Summary of Discussions at the
7th Integrated Product Policy Expert Workshop

Economic Instruments

Brussels, 19th June 2001
1. **Background Information on the Expert Workshops**

Following the adoption of the Green Paper on Integrated Product Policy (IPP) in February 2001 the European Commission embarked upon a stakeholder consultation exercise, which will finish on 30th June 2001. In addition to welcoming written comments on the Green Paper the Commission has organised a series of meetings, the first of which was the Conference to launch the stakeholder debate on the 8th and 9th of March 2001.

The Commission has also organised seven small expert workshops on particular aspects of IPP. The aim of these workshops was to inform the Commission about particular aspects of IPP to help the Commission in framing its ideas for the forthcoming follow-up Communication on IPP. Participants were invited to apply and around ten were selected on the basis of their expertise and experience. The Commission is aware that with such a small number of participants it will not be able to canvass all experiences and opinions represented. For this reason the input from such meetings is seen as being just a part of the stakeholder consultation process.

This document represents a summary of the discussions at the workshop. There was no attempt to reach conclusions or consensus and the fact that a particular viewpoint was expressed at the meeting without being contested does not necessarily mean that the Commission accepts it.

2. **Background to this Workshop**

The discussions at the Integrated Product Policy (IPP) Conference on the 8th and 9th of March revealed the need for a better understanding of the functioning of economic instruments as well as advantages and constraints of their application in practice.

The Commission therefore invited a number of experienced experts to this workshop in order to obtain a fuller picture of existing initiatives and available information. It is recognised that, for a more complete picture, it would be useful to have a more complete participation, e.g. from taxation authorities. However, this was not possible within the time and organisational framework available. This workshop should, therefore, be seen as only one of several inputs as outlined above.

3. **Participants**

Richard Almgren (Confederation of Swedish Enterprise)

Grace Barrasso (Tetra Pak Europe and Africa)

Suzanne Bergstrand (IKEA International)

Anna De Ruiter (DG Enterprise)

Henry King (EUROPEN – European Organisation for Packaging and the Environment)
Otto Linher (European Commission, DG Environment)
Christina Lytridis (European Commission, DG Taxation and Customs Union)
Alexandre Mathis (European Commission, DG Taxation and Customs Union)
Stefania Minestrini (ANPA – Italian Environment Protection Agency)
François Mirlo (Renault)
Stein Nestvold (Norwegian Ministry of Industry and Trade)
Kamini Paul (Confederation of British Industry)
Stefan Nyström (Swedish Environment Protection Agency)
Manfred Rosenstock (European Commission, DG Environment)
Peter White (Procter & Gamble)
Helen Woolston (Engineering Employers’ Federation, UK)
Herbert Zlöbl (Cleaner Production Center Austria)

4. EXTERNALITY VALUATION

Mr King reported on work in his company on the valuation of externalities. This work is to a large extent based on the ExternE methodology focusing on human health and medical costs. This method implies a significant degree of uncertainty and gives a strong weighting to energy related impacts and PM10. Problematic areas included the external cost of landfills and how to cost resource use and to value the impact of carbon. Another issue is the attribution of transport costs. Generally, the externalities measured are in a rather smaller range compared to the internal costs. In many cases, the majority of impacts are related to consumer use (e.g. detergents and shampoos). Many impacts occur abroad as supplies come from global sources. Externality valuation is preferred for company internal purposes whereas communication to the outside focuses on easily understandable arguments such as fish stocks.

Mr Zlöbl underlined that in most cases only a small part of overall life cycle impacts is situated in a single company but rather distributed along a complex product supply chains as well as the other phases of the life cycle of products.

Mrs Minestrini stated that environmental taxation should be related to the levels of environmental impacts. These impacts need to be measured and quantified by monetary valuation. Life Cycle Assessment is a tool that provides information on impacts related to the life cycle of a product or service on which ANPA is working on. Also there are methodologies such as ExternE that provide a monetary valuation for environmental costs basically related to atmosphere emissions, but these methodologies need to be extended to other environmental impacts and harmonised at the European level.
Mrs Barrasso showed Tetra Pak’s work on finding out the most relevant impacts throughout the life cycle of products. She underlined the need to look at the whole “value chain” in production, consumption and waste management. There needs to be better communication with the consumer. She also reported on work within the French national administration which inter alia focuses on the side effects of transport and traffic congestion.

Mrs Bergstrand stated that it is difficult to internalise environmental costs if there is no external steering instrument and referred to the difficulties in setting up recycling systems (see also section 7).

Mrs Paul underlined the high degree of variation of characteristics between different products. Issues such as transport and landfill could vary for the same product.

Mr White drew attention to the need to include all aspects of sustainable development in IPP, including social issues such as equity. He proposed that any economic instruments considered be evaluated according to the OECD criteria of environmental and economic efficiency, the effects on innovation, their administrability and political acceptability. The incentive provided by economic instruments should be applied as closely as possible to the desired behaviour and impact.

Ms Woolston said that to encourage the acceptance of economic instruments, it is important to communicate the strategy behind the measure and the use of the tax income to the taxpayer (eg whether and how money raised will be hypothecated).

Mr Nestvold reported on the 1996 green tax reform in Norway. Taxes on employment were reduced within an overall neutral tax reform. There are also taxes related to waste issues. In Norway, substantial work has been undertaken on the valuation of externalities. A crucial issue was the question of discount rates for impacts which occur only later in time. Among 35 economists, the recommended discount rate varied from –7 to +7.

Mr Almgren pointed out the weaknesses of many data. An exact valuation is in many cases difficult.

5. DIFFERENTIATED VAT RATES, INTER ALIA RELATED TO ECO-LABELLED PRODUCTS

Mr Almgren pointed at the relatively high costs of eco-labels which puts off many parts of industry.

Mr. Mathis and Mrs Lytridis stressed the difficulties of using VAT as an instrument for the purpose of specific policies on the basis of economic, legal and political reasons.

From an economic point of view, Mr Mathis referred that it is difficult to predict the effect on the consumer price of applying a reduced VAT rate to a particular product. Awareness raising and information campaigns directed at consumers would be a better means of stimulating increased demand for eco-label products.
Mr Mathis referred to the principle of unicity of VAT, i.e. that the same product should be taxed at the same rate. He raised the question whether VAT was the right instrument to promote environmental purposes and whether taxes on producers were not more appropriate.

He also stressed that applying the polluter-pays principle is to include external costs in the price (i.e. to internalise the external costs). It is therefore clear that a reduced VAT rate on Eco-label products will never create the internalisation of external costs and thus does not respect the polluter-pays principle\(^1\).

As for the legal basis, Mrs Lytridis explained the options for reduced rates of VAT within Annex H of the 6th VAT Directive. Even if there are many derogations for Member States which leads to a very complex system, reduced rates should remain exceptions to the standard rate. Moreover, they require unanimous approval at the EU level. The aim is to try and make the application of VAT as uniform as possible at the EU level. Under present Community legislation, reducing VAT rates on eco-labelled products is incompatible with the VAT principles of the neutrality of the tax and the unicity of rates. The new VAT strategy seeks to simplify and modernise this system.

This would provide an opportunity to abolish specific and temporary derogations and particular attention will be paid to the use of reduced VAT rates in Community policies (e.g. to help protect the environment). There is, however, a Directive on reduced VAT rates for labour intensive services. The experience with this directive shall be evaluated in 2002/2003. It would be appropriate to wait for this evaluation before launching any new projects to use VAT rates for the purpose of specific policies. She stated that the possibilities to use the VAT instrument for differentiation are in general very limited and were in the past subject to relevant Court decisions.

Mr Nystrom referred to the administrative complexities that might be related to the use of differentiated VAT rates. He said that these potential complexities were not fundamentally different from the existing patterns of VAT administration. For example, if fast food is consumed within the restaurant, it is charged a 25% VAT rate whereas if the same food is taken away, it is only subject to a 16% rate (in Sweden). The reason is that in the first case it is classified as service and in the second case as food.

Whether VAT or excise duties were used to give incentives for greener products tends to be an academic discussion. In the end, it is the price of the product that matters. It would, however, be necessary to carefully evaluate which eco-labels could benefit from reduced VAT rates in order to avoid problems with international trade. It would also necessary to look at the relationship between physical properties of a product and production methods.

\(^1\) Please note that this is a personal opinion which is not consistent with the Green Paper on Integrated Product Policy. There, the correction of existing market failures according to the polluter pays principle is identified as a general aim. As it will not be possible in each case to calculate the exact externalities, simple and administrable measures are needed. The Green Paper states in this context that “a first step might e.g. be to apply reduced VAT rates on products carrying the European eco-label.”
Mrs Barrasso reported about concerns on possible trade distortions which also raised equity and social issues, in particular in relationship to developing countries.

Mrs Minestrini stated that eco-label schemes can play an important role in promoting the diffusion of more environmentally sustainable products as they allow consumers to recognise “green products”. We know that there are different schemes and not all are based on life cycle considerations such as the European eco-label. Therefore, it is important to consider only those eco-labels that guarantee better environmental performance of the products. In reaction to a discussion on whether eco-label criteria could inhibit innovation by fixing particular technologies, she said that this is a minor danger as the criteria are related to the product performance and not to a particular process technology. Furthermore, they are periodically revised to take into account technological progress.

Mr White confirmed the need for both minimum standards to eliminate what is unsafe or unacceptable plus an incentive for the top performers. This should result in a market transformation process. He saw, however, problems in linking this just to eco-labels.

6. **Evaluation of Economic Instruments in General**

Mr King raised the idea of asking manufacturers to sign up to particular targets on the basis of voluntary screening such as practised in the ratings of electrical goods.

Mr Nystrom reported on a major evaluation of economic instruments in Sweden in 1996/97. Overall, more than 50 bn SKR were raised. This includes general energy taxes. In general, these taxes had good steering effects. They are very easy to administrate. Whereas for income tax, around 3-5% of the funds go into the administration of the tax, this was close to 0% for energy taxes. There were projects to use taxation for issues such as solvents and CFCs. In these cases, some of the projects were abandoned due to trade reasons. In some cases, command and control measures were deemed to be clearer. Other specific environmental taxes in Sweden concern batteries, chemical fertilisers, pesticides, sulphur, CO$_2$ and differentiated taxation on fuels (diesel, leaded/non-leaded). In some cases, it was difficult to evaluate the effectiveness of taxes due to the problem of identifying an appropriate baseline (i.e. what would have happened in the absence of the tax).

Mrs Paul reported on the UK approach towards tradeable permits, in particular in the context of the implementation of the EU Landfill Directive.

Ms Woolston supplied information on the UK climate change levy and also the proposed UK Greenhouse Gas Emissions Trading Scheme.

Mr White explained the UK packaging recovery note (PRN) system for the recycling of packaging. Each company putting on the market packaging above a certain minimum amount has an obligation to contribute to recycling. They have to produce evidence that the recycling has to be done in the form of PRNs. The advantage is that a market is created, the disadvantage is that there are no specific requirements for the reprocessor. There is also a certain speculative element in the system.
He also referred to the experience with the landfill tax which was in general positively received. It also allowed reductions in employers insurance contributions and the creation of an environmental fund for projects.

Another important option for economic incentives is the removal of subsidies with harmful effects on the environment.

7. **PRODUCER RESPONSIBILITY, PUBLIC/PRIVATE PARTNERSHIPS AND STATE AID**

Mr White referred to the OECD work on extended producer responsibility (EPR). In this framework, there has been extensive evaluation of the German and Dutch packaging recycling systems. There is considerable difference in administration requirements between various EPR systems. There are also various systems used as regards the financing of waste management, such as full integration of collection and recycling costs into the product price, pricing on waste, including for the recycling bin. The most efficient systems are those that provide incentives for consumers both to purchase products that produce less waste, and then to sort their waste appropriately. This can be achieved by pricing for waste management, but not by just adding waste management costs to the product price. An interesting model is also the system applied by Xerox to lease out photocopiers and refurbish them after taking them back.

Mr Nestvold reported about the Norwegian system of weight based waste taxes. On beverage packaging, there is a tax system. If a certain percentage of the packaging waste is recycled, the tax is refunded.

Mrs Bergstrand reported on projects to take back used furniture for recycling. These projects did not really take off as the amounts that were brought back were too little to make this recycling viable. Recycling of many such materials is in principle possible but clear incentives are needed. This can also result in better design for recyclability.

Mr Almgren stated that producer responsibility should be based on more individual responsibility. Greater competition is needed to make these systems more effective.

Mr Zlöbl described public/private partnerships which could also result in economic incentives for companies via cost savings. The evaluation of initiatives started in the city of Graz in Austria showed considerable success and was increasingly followed by other cities, among them Berlin, Hamburg and Munich. Similar initiatives were also emerging in Italy. More information can be found on the following website: www.cpc.at.

Mrs Minestrini said that it is important to promote incentives for environmental investments. There is also a need to clarify their definition.