POSITION PAPER

Stop Subsidies Polluting the World

RECOMMENDATIONS FOR PHASING-OUT AND REDESIGNING ENVIRONMENTALLY HARMFUL SUBSIDIES

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

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The European Environmental Bureau (EEB)

The EEB is a federation of around 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.

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OF THE EUROPEAN ENVIRONMENTAL BUREAU (EEB)

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CONTENTS

1. Introduction

Many subsidies are not only economically inefficient; they also harm the environment. Environmental NGOs have been calling for the removal of environmentally harmful subsidies for many years. The Parliament and Council of the European Union have also called for "reforms of subsidies with considerable negative effects on the environment", in their Sixth Community Environment Action Programme.[1] The European Commission went as far as setting a clear target in its sustainable development strategy, submitted to the Gothenburg Council in 2001: "Phase out subsidies to fossil fuel production and consumption by 2010."[2]

But in reality, not much has happened to achieve progress. The EU-15 missed the opportunity to start an ambitious programme for phasing-out environmentally harmful subsidies (EHS). Now, with 25 EU-Member States, the dimension of the problem has grown because every Member State has a different subsidy regime with specific regulations and beneficiaries.

Therefore the EEB calls on the EU to reform its subsidy policies, putting forward seven key specific demands. After setting out these demands, the EEB explains the environmental threats posed by specific subsidies and the opportunities arising from reforming them. Thereafter, this paper provides examples from three sectors of environmentally harmful subsidies, together with the EEB's concrete demands for tackling them.

It is not an easy task to launch a co-ordinated EU-wide plan for phasing out and reforming EHS. Member States set their own national budgets themselves and ambitious reforms of the tax systems have to be undertaken at Member State level. On the other hand, Member States must respect EU Regulations on state aid and EU directives on energy taxation and VAT. Directives on taxation can potentially provide a powerful tool for decreasing the level of EHS. However, in the past the unanimity rule on tax issues has often prevented progress on removing environmentally harmful tax exemptions and reductions. Nevertheless, these legal obstacles can be overcome if there is sufficient political will. The EEB is convinced that the effort is worthwhile because the benefits for the environment, state budgets, economic efficiency and quality of life

[1] *European Parliament and Council (2002)*
[2] *Commission of the European Communities (2001)*

which subsidy removal would bring are many times higher than the limited benefits for the current beneficiaries of EHS. The demands laid out in this paper could significantly strengthen the Lisbon process of enhancing a knowledge-based economy through increased economic efficiency.

2. The EEB's key demands to the EU and EU governments

The EEB calls on European governments and the institutions of the European Union to phase out all EHS within the next five to ten years. The following measures should be put on track:

1. **Phase out energy tax reductions and exemptions by 2010:** Member States should start this process in a coordinated manner as long as the unanimity rule prevents significant progress at EU level (e.g. phasing-out of diesel tax reduction and bilateral agreements to abolish the excise duty exemption for aviation).

2. **End all state aid for coal mining no later than 2010:** The Commission is due to submit a report by 31 December 2006 on the Council Regulation on state aid to the coal industry[3]. At that time it should present a legislative proposal to phase out such aid.

3. **Stop all kinds of preferential regulation for nuclear energy:** All funds for the decommissioning of nuclear power plants should be under independent control. Introduce new internal market law to counter rising amount of state aid. Grant no further EU loans for the construction of nuclear power plants. In the event of a serious accident, nuclear operators should be made fully liable for damages. The current public underwriting of such liabilities, via international conventions, is a *de facto* state guarantee and as such is state aid.

[3] *Council of the European Union (2002)*

4. **Phase-out and reform EHS as part of implementing the EU Sustainable Development Strategy:** The EU-commission should prepare a comprehensive report on progress towards subsidy reform for every Spring Council.
5. **Increase general pressure on Member States and establish link between Euro stability criteria and EHS removal:** The European Commission should use its competence in other political fields to increase the pressure on Member States to phase-out EHS. For example, it is not acceptable that Member States that do not comply with the Euro stability criteria grant billions in EHS, thereby increasing the burden on both their state budgets and the environment.
6. **Publish inventories of EHS in Member States and develop them into a comprehensive action plan to phase-out or redesign these subsidies.**
7. **Start nationwide and EU-wide public discussion on EHS with the involvement of NGOs.**

See Section 5. for examples related to these demands.

3. The pressure of Subsidies on the Environment and Quality of Life

With every year that passes without meaningful action, EHS put greater pressure on the environment and quality of life. For example:

Climate: The EU is the second-largest emitter of greenhouse gases in the world and thus contributes hugely to global climate change. The EU must reduce its greenhouse gas emissions by 60 - 80 per cent by 2050 in order to help prevent a dangerous increase in global temperatures (more than 2°C above pre-industrial levels). But many EU-countries are far from reaching even the modest targets of the Kyoto protocol. At the same time EU-15 Member States granted subsidies to the coal, oil and gas sector in 2001, totalling 21.7 billion Euro.[4] Not only do such subsidies help maintain high emissions within Europe, they also undermine the EU's credibility on climate change internationally.

Health: Fine particulate pollution (PM2.5) in Europe poses about the same risk to people's life expectancy as traffic accidents. Present levels of PM2.5 are now estimated to reduce Europeans' life expectancy by an average of approximately nine months.[5] Diesel cars and trucks without particle filters are responsible for a large part of these emissions. At the same time almost all EU-countries grant high tax reductions for diesel fuel.

Water quality: Intensive agriculture contributes significantly to the nitrate contamination of drinking water. Nitrogen surplus exceeds the critical level of 25 kg/ha in 91 out of 113 regions in the EU and there has been no significant reduction in nitrogen surplus in recent years.[6] At the same time, European agricultural policy still favours intensive farming with excessive use of fertilizers and manure-spreading. Removing nitrogen from polluted drinking water resources is 5-10 times more expensive than preventing pollution in the first place[7].

[4] *European Environment Agency (2004)*
[5] *European Environmental Bureau (2004a)*
[6] *European Environment Agency (2001a)*
[7] *European Environment Agency (2004a)*

Nature conservation: Europe's landscapes, and consequently its habitats, are being increasingly fragmented into smaller and smaller patches due to urban sprawl and the continued construction of roads. The average size of non-fragmented forest habitat areas is expected to fall by 13 % (from 22 to 19 km^2) by 2010 if all planned major roads are constructed.[8] The EU finances many of these road construction projects with its structural funds. But many Member States also subsidise road transport, for example with tax reductions for commuters, and increase urban sprawl by subsidising the construction of buildings on greenfield sites.

There are many more examples of subsidies threatening the environment. In the following chapters the EEB highlights only the most prominent links between subsidies and environmental problems in the sectors of transport, energy and building.

DEFINING ENVIRONMENTALLY HARMFUL SUBSIDIES (EHS)

No definition of subsidies is universally accepted. Starting from the OECD's work on subsidies[9], the following categories can be distinguished[10]:

- **Direct transfer of funds:** e.g. subsidies for coal mining
- **Fiscal incentives:** e.g. tax exemption for kerosene in aviation, tax deductions for commuters
- **Provision of goods and services other than general infrastructure:** e.g. Structural funds for the gas industry, public research & development for nuclear energy
- **Preferential regulation:** e.g. limitation of liability for nuclear energy
- **Failure to impose external costs:** e.g. exemption of fossil fuels from energy taxes

The last two categories belong to a wider definition of subsidies. The EEB concentrates its criticism on the first two categories: direct transfer of funds and fiscal incentives.

[8] *European Environment Agency (2001b)*
[9] *OECD (2004), p. 11.*
[10] *European Environment Agency (2004), p.10.*

4. The benefits of phasing out Environmentally Harmful Subsidies

Phasing EHS out contributes to sustainable development in all its dimensions:

- Lower incentives for environmentally harmful production and consumption patterns lead to a reduction in these harmful activities. Removing EHS is thus directly beneficial for the environment. Sometimes this effect can be limited due to low price elasticity of demand or because of overall growth tendencies in the economic sector. But many studies have shown that the positive effect of subsidy removal on the environment can be clearly measured.
- Subsidy removal eases the burden on state budgets. If the resulting savings are used to lower the general tax burden, this increases the overall efficiency of the economy.
- The savings made from removing EHS may also be used for investing in environmental measures. For example, it is necessary to grant subsidies for renewable energies as long as the external costs of fossil fuel burning are not fully covered by energy taxes.
- The removal of EHS increases the efficiency of the environmental policy mix. For example, if subsidies to intensive farming are decreased this eases the financial burden caused by removing nitrates from drinking water. If EHS are removed, this may also pave the way for innovative environmental technology (e.g. in the fields of energy efficiency and renewable energies). This fact is acknowledged in the EU Environmental Technology Action Plan[11]
- In some cases EHS are defended on social grounds. In these cases, however, it is often more effective to grant social transfers directly to low-income groups instead of subsidising environmentally harmful activities. EHS are often in themselves designed in a way that high-income groups benefit more from these subsidies than low-income groups. Examples are the tax exemptions for aviation and tax deductions for commuters, car owners or house owners that offer disproportional benefits to high-income groups.

[11] *Commission of the European Communities (2004a)*

- In practice, however, the high budget deficits in many EU countries forbid both tax cuts and higher public spending for social transfers and environmental measures. Even so, the removal of EHS can be positive, because it decreases the financial pressure on social transfers and environmental programmes.
- Subsidies can seriously distort prices and thus the market, giving undue preference to some actors in the economy and disadvantaging others. That greatly reduces the competitiveness of the whole economy, leading to harmful decisions at all levels. Removing EHS helps to lead to fairer competitive conditions.
- Subsidies can lead to corruption and fraud. Companies may be tempted to take morally dubious decisions in order to increase profitability on the basis of increased state aid, rather than through competing on the free market. Removing EHS eliminates this temptation.
- Finally, subsidies often distort international competition. European export subsidies for farm products interfere with local markets in developing countries, threatening agricultural production and food security in these countries.

Subsidies are often only one element in a complex set of regulations. It is necessary to combine the phasing out of EHS with a consistent redesign of other regulations that presently favour environmentally harmful activities. For example, if premiums for the construction of houses are abolished this must go hand-in-hand with stricter policy over granting building permits.

SUBSIDIES IN THE EU BUDGET

The EU itself grants billions of Euros in environmentally harmful subsidies every year:

The **Common Agricultural Policy** (CAP) absorbs 47 billion Euros annually (2003), almost half of the EU budget.[12] Current farming systems are frequently environmentally damaging, cause excessive suffering to farm animals and are extremely wasteful; for example, by degrading soils and extracting water at unsustainable rates. The CAP has been one of the driving factors behind the tremendous environmental problems associated with the intensification of agriculture and has contributed to the depletion of biodiversity. The CAP is able to support environmentally friendly farming and sustainable rural development but funds for such measures remain limited. A further shift in support will be necessary from market measures and direct payments to environmentally friendly farming embedded in a sustainable rural development policy – together with a responsible attitude towards farmers in developing countries.

Detailed proposals for CAP subsidy reform have been developed separately by the EEB's agricultural working group. More information is available at http://www.eeb.org/activities/agriculture/Index.htm

Structural and Cohesion Funds (SF/CF) are the second biggest part of the EU budget. These funds constitute a substantial financial resource and will influence the economic, social and environmental development of the new Member States. NGO experience with pre-accession funds has shown that this support is essential; but that if not used sustainably it can have a negative rather than a positive effect on the environment, the economy and social cohesion. Additionally, if such funds are not subject to public consultation and decision-making, and to public scrutiny, they may end up supporting short-term political interests and even be at risk of being used fraudulently. The structural funds have been revised several times over the past 15 years and the environment and sustainable development provisions strengthened. Nevertheless, practical experience shows that funds continue to be used in ways that undermine agreed environmental and nature conservation objectives[13], including even the economic and social goals they are designed to achieve. More information is available at: http://www.coalition-on-eufunds.org/

[12] *European Environmental Bureau (2004b)*
[13] *WWF (2003)*

5. Examples of Environmentally Harmful Subsidies in EU Member States

5.1. TRANSPORT

a) Tax Exemptions for Aviation

Scope of the subsidy: Kerosene used for commercial aviation is exempt both from excise duties and from energy taxes in almost all EU countries. Also, there are many cases of direct subsidies to aviation, e.g. in the form of investment aid for airports. For example, Hungary has recently received a EUR 15 million grant from the Cohesion Fund for the development of Hungarian air transport control infrastructure. In addition, intra-Community and international flight-tickets are exempt from VAT in the whole EU, and domestic flights are taxed with reduced VAT rates in most Member States:

TABLE 1: VAT rates applied to domestic air flights in comparison to standard VAT rates in EU-25 Member States (Situation at 1st September 2004) [figures in percent]:

COUNTRY	AT	BE	CY	CZ	DK	DE	EE	EL	ES	FI	FR	HU	IE	IT	LV	LT	LU	MT	NL	PL	PT	SE	SI	SK	UK
Domestic flights	10	6	15	5	[ex]	16	18	8	7	8	5.5	15	[ex]	10	18	5	3	0	19	7	5	6	8.5	19	0
Standard rate	20	21	15	19	25	16	18	18	16	22	19.6	25	21	20	18	18	15	18	19	22	19	25	20	19	17.5

0 = zero rate (exemption with refund of tax paid at preceding stage); [ex] = exemption.[14]

Environmental dimension: Aviation contributes 12 per cent of global CO_2 transport emissions. Under business-as-usual, emissions are expected to triple over the next 15 years, as compared to 1990.[15] The abolition of excise duty exemption, and introduction of a kerosene tax of 0.2 € per litre, would decrease the emissions from air traffic by 25-30 per cent by 2025 in comparison with a business-as-usual scenario.[16] This would also reduce the perceived need to build additional airport infrastructure, thus saving large amounts of public money.

[14] *Commission of the European Communities (2004b)*

[15] *For more information, please refer to: http://www.natuurenmilieu.nl/org/mobiliteit_aviation.php*

[16] *German Advisory Council on Global Change (WBGU) (2002)*

EU-legislation: Article 14 of the EU energy tax directive 2003/96/EC states that kerosene is exempt from excise duties in general. But Member States may introduce a kerosene tax for domestic flights and they may enter into bilateral agreements with other Member States in order to tax intra-Community flights.

Situation in Member States: The Netherlands introduced a kerosene tax for domestic flights in January 2005, at a rate of € 206.28 per 1000 litres.[17] Other European countries, like Norway, Sweden and Switzerland, tried to introduce kerosene taxes or emission charges in the 1990s but abolished them because of restrictions from international law on how they were set up. In many Member States there is public debate with strong support for ending fiscal subsidies for the aviation sector. But those countries that opposed the abolition of the tax exemption at EU-level (e.g. Ireland, Spain) during the negotiations on the EU energy tax directive have not changed their minds. Therefore it seems unlikely that the necessary unanimity will be forthcoming in the ECOFIN council.

EEB call to governments: The EEB urges all Member States to consent to abolishing tax exemptions for aviation fuels at EU-level. If this cannot be achieved, like-minded countries should go ahead and change their bilateral air service agreements (ASAs) in order to introduce a kerosene tax both on domestic flights and on intra-Community flights between these countries. There is also an argument for like-minded countries using the enhanced cooperation mechanism. Furthermore, all direct subsidies to aviation must end. In addition, all Member States should apply their standard national VAT rate to both domestic and cross-border flights within the EU.

b) Diesel Tax reduction

Scope of the subsidy: Excise duty for diesel is substantially lower than for unleaded petrol in almost all Member States. On average the excise duty on diesel is 26 per cent (12.3 Cent per litre) lower than on petrol. This situation is also reflected in the minimum tax rates of the EU energy tax directive. While the current minimum rate for unleaded petrol is 359 EUR per 1000 litres, it is only 302 EUR for diesel.

[17] *The Netherlands (2004)*

TABLE 2: Excise duty for motor fuels in EU-25 Member States (Situation at 1st May 2004) [EUR per 1000 litre]:[18]

COUNTRY	AT	BE	CY	CZ	DK	DE	EE	EL	ES	FI	FR	HU	IE	IT	LV	LT	LU	MT	NL	PL	PT	SE	SI	SK	UK
Diesel	302	315	245	312	470	406	245	245	294	319	417	335	368	403	245	253	245	246	360	249	308	366	307	351	668
Unleaded Petrol	417	508	299	340	655	539	337	296	396	588	640	459	547	542	287	442	288	310	659	320	523	527	362	376	688

Low sulphur tax rate is shown, if differentiated. For petrol the tax rate for 95 octane is shown. Numbers in italics: several differentiated tax rates are applied.

Environmental dimension: Diesel has a 13 per cent higher CO_2-content per litre than petrol. The particle emissions from diesel cars and trucks without a particulate filter are a major cause of lung cancer and other diseases. On the other hand, many diesel cars consume considerably less fuel than cars with petrol. In total, however, there is no environmental justification for the diesel tax reduction. Although there may be some reasons for a tax differentiation according to CO_2-content (which then would lead to diesel being taxed higher than petrol), the most practical solution is a level playing-field, with similar tax rates for standard diesel and petrol.

Economic dimension: The low diesel tax rate is often justified by using the argument that hauliers needed the tax reduction to be internationally competitive. However, this argument holds only from the perspective of individual Member States that are negatively affected by tank tourism, and then only if neighbouring countries apply substantially lower excise duties on diesel. For the vast majority of Member States, a uniform tax rate for diesel and petrol would not distort competition. Diesel tax reduction can be justified on competitiveness grounds only at the eastern and south-eastern borders of the EU. There, fuel tourism is an enormous problem. For example, in Hungary, many trucks from Ukraine and Romania enter with up to 1000 litres of often low quality diesel in their tanks, which they then use to drive across the EU. The distortion should be addressed by introducing extra taxes or custom duties on fuels brought into the EU from non-EU countries in the tanks of motor vehicles. This would have the advantage of ending a huge fiscal subsidy to road transportation and would also contribute to fairer competition between road and rail.

[18] *Commission of the European Communities (2004c)*

EEB call to governments: The ECOFIN council should make a new attempt to raise the minimum tax rates for diesel to the level of unleaded petrol. Special taxes or custom duties should be introduced on fuel brought into the EU in the tanks of motor vehicles from non-EU countries.

c) Tax deductions for commuters

Scope of the subsidy: Many Member States grant special tax deductions to commuters. Several forms with different environmental effects can be distinguished:

Type of Tax Deduction	Environmental and Social Effects
(Part of) commuter cost deductible from income tax:	Environmentally negative, because it creates incentive to commute long distances.
(Part of) commuter cost deductible from taxable income:	Socially negative, also, because those with high income receive high tax deduction.
Similar tax rebate for all means of transport:	May create a positive incentive to use public transport, because the costs of private cars are normally higher. May also be an incentive to cycle or walk.
Differentiated tax rebate depending on means of transport:	If car users are allowed to deduct higher costs from their taxable income than commuters who use public transport, this creates a negative incentive to using public transport.

In practice there are many more different provisions in EU Member States, which sometimes depend on the availability of public transport, and which may set minimum or maximum distances for which the provision applies.

Environmental dimension: Tax incentives for commuters to use private cars contribute to urban sprawl and deterioration in the quality of life in cities.

Social dimension: It is certainly the case that many people in rural areas have to commute relatively long distances and that reasonable public transport is often unavailable in rural areas. On the other hand, one must make a clear distinction between rural and urban. Tax incentives for commuters are used to a higher extent by high-income groups in urban areas who move out to the suburbs. This, in turn, creates more social problems in the cities due to a segregation of the pop-

ulation; and the wealthier are more able in practice to benefit from the tax breaks. In other regions of the world, like the USA, commuters cannot deduct commuting costs from their income tax base.

Legal situation in the EU: Income taxation is almost exclusively the domain of the Member States, provided it does not affect the free movement of persons, workers, capital and services. But as the tax deductions for commuters stand clearly in opposition to the aims of the EU Sustainable Development Strategy, there is some scope for common action.

EEB call to governments: The first step to reduce commuters' tax privileges in a co-ordinated way should be regular reporting of Member States to the EU Commission. While it is difficult to prescribe detailed rules at EU level for the reduction of subsidies to commuters, governments should at least agree on the following principles:

- Tax deduction should be substantially decreased within five years.
- The amount of the tax credit should not depend on the individual income of the commuter.
- Tax credit should not be higher for the use of private cars than for public transport.
- The tax credit should be limited to a maximum commuting distance, above which there is no further increase.

ILLEGAL DECLARATION OF COMPANY CARS IN HUNGARY – CASE STUDY

In Hungary the state loses revenue of at least HUF 600 billion each year 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.

Author: András Lukács, Clean Air Action Group, Hungary[19]

[19] *See also in more detail: Clean Air Action Group - "Lélegzet" Foundation / Károly Kiss (2004)*

d) Other examples of subsidies in the transport sector

There are numerous other subsidies and preferential regulations in the transport sector in the EU which are not applied in all Member States. For example:

- Exemption from VAT for the construction of motorways
- Company tax privileges for car manufacturers
- Limited liability of car insurance companies for the costs of accidents: the costs of medical treatment are not covered by car insurance but by health insurance, and thus the general public.
- Safety rules for road transport are much less strict than for rail transport.
- The general level of excise duties and energy taxes on motor fuels does not cover external costs of road transport.
- Free parking in public spaces

5.2. ENERGY

Available Data: The EU Commission published an inventory in 2002 of public aid granted to different energy sources[20]. This report is a valuable source of information and a first step towards a more comprehensive report on EHS that should be published by the EU. However, the report does not give sufficient weight to the adverse effects of energy subsidies on the environment. Instead, it mentions the security of energy supply as a justification for subsidies.[21]

[20] *Commission of the European Communities (2002)*

[21] *"Spain, Austria and Ireland have been authorised by the Commission to implement various compensation schemes for electricity generated from solid fuels … It is basically a premium for generating electricity from indigenous fuel, justified on the grounds of security of the energy supply." p. 26.*

"It is not entirely clear whether such reductions of, or exemptions from, excise duty constitute aid to oil. Most of the reductions and exemptions are not intended to promote the use of mineral oils. They are measures taken to give an advantage to a particular economic sector by reducing the tax burden on a category of costs in that sector, i.e. the costs of heating fuel or motor fuel. (…) In view of these facts the concept of aid to oil through reductions of or exemptions from excise duties is a wholly relative notion to be treated with due care. p. 32 Commission of the European Communities (2002)

The European Environment Agency estimates the level of energy subsidies in the EU as follows:

TABLE 3: 2001 Indicative estimates of total energy subsidies, EU-15, [EUR billion]:

	Solid Fuel	Oil and gas	Nuclear	Renewables	Total
2001 On-budget	> 6.4	>0.2	>1.0	>0.6	>8.2
2001 Off-budget	> 6.6	> 8.5	> 1.2	> 4.7	> 21.0
Total	> 13.0	> 8.7	> 2.2	> 5.3	> 29.2

Source: European Environment Agency: Energy subsidies in the European Union: A brief overview. EEA technical report 1/2004

a) Coal Mining:

Situation in EU and Member States: The European Coal and Steel Community (ECSC) Treaty expired in 2002. It was followed by Council Regulation No. 1407/2002 on State aid to the coal industry. In the EU-15, Germany, France, Spain and the United Kingdom have granted substantial subsidies for coal extraction in recent years. Total aid amounted to 6.3 billion EUR in 2001 but has since decreased.[22] The United Kingdom has reduced its subsidies, both per ton of coal and in absolute terms. France will cease coal extraction in 2005. Germany has reduced its subsidies, but they are still very high both in absolute terms and per ton (see case study).

In the new Member States, Poland has a very high extraction of hard coal combined with a complex system of export and restructuring subsidies. (See case study)

Environmental dimension: Coal mining is environmentally very damaging in open cast mines (destruction of landscapes, changes in groundwater flow, acid mine drainage, dust emissions) as well as in underground mining (mining damages to buildings). Coal is very inefficient when used for electricity generation and causes twice as much CO_2-emission per kWh electricity as natural gas.

Defenders of coal subsidies argue that phasing out coal subsidies does not imply that less coal would be used in electricity generation, but rather that it would be substituted by imported coal. But that is only true if price effects on the global coal market are ignored. If large coal consumers like Germany were to stop subsidising their coal extraction, a large proportion of Germany's coal consumption would come from the world market. This increased demand would in turn would lead to a higher world market price, and to a lower level of coal consumption worldwide.

[22] *Commission of the European Communities (2002), p. 24*

EEB call to governments and the EU: All subsidies for coal mining should be phased out by 2010. The current Council Regulation on State aid to the coal industry should not be extended. In particular, the provision to accept State aid for maintaining access to coal reserves must end by 2010[23]. There is no justification for this provision because a sufficient amount of coal to guarantee security of energy supply is available on the world market. However, it is crucial that the EU reduce its coal consumption in order to comply with its long-term targets for climate protection.

SUBSIDIES FOR COAL MINING IN POLAND – CASE STUDY

Coal plays an important role in the Polish energy sector. In 2002 hard coal accounted for 73.85% and lignite for 15.15% of total primary energy production in the country (80.77% and 14.53% respectively in 1992). Although domestic extraction has declined by 24% since 1995, Poland is still ranked 7th in the world of hard coal producers. Employment in the coal mining sector decreased from 294,500 in 1995 to 166,900 in 2002.

The government has introduced successive restructuring programmes for the sector since the early 1990s; most often in the form of direct grants and debt forgiveness. These types of support amounted to 15 billion PLN in the 1990s in nominal prices; or 34 billion at 2001 prices (= 8.5 billion Euro). The latest restructuring programme sets up subsidies of 9.6 billion PLN (4.8 billion PLN of which are direct grants) for 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, the reported state aid is just a fraction of the subsidisation in the sector. Thanks to export subsidies, Polish mines were able to sell coal on foreign markets at a price that was below the cost of extraction. The annual value of export subsidies to hard coal was 350-450 million USD at the end of the 1990s.[24]

The recent rise in prices on the world coal market has improved the economic situation of some coal mines, raising questions about the rationale of state support for profitable companies. The Ministry of Economy and Labour is considering withdrawing financial support for selected mines, but faces strong resistance.

Author: Wojciech Stodulski, Institute for Sustainable Development, Poland

[23] *Council of the European Union (2002), Article 5*

[24] *B. Fiedor and A. Graczyk (2002)*

SUBSIDIES FOR COAL MINING IN GERMANY – CASE STUDY

The high level of subsidies for hard coal mining has a long tradition in Germany. Since 1980 around 100 billion Euro have been paid in subsidies to the coal mining industry. Production costs in German coal mines are approximately 140 Euro per ton, while the world market price is only between 38 and 55 Euro. The number of workers employed in the coal-mining sector fell from 130,000 in 1990 to 44,000 in 2003. The annual subsidies have been steadily reduced: from 4.5 billion Euro in 1997 to 2.8 billion Euro in 2005. Each German coal miner is presently subsidised by the state to the tune of 78,000 Euro per year.

The German Council on Sustainable Development had demanded that coal subsidies be phased out by 2010. But the 'red-green' government recently agreed to continue paying until 2012, albeit at decreasing levels (subsidies will be 1.8 billion Euro by 2012.). It was agreed that the subsidies would be further reduced if the world market price rises and the difference between production costs in Germany and world market prices decreases.

The majority of experts and public opinion in Germany criticise the coal subsidies – not only from an environmental perspective, but also as a waste of money. If the money were used for efficient energy use and renewable energies, many more people could be employed and the long-term targets to reduce greenhouse gas emissions could be reached more easily.

Author: Matthias Seiche, BUND / Friends of the Earth, Germany

b) Subsidies to Nuclear Energy

Scope of the subsidies: The construction of nuclear power plants in Europe was only possible because governments spent billions in direct subsidies in the early phase of nuclear energy. Even today there are substantial subsidies and preferential regulations for the nuclear industry:

The Euratom Treaty of 1957, set up to promote nuclear power, is to be kept in force alongside the new Constitution of the European Union, against vociferous, Europe-wide civil society opposition. Euratom grants credits which are supposed to increase the security of nuclear power plants but which in reality are also scheduled for new reactor projects in Eastern Europe[25]

[25] *The EU-Commission has approved 688 million Euro for the K2R4 reactors in Ukraine and 250 million Euro for the construction of Cernadova 2 in Romania. Source: Deutscher Bundestag (2003)*

The input of uranium for electricity generation is tax-free, whereas the input of natural gas is subject to a primary energy tax in some Member States (e.g. Germany). The EU energy tax directive demands the abolition of energy taxes on fuels used for electricity generation, but this provision has yet to be fully implemented.

National laws limit liability for nuclear accidents to thresholds that are far below the expected damage if a major nuclear accident occurs.[26]

Electricity companies have to set aside decommissioning funds for the dismantling of nuclear power plants and the final disposal of nuclear waste. These funds have instead been excessively used by the companies to buy other companies and increase their market power.

BRITISH ENERGY RESCUED BY EUROPEAN COMMISSION – CASE STUDY

British Energy ran into financial difficulties in 2002, narrowly avoiding bankruptcy through an emergency loan from the UK government. The Commission approved a proposal by the British Government to 'restructure' the company. This included approximately six billion Euro in state aid, paid for on-going operating costs and for much of the huge nuclear decommissioning costs over the remainder of this century.

The British Energy case was a test of the relationship between the competition laws in the EC treaty and the Euratom treaty. "Euratom cannot be an excuse for state aid. Other industries carry risks and hazards, but this does not mean they get subsidies. The same rules that apply elsewhere must also apply to the nuclear industry," commented Friends of the Earth Scotland in a press release.

Source: Friends of the Earth Scotland[27]

EEB call to the EU and Member States: The EU Commission and many Member States must stop their pro nuclear policy, which gives nuclear electricity generation unfair economic advantages worth billions of Euro, thus maintaining this dangerous form of electricity generation even though it would not be competitive without these subsidies.

[26] *In Germany, the liability is limited to 2.5 billion Euro which is about 0,1 per cent of the expected damage if a major nuclear accident occurs. Source: BUND/Friends of the Earth Germany (2003)*

[27] *Friends of the Earth Scotland (2004)*

c) Other Examples of Subsidies in the Energy Sector

- Exemption of fossil fuels from energy taxes: e.g. exemption of coal from energy tax system in Germany
- Subsidised consumer tariffs for electricity in specific regions – e.g. on Mediterranean islands (see case study, below)
- VAT reduction for heating fuels: e.g. in Belgium, Ireland, Luxembourg[28]

SUBSIDISED CONSUMER TARIFFS FOR ELECTRICITY ON MEDITERRANEAN ISLANDS - CASE STUDY

On Mediterranean islands without cable connection to the mainland, the costs of electricity production (by diesel generators) are much higher than on the mainland. Typically, they range from 0.20 to 0.50 euro/kWh, which is 5 - 10 times higher than the average bulk electricity generation cost on the continent. Under free market conditions (without subsidies), these high diesel costs would make renewable electricity generators (wind and solar photovoltaic) economically viable on the islands.

However in Italy and in Greece the high cost of diesel power on the islands is hidden by subsidised electricity consumer tariffs originally intended, quite legitimately, to alleviate the hardships of life of island populations. The gap between the electricity tariffs paid by consumers and the actual costs of electricity (and also of water) on the islands is covered either by governmental subsidies (for example by the Cassa Conguagli in Italy) or else by the national utility (PPC in Greece).

Subsidised consumer tariffs produce a market distortion. Under such conditions, renewables have no chance of competing against conventional (subsidised) diesel power and water supplies, despite what should be a good market niche (the Mediterranean islands) that may in time be less costly than conventional power. Moreover, subsidised tariffs induce islanders not to save but to boost consumption and thus support the existing conventional energy system.

Author: Massimo Serafini, Legambiente, Italy

[28] *Commission of the European Communities (2004b)*

5.3. BUILDING SECTOR

Environmental dimension: Having a place to live is a basic human need. However, the construction of new houses often leads to urban sprawl and reduces the size of natural habitats. The average size of dwellings per capita has increased substantially over the last twenty years. At the same time there is a rising number of regions with empty houses and flats. Therefore, all subsidies that give incentives for the construction of buildings may be considered as potentially environmentally harmful.

Scope of the subsidies:

- Fiscal incentives for buying private homes (see case study Germany)
- Sale of municipal building land at prices below market value
- Subsidised credit schemes for the construction of buildings
- Social housing schemes that concentrate on the construction of new buildings

BUILDING SUBSIDIES IN HUNGARY – CASE STUDY

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.

Author: András Lukács, Clean Air Action Group, Hungary[29]

[29] *See also, in more datail: Clean Air Action Group - "Lélegzet" Foundation / Károly Kiss (2004)*

EEB call to Member States:

- Subsidies for the construction of new houses should only be granted in regions where the supply of accommodation is too low to meet the demand for reasonable housing space. Strict ecological standards should be applied (flats rather than detached family houses, best available standards of insulation, ecological building material, no building on greenfield sites, good accessibility to public transport etc.).
- Subsidies made available for the construction of new houses should be sharply reduced. Some of the public money thus saved should be invested in subsidies for the insulation of existing buildings. This is a very effective investment for fulfilling long-term climate-protection targets. The insulation of houses is also beneficial from a social point of view, because it reduces heating costs and increases quality of life. Such action would support EU policy on energy efficiency of buildings.
- More emphasis should be placed on the use of existing houses in social housing schemes. This can be achieved by the public purchase of residency rights, which are then granted to low-income households. Another alternative is the direct transfer of money to needy households rather than subsidising the construction sector. This would also have the effect of increasing the individual agency of the people affected.
- These very general recommendations can only be a starting-point for a more in-depth analysis of subsidies for the building sector. Reforms should be designed in a way that gives more weight to ecological considerations and to the specific social circumstances in the affected regions.

PREMIUM FOR BUYING OWNER-OCCUPIED HOUSES IN GERMANY - CASE STUDY

Private households who buy a house or flat for their own use receive a premium ("*Eigenheimzulage*"). The premium is worth 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 organisations because it created an incentive to build new houses in suburban areas rather than to renovate existing houses. Urban sprawl and excessive land-use is a widespread problem in Germany: 97 hectares of land are developed each day. The government wants to reduce this rate to 30 hectares per day by 2020 (according to its 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) and disproportionately benefits the well-off who are in a position to buy their own property. The federal government wants to abolish the premium, but has yet to convince the federal states (Länder/Bundesrat), which have to give their consent.

Author: Matthias Seiche, BUND / Friends of the Earth, Germany

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