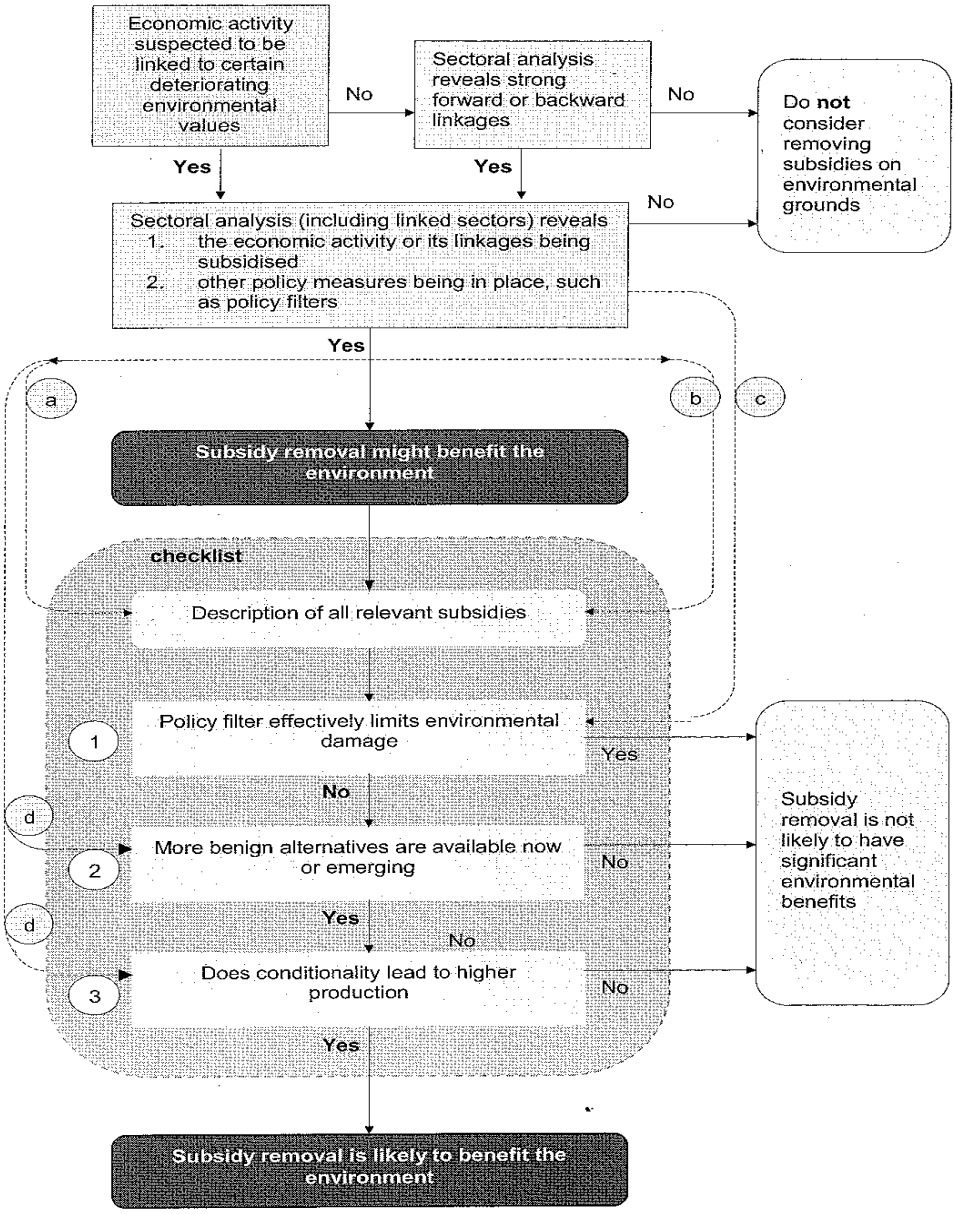
Without doubt, the OECD represents the international platform which has carried out the most thorough investigation of harmful subsidy policies and strategies for reform. The list mentions some inspiring results from OECD efforts during the last ten years.

Last but not least, we would like to highlight the position paper on environmentally harmful subsidies which is published by the EEB along with this document. This is an example of NGO activity on the international (EU) scale. For examples of national NGO activities and their results, please see Annexes.

Annexes

1. OECD checklist – flowchart (p. 70 from SG/SD(2004)3 – synthesis report

Chart 1. Flow chart of the checklist



2. EHS in Hungary

Some striking examples of environmentally harmful subsidies in Hungary are the following:

1. In Hungary the state loses revenue of at least HUF 600 billion each year [5] due to the fact that private car use is very often accounted for illegally as a company expense item, and thus the payment of personal income tax and social security tax is evaded. This sum exceeds all state revenues from yearly fuel and car taxes. The Finance Ministry is well aware of the problem, but no politician dares to take appropriate measures, fearing the reaction of the country's 2.7 million car owners

2. A hidden subsidy given to road freight transport is that safety and other rules and checks for rail are much stricter than for road transport. Even the more lenient rules are often ignored by truck drivers. According to expert estimations, truck transporters in Hungary would have to nearly double their prices if they were to respect all regulations.

3. Each year, heavy trucks cause more than HUF 400 billion in damage to roads, buildings and other vehicles. At the same time, the state's annual revenue from fuel taxes and vehicle taxes from heavy trucks is only about one-tenth of this sum.

4. The construction of motorways is exempt from the payment of VAT. Every other construction (e.g. that of railway lines or housing) is subject to 25 per cent VAT.

5. In Hungary each year a substantial amount of countryside and agricultural land is converted into building land. One of the main reasons for the destruction of green areas in Hungary is that the profits resulting from the appreciation of real estate make individual owners richer, while the damage and costs are borne by the whole society. Such damage results partly from the destruction of valuable green areas. Besides, public money is used for necessary new infrastructure – roads, public transport, water, sewers, healthcare services, schools, etc. Also, subsidies are given for the construction of new houses without any environmental or nature protection requirements. All this means that an enormous subsidy is given to stimulate the destruction of nature.

6. In Hungarian agriculture about 50 per cent of direct state subsidies (more than HUF 100 billion yearly) can be considered as environmentally harmful. As regards non-internalized environmental damage, it is estimated that agriculture burdens Hungarian society with external costs totalling at least HUF 250 billion.

See also the study *Environmentally Harmful Subsidies in the Hungarian Economy,* http://www.levego.hu/english/environmental_fiscal_reform/harmful-subsidies.pdf

Contact:

András LUKÁCSLeveg_ Munkacsoport / Clean Air Action Group
E-mail: lukacs@levego.hu

Internet: http://www.levego.hu

[5] 1 Euro = 245.63 HUF

Urban sprawl: New houses north-west of Budapest, in an area with the richest biodiversity in Hungary
(photo: WWF Hungary)

3. EHS in Czech Republic

Although many environmentally harmful support measures have already been removed in the Czech Republic - such as direct social allowances for heat, cross-subsidies for electricity, reduced rate VAT for energy[6], import quotas for coal - many still remain. Among the many cases of inefficient and ineffective allocation of public resources being spent on projects and activities, including environmentally improving ones, we can highlight the following :

- green diesel fuel as a means of supporting primary agricultural production through refunding 60 per cent of the excise tax on diesel and other oils used in primary agricultural production and forestry. This rebate was also maintained in a new Excise Taxation Act that has been in force since January 2004. Lost public revenues are estimated at about 40 million € yearly (6 per cent of total revenues from diesel taxation, and 0.2 per cent of total public revenues). This support represents one of the most obvious cases of EHS in the Czech Republic. This unsystematic and environmentally harmful support measure was introduced to compensate farmers for the unsystematic increase in the prices of inputs into agriculture while outputs were kept at a low level;
- central heating subject to reduced rate VAT (5 per cent rate, instead of 19 per cent, formerly 22 per cent before January 2004). This support was estimated to cost about 30 million € in the form of lost VAT revenues at the end of the 1990s. The beneficiaries are mainly households living in apartment blocks, including a significant number of high-income household groups
- maximum liability ceiling for nuclear power plants (relevant for the risk financial responsibility) and regulation of obligatory reserves for nuclear waste disposal that hardly cover related costs
- lower taxation of diesel than petrol even if the damage to human health in particular is evidently higher for diesel engines than for petrol ones (although the new Act lowered the rate difference)
- provision of road transport infrastructure under marginal costs
- non-internalisation of externalities, of energy conversion and energy use in particular (see ExternE-Pol Final Report for their estimation in EC forthcoming)

Actions and activities

Governmental bodies

The most active is the Czech Ministry of the Environment that initiated and consequently funded a project in 2000-2001 entitled "Analysis of Public Subsidies with Adverse Environmental Impact that are not in accordance with the Principles of Sustainable Development" (see Becvar et Ruzickova 2003 for overview). The project followed current OECD guidelines and analysed several support measures. The Czech MoE also supports the OECD work in this field and application of its checklist in particular.

Firstly, the relation to their purpose, supposed time of duration, level of contribution etc. was evaluated. In the second stage, support measures with a potentially negative impact on the

[6] For instance, cross-subsidies for electricity and gas were estimated at 2.9 bln. USD during 1994-1998, indirect subsidies mostly in the form of a reduced VAT rate applied at 0.9 bln. USD. Direct subsidies for that period amounted to 1.9 bln. USD, mostly dominated by social support for heat (0.9 bln. USD) and support for coal mining decline (0.55 bln. USD). In comparison, subsidies for renewables were (0.4 bln. USD), and for energy savings significantly lower still. (0.06 bln. USD) for that period.(Florian, M. (1999): Analyza dotaci v energetice. (Analysis of subsidies in energy sector). SEVEn - The Energy Efficiency Center, and GREENPEACE,Prague. 24 pp.)

environment were analysed. The third stage represented a detailed analysis of some chosen support measures using a uniform methodology.

NGOs and research institutes

Environmentally promoting subsidies have been the main interest of Czech NGOs. They have however increased their interest in EHS as well. Work on this has been carried out jointly by environmental NGOs and research and academic institutes, and has included :

- a study in collaboration with various research institutes during 2000-2001 on the identification and assessment of several EHS
- seminar on "Environmental Subsidy Reform: how to tackle harmful subsidies" held in November, 21-22, 2003 in Prague and jointly co-organised by European Environmental Bureau, Society for Sustainable Living (Czech NGO), and Charles University Environment Center, Prague. The main goal of the seminar was to promote subsidy reform as an instrument to move towards greater sustainability in a cost effective way, and exchange information and increase awareness
- "State Budget Bill proposal of the Czech Republic for year 2003" prepared jointly by NGOs and research institutes This also highlighted several items of expenditure within the state budget to be removed or changed
- a study focussing on the identification of EHS, based on expert appraisal and including a concrete proposal for their removal This study was prepared in coordination with the Czech eco-NGO umbrella organisation Green Circle and concluded in November 2004, prior to negotiations for the State Budget Bill for 2005. The study focussed on subsidies and support measures at state and local level, with a proposal based on concrete case studies.

Contact

Milan SCASNY
SSL - Society for Sustainable Living
Charles University Environmental Center
Czech Republic
Email: milan.scasny@czp.cuni.cz
Web: www.ecn.cz/rtk

4. EHS in Poland

Coal Mining

Coal plays an important role in the Polish energy sector. In 2002 hard coal provided 73.85 per cent of total primary energy production in the country, while lignite provided 15.15 per cent (in 1992, figures were 80.77 per cent and 14.53 per cent). Although domestic extraction has declined by 24 per cent since 1995 (see table 1), Poland still ranks high (7th) among the world's hard coal producers.

Table 1. Production of hard coal (in millions tonnes).

1995	2000	2001	2002
137	103	104	104

A slight decrease in the above mentioned figures is also reflected in total employment figures in the sector (see table 2). However, coal mining remains one of the biggest burdens for the Polish state budget.

Table 2.Mining of coal and lignite - employed persons (in thousands).

1995	2000	2001	2002
294,5	174,3	171,5	166,9

Since the early nineties the government has introduced successive restructuring programmes for the sector, aimed at a decrease in production capacity and employment, and increased profitability in Polish coal mining. The most popular forms of state aid have been direct grant and debt forgiveness. These types of support for the sector amounted in the1990s to 15 billion PLN[7] in nominal prices, which means 34 billion in 2001 prices (as a comparison,, total state aid has remained around. 11 billion yearly in recent years). The latest restructuring programme set up subsidies of 9.6 billion PLN, of which. 8 billion PLN are direct grants, within the period 2004-2010. Subsidies are usually earmarked for social purposes (severances for laid off miners), forgiveness of financial commitments (e.g. environmental fees) and counteracting environmental problems caused by closed mines.

Nonetheless, reported state aid constitutes only a share of the subsidisation which exists in the sector. Coal quotas for foreign coal as well as subsidies for coal exports enable domestic mines to increase extraction. Thanks to export subsidies, Polish mines were able to sell coal on foreign markets for less than the cost of extraction. According to the evaluation of B.Fiedor and A.Graczyk (*Removing/ Restructuring Distortional Energy Subsidies in Poland,* www.env.cz/www/zamest.nsf/0/2c7b3bfbe711ffbfc12568f00026ae88?OpenDocument)the annual value of export subsidies for hard coal was 350-450 million USD at the end of the nineties. The authors also point out other specific forms of subsidising hard coal production which are related to the organisational structure of the hard coal sector. As the mines have been merged into coal companies consisting of up to around 15 plants, the most effective and profitable mines have been granting subsidies from their revenue to the weakest ones. However, the calculation of cross-subsidisation within particular coal companies is practically impossible. This is simply due to the fact that no official statistical data on the practice is

[7] 1 Euro = 4.074 PLN

available. Secondly, the coal companies are interested in hiding such data because revealing it would lead to increased corporate taxes.

The recent favourable situation in the world coal market has improved the economic situation of some coal mines, raising questions about the rationale for maintenance of state support for profitable companies. The Ministry of Economy and Labour is considering the withdrawal of financial support for selected mines but faces strong resistance. According to the Ministry, profits gained due to the market boom should be earmarked for financing necessary reforms, and state support could not be consumed by an increase in miners' wages. This aim is underlined in the governmental plan of access to the deposits, which contains a statement saying that any company exceeding a 3 per cent annual wage increase would lose the right to state support. Nevertheless, certain mines, under pressure from labour unions, have found ways of fulfilling miners` financial requests without breaking the above mentioned obligation (using for example premiums, trade vouchers).

The plan indicates that Polish mines are to "operate in an economic effective manner", with workforce numbers adjusted to extraction capabilities and the market situation. Therefore two scenarios of branch development are included in the plan .Firstly, when there is high demand for domestic coal, extraction would be limited only in the least effective mines (by 7.8 million tones) with a decrease in the workforce of 20,000. Secondly, when favourable market conditions end, production would be reduced by 14.5 million tonnes and the workforce by 25,000 miners.

For the first time in years, there has been positive feedback to the idea of questioning the rationality behind earmarking considerable public funds for the mining sector This has been facilitated by the intensity of current discussions on the effectiveness of the sector. However, environmental considerations are still underestimated.

Energy

One of the main areas of concern in the energy sector nowadays is long-term contracts. In the period between 1994 and 2001, the Polish Power Grid Company (PSE – a monopolist on the energy distribution market, a joint stock company wholly owned by the State Treasury) underwrote an agreement (long-term contracts – KDT) with energy companies on energy sales at high, fixed (non-market) prices. Price regulation which guarantees extra revenue for producers is a clear subsidy, and is additionally environmentally harmful if these are producers of energy which is based on fossil fuels (in Poland more than 97 per cent of electricity has been produced from thermal plants since the beginning of the nineties). Long-term contracts served as a security for loans taken out by the energy companies. Loans totalling 17 billion PLN have been earmarked not only for expanding production capacity or social purposes, but for modernisation and restructuring programmes, including environmentally friendly investment projects (pollution abatement, combustion efficiency, waste management) as well. These financial efforts have brought certain positive results for the environment, which are reflected in the table below.

Table 3. Emissions from power generating plants (in thousand tones).

	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
SO2	1310	1290	1270	1223	1195	1107	1034	915	805	769
NO2	370	380	380	377	360	310	264	247	237	242
particulates	420	345	260	193	157	117	94	72	64	58

Currently about 40 per cent of energy sold on the domestic market remains under KDTs. However, the European Commission has judged contracts as inconsistent with EU state aid regulations, recommending their removal. The first proposal of state compensation for energy producers who renounce contracts has also been questioned by the EC. Following EC suggestions, the Energy Regulatory Authority of Poland proposed a system where compensation is paid in two phases – a base payment of 10.6 billion PLN, and in the following years, depending on the market situation, payments of up to 14.2 billion PLN.

Analysing the other supply oriented energy subsidy policies (soft loans, state guarantees) their secondary significance for power plants should be stressed. Due to the excessive capacity of the electro energetic sector, most investments have been directed towards fulfilling even more stringent emission standards. There have however been subsidies for energy consumers, within the lump sum system for gas and heat. The system generates cross-subsidisation between thrifty consumers financing households with higher consumptions of gas and heat. The scale of cross-subsidisation has been steadily decreasing because of the introduction of a system of individual measuring..

Contact:

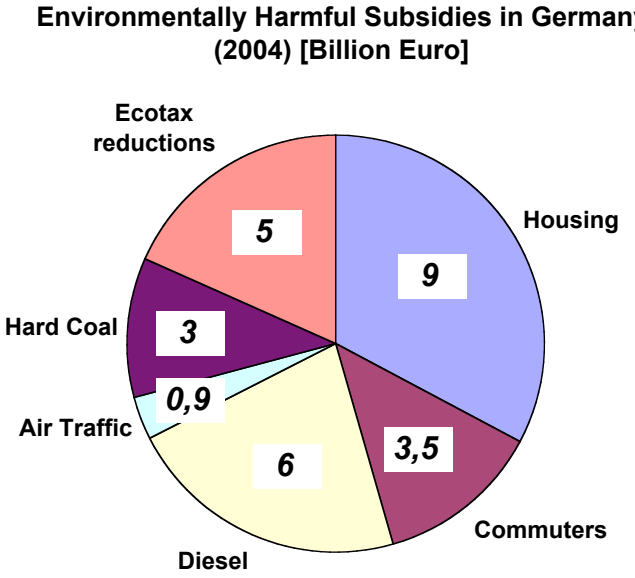
Wojciech Stodulski
ISD - Institute for Sustainable Development Instytut Na Rzecz Ekorozwoju
Poland
Email: w.stodulski@ine-isd.org.pl
Web: www.ine-isd.org.pl

5. EHS in Germany

Introduction

The reduction of subsidies is widely discussed in the German media and politics. The debate is mainly driven by general concern over the deficit of the state budget and the economic inefficiency of subsidies. However, environmentally harmful subsidies also play a major role and are controversial. BUND/Friends of the Earth Germany has a long record of campaigning on environmentally harmful subsidies, with policy papers published in 1997, 1999 and 2003 and media action in 2003.

BUND/Friends of the Earth criticises in particular the following environmentally harmful subsidies:



1. Premium for Buying Owner-Occupied Houses ("Eigenheimzulage")

Private households which buy a house or flat for their own use receive a premium (negative income tax). The premium is 1250 Euro per year over a period of 8 years. Until December 2003 the premium was even higher: 1227 Euro for old houses and 2556 Euro for newly built houses.

This difference was criticised by environmental organizations because it created an incentive to build new houses in suburban areas rather than renovate existing houses. Urban sprawl and excessive land-use is a widespread problem in Germany where 97 hectares of land are developed each day. The government wants to reduce this rate to 30 hectares per day by 2020 (sustainable development strategy).

The premium is also controversial because of an excess supply of flats in many regions (especially in Eastern Germany) and because it is the largest of all subsidies (9.4 billion Euro in 2003). The federal government of Social Democrats and Greens wants to abolish the premium but cannot get the consent of the states (Länder/Bundesrat) which are dominated by the Christian Democrats.

2. Commuters Flat Rate Mileage Allowance ("Entfernungspauschale")

Commuters can reduce their tax base for their income tax by 30 cents per kilometre travelled per working day. (Example: distance to work: 50 km, 220 working days = 3300 Euro reduction of tax base. Marginal tax rate e.g. 40 per cent = 1320 Euro tax reduction per year. With a lower income and lower marginal tax rate of e.g. 30 per cent, the tax reduction is 990 Euro.)

This subsidy has very negative effects on the environment as it gives a high incentive for employed people to move out of the cities and to commute long distances from suburban areas to the work places in the cities.

BUND/Friends of the Earth Germany wants to abolish the allowance in the long run. But there are social concerns that commuters in rural areas do not have a chance to get a job near to their home. Therefore BUND proposes a different system in which the allowance does not depend on the individual income of the commuter but only on the distance (with a cap on very long distances).

The federal government proposes a reduction in the allowance from 30 cent to 15 cent per kilometre but cannot get approval from the states. Until 2001 the allowance was higher for commuters with private cars than for commuters using public transport. This has been changed so that there is a level playing field for public and private transport.

3. Diesel Tax Reduction

The excise duty on diesel fuel is 18.45 cents per litre lower than for unleaded petrol (since 1989). The tax reduction for diesel was originally introduced to protect road haulage in international competition. But as a result of the tax difference the number of private diesel cars has risen sharply in recent years. Already in 2003, 44 per cent of all newly registered cars had a diesel engine.

The tax reduction is environmentally harmful because of the high particle emissions of most diesel cars and because the CO_2 emissions per litre of diesel are 13 per cent higher than those of petrol.

On the other hand, annual road tax for diesel cars is far higher than for cars with petrol engines. Therefore BUND is asking that the excise duty on diesel be adjusted and brought into line with the rate on petrol within six years This change should be combined with road tax reform, in which the amount payable is dependent on CO_2 emissions, other pollutants and noise emissions.

4. Tax Exemptions for Air Traffic

Commercial air traffic is exempt from excise duties on kerosene as it is in all EU countries. Domestic flights are subject to VAT but international flights are not.

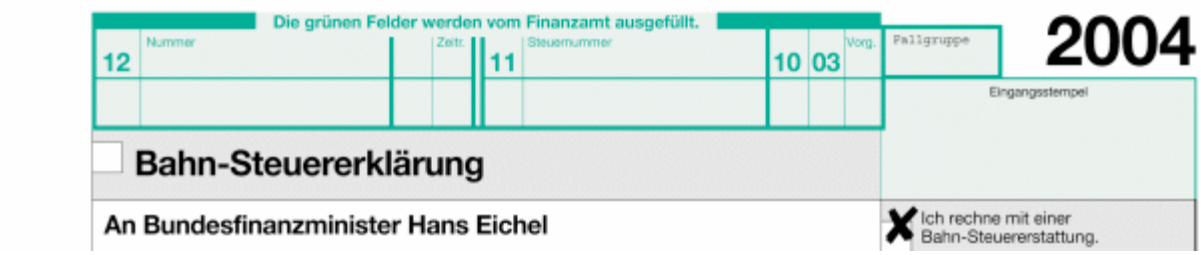
BUND strongly criticizes these tax exemptions because air traffic severely threatens the climate and is growing rapidly. Moreover, German railways are hit by unfair competition from airlines. The railways pay excise duty on electricity and diesel as well as the full VAT rate on long-distance domestic and international journeys.

In principle there is political consensus in Germany that the tax exemptions for air traffic should be abolished. But it is difficult to reach agreement on which steps should be undertaken as long as the unanimity rule in the EU prevents an EU-wide solution.

BUND/Friends of the Earth has demanded the introduction of a kerosene tax on domestic flights since the EU energy tax directive entered into force in 2004. This could be a very important first step for an initiative together with other EU countries which would introduce a kerosene tax in bilateral agreements (additional tax revenue for Germany is estimated at 373 million Euro per annum).

The federal government tried to introduce VAT for international flights (for the part of the journey across German territory) in 2003. But the states refused their approval.

BUND Internet-Action for the Introduction of a Kerosene Tax:
http://www.bund.net/aktionen/steuergerechtigkeit/send.php



5. Subsidies for Hard Coal

There is a long tradition in Germany of high levels of subsidies for hard coal. Since 1980 around 100 billion Euro of subsidies have been paid to the coal mining industry. Production costs in German coal mines are approximately 140 Euro per tonne, while the world market price is only between 38 – 55 Euro. The number of employed workers in the coal mining sector fell from 130,000 in 1990 to 44,000 in 2003. The subsidies were reduced from 4.5 billion Euro per year in 1997 to 2.8 billion Euro in 2005. They will be further reduced to 1.8 billion Euro by 2012.

Coal subsidies in Germany are environmentally harmful if the price effects on the global coal market are considered. If Germany did not subsidise its coal consumption, a large proportion would instead be fed by the world market. This would increase world demand, lead to a higher world market price and a lower level of coal consumption world wide. However, it is difficult to measure this effect due to Germany's relatively small share of world consumption and because the price elasticity of demand is uncertain.

The majority of experts and public opinion in Germany also criticise coal subsidies as a waste of money. If the money was used for efficient energy use and renewable energy, many more people could be employed and the long-term targets of reducing greenhouse gas emissions could be reached more easily. Presently the state subsidises one worker in the coal mines to the tune of 78,000 Euro per year.

The German government's Council on Sustainable Development demanded the phasing out of coal subsidies by 2010. But the coalition of Social democrats and Greens reached an agreement to continue the subsidies until 2012 at decreasing levels. It was agreed that the subsidies must be further reduced if the world market price rises and the difference between production costs in Germany and world market prices decreases.

6. Reductions of Ecotaxes for the Industry

Since the beginning of the ecological tax reform in 1999 companies which belong to the production sector have been granted high tax reductions. The general reduction was 80 per

cent until 2002 and 40 per cent from 2003 onwards. In addition, energy intensive companies only pay a marginal tax rate of 3 per cent of the regular ecotaxes on electricity, mineral oil for heating purposes and natural gas. These tax reductions – together with the ecotax reductions for agriculture and other sectors - amounted to.5.6 billion Euro in 2004.

Even the Ministry of Finance criticises the tax reductions because they are very high and not well designed. BUND/Friends of the Earth acknowledges that there must be some energy tax reductions for very energy intensive industries as long as tax rates are substantially lower in many EU countries. However, these reductions should be granted only to installations which take part in the European emissions trading scheme and to companies which fulfil the criteria of energy intensive industries as they are laid down in the EU energy tax directive. Currently all companies which statistically belong to the production sector qualify for a 40 per cent ecotax reduction. This rule is too unspecific and must be abolished by the end of 2006, according to the energy tax directive.

BUND Media Action in Front of the German Bundesrat (state chamber) in June 2003:

Contact:

Matthias Seiche
BUND / Friends of the Earth Germany
Am Köllnischen Park 1, D - 10179 Berlin
Tel. +49 - (0)30 - 275 86 - 433, Fax - 440
mail: matthias.seiche@bund.net
www.bund.net

EEB PUBLICATION NUMBER: 2004/015

EUROPEAN ENVIRONMENTAL BUREAU PUBLICATIONS 2004

2004/001 **Memorandum to the Irish Presidency** (January 2004)
2004/002 **Industry Handbook** (revised edition) (in preparation)
2004/003 **EEB Annual Conference 2003: The Europe we Want** (March 2004)
2004/004 **Towards waste prevention and steering of waste streams: A thematic vision** (March 2004)
2004/005 **EEB Annual Report 2003** (July)
2004/006 **EEB stakeholder conference on the thematic strategy on waste recycling and prevention** (March 2004)
2004/007 **What did enlargement bring to the environment? A survey of the environment and sustainable development in the new Member States** (April 2004)
2004/008 **European chemicals policy reform: From emotions to facts, EEB conference 24 March 2004** (May 2004)
2004/009 **EEB workshop on the thematic strategy for soil protection, 27 October 2003, Brussels** (June 2004)
2004/010 **The future of rural development policy** (July 2004)
2004/011 **Memorandum to the Dutch EU Presidency** (July 2004)
2004/012 **Article 6 Watch Briefing Document** (June 2004)
2004/013 **Annual conference report** (December 2004)

PUBLICATIONS 2005

2005/001 **Memorandum to the Luxembourg Presidency** (January 2005)

JOINT PUBLICATIONS

WITH WWF **A Resource for Environmental NGOs on the Guidance for the Implementation of the Water framework Directive** (March 2004)
WITH G8 **Towards a Green EU Constitution: Greening the European Convention proposal** – August 2003
WITH ETUC & SOCIAL PLATFORM **Towards a Sustainable Future (February 2004) and Investing in Sustainable Development (June 2004)**

JOINT NEWSLETTERS

Participate, with Public Participation Campaign Committee
Sustainable Mediterranean, with MIO-ECSDE and RAED

European Environmental Bureau (EEB)
Boulevard de Waterloo 34 | B-1000 Brussels | Belgium
Tel.: +32 2 289 1090 | **Fax:** +32 2 289 1099
E-mail: eeb@eeb.org
Websites: www.eeb.org, www.ecotax.net,
www.chemicalreaction.org, www.participate.org

AN INTERNATIONAL NON-PROFIT ASSOCIATION
ASSOCIATION INTERNATIONALE SANS BUT LUCRATIF