

Does the polluter profit?

EHSs and EFSs: bonuses that save the environment and subsidies that foster pollution

May 2018

Incentives, exemptions, benefits: every year the State spends 76 billion Euros on fiscal expenditure. But do these measures always respect the environment? Paradoxically, the answer is no. According to the first (and still incomplete) **Catalogue of Environmental Subsidies**, drafted by the Ministry of Environment with the technical advice of Sogesid, in 2016 about **16.2 billion Euros were allocated for SADs (EHSs - environmentally harmful subsidies)**, while 15.7 billion were allocated for SAFs (EFSs - environmentally friendly subsidies).

Is there a way to reorganise incentive mechanisms and subsidies in order to make them more consistent with the Italy's environmental targets?

The Catalogue of Environmental Subsidies – of which the Impact Assessment Office hereby publishes a critical review – has analysed the **schemes** approved by several governments so as to **consider their preconditions and effectiveness from an environmental standpoint**, in order to provide the public and the institutions with all the information required for the **possible reform called for by G20, G7, OECD and other international bodies**. The second edition of the Catalogue is due in July 2018.

The starting point

Every year, as set forth under article 68 of law n. 221 of 2015, the Ministry of Environment must draft the *Catalogue of environmentally harmful subsidies and of environmentally friendly subsidies*.

Table 1. Type of subsidies analysed by the Catalogue

	Class	
Direct transfers of funds	<i>On-budget</i>	Direct subsidies
Potential direct transfers of funds		
Foregone revenues	<i>Off-budget</i>	
Regulatory support mechanisms		Indirect subsidies
Tax exemptions and rebates		Tax expenditures, exemption, tax credit, etc.
Selective exemptions of government standards		
Implicit income transfers resulting from a lack of full cost pricing		

Source: adapted from OECD (2005)

Analysis

The first edition of the *Catalogue* considered 131 subsidy schemes that were potentially relevant from an environmental standpoint, for an overall financial value, in 2016, of about **41 billion Euros: that is 2.5% of GDP.**

The number of subsidies allocated by the several levels of Public Administration, concealed amid the creases of national and regional laws, is obviously much higher, but currently it cannot be fully quantified.

Subsidies include not only direct transfers, but also exemptions and allowances within the several tax regimes (the so-called "tax expenditures"). For example excise duties on energy products or reduced VAT rates (Table 1).

The subsidies considered in the first *Catalogue* were classified into **5 categories**: energy, transport, agriculture, goods and services with a reduced VAT rate and the residual category, defined as "other".

Among the **131** measures reviewed, **56 are direct subsidies, while 75 fall within the "tax expenditure" category**. Direct subsidies account for 19 billion Euros, while tax expenditure total 22 billion.

As a general rule, all public subsidies should either be "pro-environment" or "neutral" (namely, not impacting significantly on the environment). However, according to the *Catalogue*, environmentally **harmful subsidies (EHSs - SADs) totalled 16.2 billion Euros**. The so-called "**uncertain**" subsidies, which entail both positive and negative environmental impacts, account for **5.8 billion**.

The good and the bad

The *Catalogue* assesses the environmental compatibility of several subsidies, identifying:

- **57 environmentally harmful subsidies (EHSs - SADs)**, for an overall financial expenditure of 16.2 billion Euros
- **46 environmentally friendly subsidies (EFSs - SAFs)**, for a value of 15.7 billion
- **27 "uncertain" subsidies**, accounting for 5.8 billion
- **1 single "neutral" measure (SANs)**, for 3.5 billion.

Table 2. Values of SADs, SAFs, SANs, "uncertain," by subsidy category (millions of Euros)

Subsidy Category	EHSs - SADs	EFs - SAFs	ENSs - SANs	Uncert ain	Total (mln €)	Total (%)
Agriculture	154	2.231		4.068	6.453	15,7%
Energy	11.550	12.145			23.695	57,6%
Transport	202	200		65	468	1,1%
Other	700	1.079	3.538	1.634	6.950	16,9%
VAT	3.561	25			3.586	8,7%
Total (mln €)	16.167	15.679	3.538	5.767	41.151	100,0%
Total (%)	39,3%	38,1%	8,6%	14,0%	100,0%	

Source: MATTM - UAT Sogesid (2017) for 2016

For some types of subsidies – both friendly and harmful to the environment – the financial effects on the State's budget still have not been quantified, due to lack of data and calculation complexity: hence the overall figures are provisional and must be accordingly considered. A close monitoring of scientific literature is required to settle the cases classified as "uncertain".

In detail: environmentally harmful subsidies

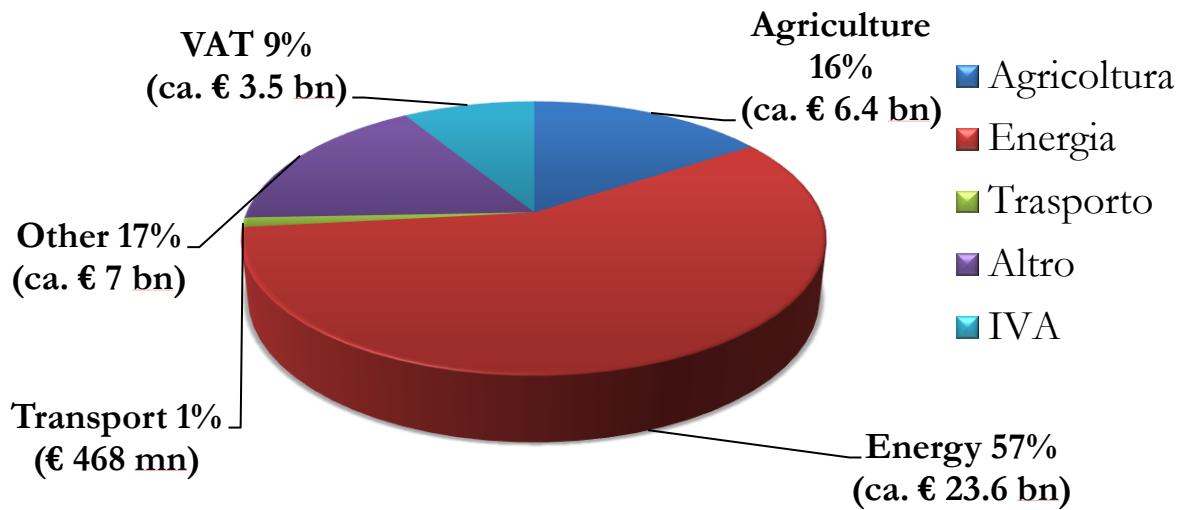
Over **97% of the environmentally harmful subsidies** identified in the *Catalogue* consist of **tax rebates**, while only 3% are direct allocations.

The phenomenon deserves further investigation, but the idea is that, historically speaking, it has always been much easier to pass environmentally contradictory incentives, adopting amendments and rules departing from the general principles of the regulation, such as the well-known environmental prevention principle and the "polluter pays principle".

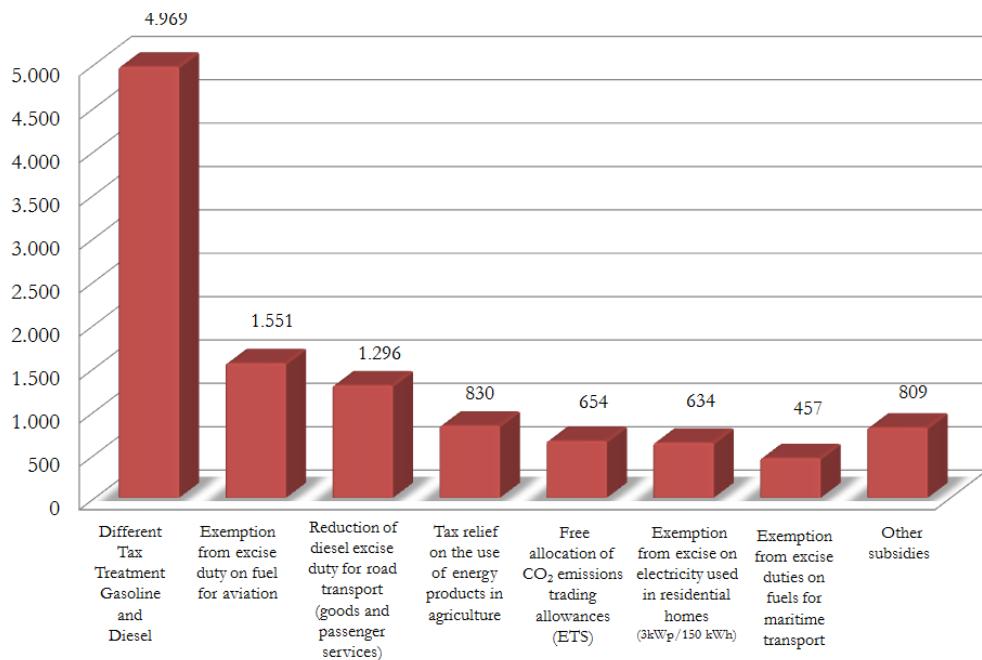
The **most burdensome subsidy is the excise duty gap between petrol and diesel fuel (lower rate for the latter)**, which in passenger vehicle transportation entails a total revenue shortfall of about 5 billion Euros (about 6 billion including VAT).

The detailed analysis of quantified EHSs (SADs) by tax category shows:

- 26 measures concerning excise duties on energy products (mostly exemptions or allowances as compared with the 'normal' excise duty levels)
- 14 types of products with a reduced VAT rate
- 7 schemes for income tax allowances (IRPEF/IRES)
- 5 schemes of direct subsidies (agriculture)
- 5 subsidy measures concerning other types of taxation (free allocation of ETS permits, discounts on anchorage dues, tonnage tax, TASI waste collection fee and water management fees).

Figure 1 – Value of EHSs per category (millions of Euros)

Source: MATTM - UAT Sogesid (2017) for 2016

Figure 2 – Energy EHSs breakdown (millions of Euros)

Source: MATTM - UAT Sogesid (2017) for 2016

In detail: environmentally friendly subsidies

The overall value of environmentally friendly subsidies identified by the *Catalogue* is 15.7 billion Euros (according to the data for 2015), **12.1 billion of which (77%) are for energy**, fol-

lowed by **agriculture with 2.2 billion** (14%).

For the **energy sector**, the *Catalogue* identifies:

- Feed-in tariff for photovoltaic energy
- Green certificates
- All-inclusive tariff

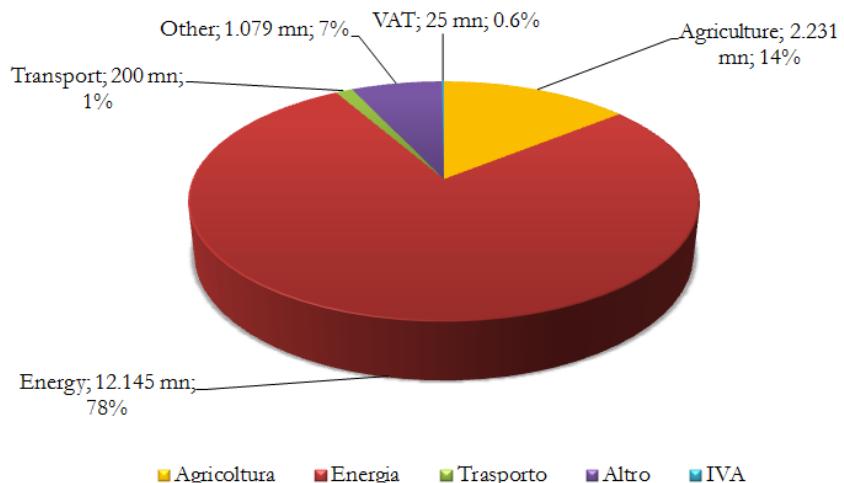
- CIP-6: incentive mechanism for energy produced by renewable and similar sources
- Auctions and registers
- Energy Efficiency Titles (TEE) or White Certificates (CB)
- Support scheme for renewable energy used

for heating and cooling ("Conto termico")

- National Fund for Energy Efficiency

In 2015, roughly 6.3 billion Euros were spent for the Feed-In-Tariff for photovoltaic energy alone, and 5.8 billion for renewable energies other than sola

Figure 3 – Value of EFSs per category, millions of Euros (% of the total)



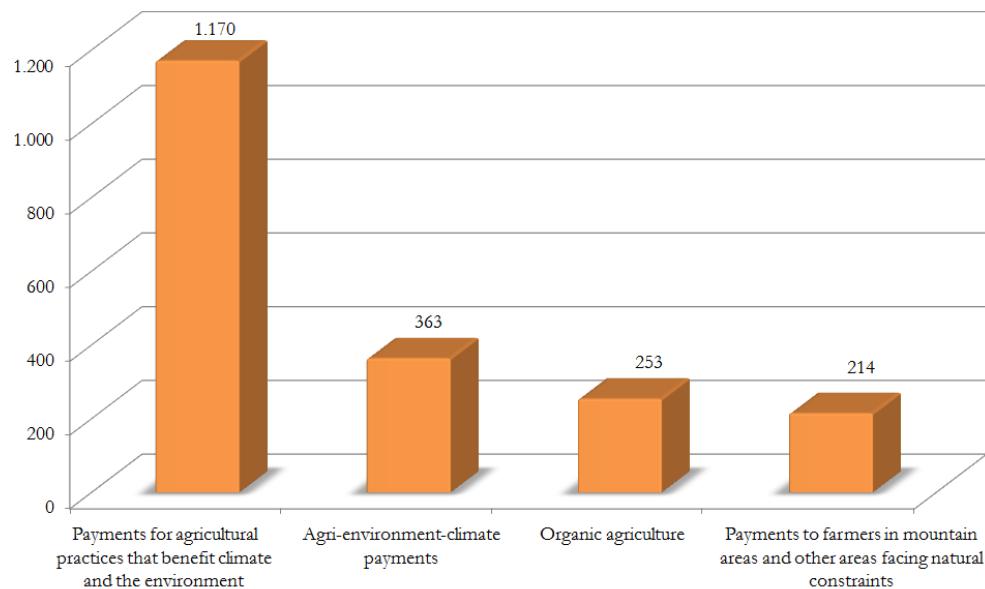
Source: MATTM - UAT Sogesid (2017)

The EFSs (SAFs) identified in agriculture are mainly direct subsidies, including:

- Agricultural practices that benefit climate and environment
- Agricultural-climatic-environmental payments
- Biological (organic) agriculture
- Allowances for areas under environmental constraints or other specific constraints

The most common type of environmentally friendly subsidy, in financial terms, is the payment for agricultural practices that benefit climate and environment, as the so-called *greening*: 1.2 billion Euros.

Focus

Figure 4 – Value of the main EFSs (SAFs) in agriculture (millions of Euros)

Source: MATTM - UAT Sogesid (2017)

What's missing?

The *Catalogue* is basically a periodical report being constantly updated. Entire areas of expenditure (i.e. EU, national and regional expenditure laws) are yet to be analysed in order to identify, assess and quantify the relevant subsidies from an environmental standpoint. The following are yet to be considered:

- direct subsidies under the jurisdiction of Ministries other than the Environment Ministry (Economic Development, Infrastructure and Transport, Tourism), including subsidies allocated through Regional Governments;
- structural funds used in national and regional operational programmes (PONs and PORs);
- implicit subsidies (e.g. benefits for the payment of royalties).

Conclusions

Calling upon fiscal allowances and tax expenditures seems to have facilitated the approval of measures clashing with the environment, while opting for direct transfers apparently makes such measures consistent with their environmental goals. Actually:

- **EHSs (SADs) account for 71% of the tax expenditures considered** and EFSs (SAFs) for 5%
- **76% of the direct subsidies considered are EFSs (SAFs)** and 2% EHSs (SADs).

The vast majority of direct subsidies harmful to the environment can be found in agriculture, especially when supporting factory farming.

The *Catalogue* identifies **environmentally harmful subsidies even in measures falling under the reduced VAT rates (4% and 10%)**: the allowance reduces the price incentive for a more efficient consumption of products that are directly or indirectly harmful to the environment, thus generating a negative environmental impact.

This specific case includes, among others, the

reduced VAT rate (4%) for **nitrogen fertilisers** and the 10% VAT rate for **water** and **mineral waters**, for **electricity** used by households, farms and manufacturing companies, for household-use **methane gas**, for **phytosanitary products, including insecticides and herbicides**. Obviously, as the *Catalogue* itself suggests, a possible reform of rates would require the identification of alternative direct measures capable of achieving social and redistribution goals.

The *Catalogue* can help improve subsidy transparency in Italy, but the "in retrospect" nature of its analysis unquestionably reveals **the need for our country to conduct an ex ante environmental assessment of the subsidies** when drafting the rules.

Observations

Based on the information provided by the *Catalogue*, a cognitive tool requested by the Parliament, the Government can consider a number of intervention options, ranging from the possibility of **gradually removing harmful subsidies**, trying to recycle the revenues for other uses (even within the same sector, so as to minimise possible impacts on international competitiveness), to the possibility of **reform-ing the subsidy**, confirming the financial commitment while introducing environmental conditionalities.

The dossier

- analyses the subsidies allocated in Italy
- assesses environmental compatibility based on the available scientific evidence
- reports or estimates the financial effect (foregone revenues or expenditure) of harmful or friendly subsidies

- highlights policy options consistent with EU recommendations and international commitments.

Further reading

UVI, *Fiscal expenditure in Italy in the first annual report (2016). Rules, orientation and elements required for assessment*. Analysis document n.8, September 2017.

UVI, *Does the polluter pay? Environmental taxes and subsidies harmful to the environment. A possible reform in view of the externalities of economic activities in Italy*. Assessment document n.6, December 2017.

The *Catalogue* was drafted by

ALDO RAVAZZI DOUVAN (COORDINATOR), CECILIA CAMPOREALE, GIONATA CASTALDI, LUCA GRASSI, MARIO IANNOTTI, GRETI LUCARONI, ANDREA MOLOCCHI.

Gruppo di economia ambientale - U.A.T. Sogesid S.p.A. - Ministry of Environment, Land and Sea

Focus by

UVI – IMPACT ASSESSMENT OFFICE
Senate of the Republic
uvi@senato.it



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