Greening VAT in Europe

Green Budget Europe position paper on the green paper on the future of VAT

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1. Introduction

Green Budget Europe proposes that VAT be reformed and restructured in line with the EU’s overarching climate and environmental goals. This can be done by modifying VAT rates in line with the environmental impacts of particular products. On the one hand, this means applying reduced or zero rates to products which are themselves or can bring about improved energy- and resource-efficiency, e.g. highly efficient white goods, insulation materials, recycled items. On the other hand, this means taxing at the full VAT rate resource- or energy-intensive products and services, e.g. meat and dairy products, air travel, international shipping.

The principle of using price signals to change behaviour is well-established in the EU, not least in the Europe 2020 Strategy and the recent publication of a revision for the Energy Tax Directive. Moreover, the November 2008 Economic Recovery Plan specifically called for the greening of VAT systems to stimulate demand for environmentally friendly products.

2. Greening VAT

Greening VAT by applying different rates according to the environmental performance of products will not compromise the neutrality of the impact of VAT, but rather iron out some distortions in the current market for energy- and resource-intensive products. This is because while different products are associated with very different environmental costs during their life-cycle, these costs are not reflected in the prices of these products, i.e. these costs are not internalised. Thus, products that are environmentally damaging may be cheaper than products that are more beneficial to the environment and thus associated with lower environmental costs during their life-cycle. Differentiated VAT rates in line with clearly defined environmental impacts

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1 Green Budget Europe (GBE) is a registered interest representative ID number 74535104992-35.
2 A case in point is the price differential between products from organic and conventional agriculture, the former being considerably more expensive while having more positive environmental outcomes in rela-
goals can be one way of internalising these costs and creating a level playing field between products or services.

For example, existing exemptions for air and sea travel create environmentally harmful distortions within the economy that explicitly act against the EU’s climate and environment targets, as VAT exemptions give air and sea transport in the EU a competitive advantage over other transport modes. Thus, there is a strong economic argument in favour of applying the full VAT rate to air and sea travel.

Conversely, there are sound equity and ecological arguments in favour of applying a lower or zero rate of VAT on local public transport modes, in recognition of the fact that travel on public transport is environmentally and economically more efficient and has additional societal benefits, including reduced congestion, less GHG emissions, and lower local air pollution.

Greening the VAT system in this way – not only in relation to transport, but also in relation to other products and services – would not compromise the amount of revenues raised, but rather would shift the tax base towards products that are more environmentally damaging. This would mean that the polluter pays principle would be applied to VAT in the EU. Greening VAT would also support complementary policy approaches such as energy efficiency labelling by giving consumers additional information on the energy performance of products in the price of that product and the VAT rate applicable.

Experience shows that changing the relative prices of products will change consumer behaviour and encourage environmentally sound purchasing decisions. Energy- and resource efficient products would also benefit from a possible ‘signalling effect’ of the reduced / zero VAT rate, if properly communicated. As well, pay-back times for more expensive energy-efficient equipment or appliances will be reduced. All of these factors would act to accelerate the market penetration of energy and resource efficient products, goods and services.

3. **Evidence base in favour of greening VAT**

The results of several research projects have shown that the potential for using differentiated rates of VAT to act as an economic instrument in favour of reduced environmental impacts is significant, for example:

1. The Wupperthal Institute’s project *Material Efficiency and Resource Conservation project* showed that increased VAT on meat and dairy products in the EU-27 would result in a reduction in meat consumption of 2-7% (between 1 and 3 million tonnes) and in corresponding reductions in CO₂ emissions of between 12 and 21 million tonnes of CO₂ equivalent. Tax revenues from the increase could amount to as much as 21 million Euros annually.

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2. IVM research has estimated that the environmental impact of a zero VAT rate on energy-efficient condensing boilers, assuming certain changes in behaviour in response to changing relative prices, would result in reduced CO₂ emissions of 18 million tonnes in the EU-27.⁴

3. IVM estimated in 2005 that the VAT exemptions on domestic energy use results in increased CO₂ emissions of 20 million tonnes annually.⁵

4. **Concrete GBE proposals**

- Repeal of the VAT waiver for international, intra EU and domestic flights,
- Repeal of the VAT waiver for shipping,
- Repeal of reduced VAT rate for resource-intensive foods, meat, and milk products,
- Repeal of lower rates for domestic energy use (the impact of increased prices on vulnerable households can be compensated for by other means),
- Introduction of reduced VAT rates for rail traffic and public transport,
- Reduced VAT rate for particularly resource- or energy-efficient business,
- Reduced VAT rates for labelled products, eg. Blauer Engel, Resource Angel,
- Reduced VAT rates for energy/water-efficient equipment (A++),
- Reduced VAT rates for products with a high-level of recycled or reused materials, such as recycled paper products and alternatives to peat.

5. **Summary**

The above list is by no means exhaustive, but has been included to convey a sense of the potential for greening of the VAT system by taking environmental impact in to account. If VAT were greened in this way, it would influence consumer purchasing decisions over and above the simple price impact of an intelligent VAT policy, and support other policy instruments to bring about the transition to a green economy in the EU.

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⁴ Ibid.
⁵ Ibid.