Reforming subsidies that harm the environment

Subsidies support economic sectors and grant advantages to consumers, but can harm the environment. A new study has tested a number of existing tools for assessing environmentally harmful subsidies (EHS), developed a comprehensive methodology for identifying and analysing EHS and highlighted opportunities for reforming them.

An EHS is “a government action that confers an advantage on consumers or producers, in order to supplement their income or lower their costs, but in doing so, discriminates against sound environmental practices”. EHS are quite significant in size and recently there has been renewed interest in their reform.

The study, commissioned by the European Commission, applied the tools developed by the Organisation for Economic Co-operation and Development (OECD) on EHS in an EU context. Using six case studies it tested three OECD tools - the “quick scan”, the “checklist” and the “integrated assessment” framework - and suggested improvements. Case studies included biofuels tax exemption in Germany, preferential taxation for company cars in the Netherlands, VAT reduction for domestic energy consumption in the UK, nuclear energy decommissioning subsidies in Germany, differentiated tax rates for diesel vs. petrol in three countries and irrigation water subsidies in Spain.

For each case study the research team estimated the environmental impact, the size of the subsidy, the social and economic impacts and options for policy reform. The case studies confirmed that significant amounts of money are provided to subsidies that cause environmental damage. For example, preferential tax for company cars is estimated to cost €2.2-2.6 billion in the Netherlands and has negative impacts on air pollution and climate change. In most cases these subsidies do not fulfill their original objectives. For example, the reduction of VAT for domestic energy in the UK has protected low-income households, but it has also reduced energy costs for many unintended recipients.

The study suggested that the OECD tools should be integrated into one methodology for identification and assessment of environmentally harmful subsidies and more consideration should be given to impacts of subsidies on trade, competitiveness and SMEs. This methodology is a quick and easy-to-use EHS reform tool to guide policy makers through four stages of the reform process:

1. **Screening of subsidies** – identifying and prioritising subsidies with clear potential environmental harm and viable for reform.
2. **Application of the checklist** – assessing whether the reform or removal of the subsidy can bring environmental benefits.
3. **Broader assessment of subsidies** – analysing in more detail the impacts of subsidies with regard to their social and economic impacts and to the achievement of targets for which they were introduced.

The study also developed a ‘recipe book’ on how to quantify the total size of subsidies. Since the decision on reforming subsidies is often taken by non-specialists, it developed a ‘summary assessment table’ and a ‘subsidy identity card’ to easily communicate the characteristics and impacts of subsidies and the reform options.

The recent economic crisis and governmental recovery plans provide an opportunity to reform EHS. Moreover, the discussion on the Europe 2020 strategy – the successor of the Lisbon strategy – and the review of the EU Sustainable Strategy could provide more opportunities.


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