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New Instruments for Environmental Policy in the EU

New Environmental Policy Instruments
in Italy

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ROBERT SCHUMAN CENTRE

**New Instruments for Environmental Policy in the EU
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in Italy**

ALBERTO MAJOCCHI

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European University Institute
Badia Fiesolana
I – 50016 San Domenico (FI)
Italy**

Italian environmental policy has traditionally been marked by a commitment to direct regulation, through a system of command and control measures. The impetus for regulation in certain sectors was strictly domestic, reflecting increasing concern for environmental protection. In other sectors, where domestic support was lacking or legislation insufficient, increasingly stringent Italian environmental regulation stemmed from obligations under EC law. In recent years, in response to the shortcomings of traditional methods, Italian environmental policy has undergone something of an in-depth transformation, with the introduction of new instruments replacing commitment to command and control. After reviewing the general arguments surrounding the choice of environmental instruments, the first part of this paper explores some of the shortcomings of traditional instruments, and identifies the configuration of domestic and EC pressures animating the shift towards a new generation of environmental tools. This is followed by an examination of the advantages and disadvantages of several new tools as they have been applied in Italy. Particular attention is paid to the policy design and institutional framework necessary for achieving the simultaneous goals of increased economic efficiency and environmental protection.

Economic Competitiveness and Instrument Choice

In the current Italian debate about sustainable development the idea frequently emerges that environmental protection could be a significant hindrance to economic growth. This is clearly a misperception that must be openly clarified. From this point of view a useful distinction has to be introduced between regulations and economic instruments implemented in the management of environmental policy. Regulations impose a constraint on economic activity so that emissions into the environment are limited. Firms are obliged to comply with these constraints through control measures that are normally applied at the end of the pipe or through changes in the structure of the production process. They have to face a cost that is difficult to evaluate *ex ante*, but nonetheless has an impact on the competitive position of the firm, and so on growth. The conventional wisdom is that environmental regulations impose significant costs, slow productivity growth and thereby hinder the ability of domestic firms to compete in international markets. This loss of competitiveness is believed to be reflected in declining exports, increasing imports and a long-term movement of manufacturing capacity abroad, particularly in pollution-intensive industries (see Golub 1997).

In the literature the use of economic instruments is normally considered more efficient, every time the marginal costs of pollution control for different

firms are not the same. This means that it is cheaper to achieve an environmental goal through the use of economic instruments rather than regulations--static efficiency--and, furthermore, that the economic instruments provide a permanent incentive to improve environmental performances, while this incentive does not exist in the case of regulations since the firms have no reason to go further once the standard has been achieved--dynamic efficiency.

Even if the advantages of these new tools can be precisely defined, in practice the implementation of economic instruments for improving environmental conditions are powerfully resisted since the costs which they determine are quite clear to notice and the negative impact on competitiveness--at least in the short run--can be easily perceived by the firms affected by their burden. Hence, the current view that competitiveness could be worsened by the implementation of stringent environmental policy makes it more difficult to adopt new measures, especially when global, and not domestic, environmental goods are affected by policy decisions.

In fact, this fear is misplaced, as evidence of countries deliberately resorting to low environmental standards to gain competitive advantage or to attract investments does not seem available. No systematic competitive impacts from disparate environmental regulations, no significant loss of markets, domestically or abroad, due to eco-dumping, nor industrial migration to countries with lower environmental standards has been documented. As far as the United States is concerned, a recent study shows that "there is relatively little evidence to support the hypothesis that environmental regulations have had a large adverse effect on competitiveness, however that elusive term is defined. Although the long-run social costs of environmental regulations may be significant, including adverse effects on productivity, studies attempting to measure the effect of environmental regulation on net exports, overall trade flows, and plant-location decisions have produced estimates that are either small, statistically insignificant, or not robust to tests of model specification" (Jaffe et al. 1995:157-158).

There are different reasons why the effects of environmental regulation on competitiveness are small. For all but the most heavily regulated industries the cost of complying with environmental regulation is a relatively small share of total cost of production. Even where there are substantial differences between environmental requirements within the internal market and abroad, domestic firms--and other multinationals as well--are reluctant to build less-than-state-of-the-art plants in foreign countries. Finally, even in developing countries where environmental standards, and certainly enforcement capabilities, are relatively weak, new plants normally embody more pollution control than is required.

Therefore, "even significant *statutory* differences in pollution control requirements between countries may not result in significant effects on plant location or other manifestations of competitiveness" (Jaffe et al. 1995:158).

Recently a new view is emerging, that assumes the need to use a comprehensive package of both regulations and economic instruments, and links strict environmental standards with an improvement of competitiveness in the long run. Michael E. Porter's view is now widely shared that "stringent standards for product performance, product safety, and environmental impact pressure companies to improve quality, upgrade technology, and provide features that respond to consumer and social demands. Easing standards, however tempting, is counterproductive" (Porter 1990). Recently, an EPA Conference as well remarked that environmental regulations induce more cost-effective processes that both reduce emissions and the overall costs of doing business. Following these ideas environmental regulations begin to be seen not only benign in their impacts on international competitiveness, but actually as a net positive force driving private firms and the whole economy to become more competitive in international markets.

However, the previous conclusion that environmental protection could promote competitiveness is correct only when a sound environmental policy is effectively in place. In this perspective it should be kept in mind that the main goal of environmental taxes is not to provide new revenues to the government, but to change behaviour. Hence, the impact on competitiveness following the use of environmental charges should be evaluated assuming that the rule of revenue neutrality is really accomplished, that is taking into account also the effects deriving from the cut in other taxes made possible through the use of the revenue of environmental levies. In this case many empirical studies either within the EC or in the United States show that any negative impact on employment or national income tends to disappear.

The use of the revenue is thus as important as the levy of the environmental charge. From this it follows that a sound environmental policy, largely utilising economic instruments, should be shaped in a way such as to take advantage of the possibility to employ both incentives and disincentives for environmental protection. The charge has the main task of internalising external effects so as to avoid a market failure and to include the real costs of the use of natural resources into the decisions taken by producers and consumers. The revenue raised through the levying of the environmental charge could then be used either to cut the rates of other taxes that have a distorting impact on the economy or to provide incentives to smooth the conversion of firms and consumers to the new market conditions, thus overcoming the difficulties--and

the following costs--due to the existence of widespread market imperfections (Convery et al. 1996).

If this view is correctly adopted, a more positive view of environmental policy emerges. The environment can be seen really as a resource, an opportunity, not as a constraint that hinders economic growth. Hence, expenditures for protecting the environment should be evaluated not only as additional costs for industrial production, but somewhat as investments that in the long run could increase competitiveness through a spur to technological innovation. Environmental charges are not only a new burden for industries and consumers, but also a way to cut distortionary taxes and raise welfare.

There is another important feature characterising the possible use of environmental charges. In the modern industrial society a huge change is presently under way. Science is becoming a very important production factor (Gerelli 1995) and Western industrialised countries will be able to face successfully the competition of the industrialising world--where the level of wages is enormously lower--only if the possibilities linked to the use of new technologies are fully exploited and the labour force is highly qualified (Krugman 1994). This structural change requires a further integration of environmental considerations into other policy areas so that an effective model of sustainable growth could be achieved. This highlights another important task for fiscal policy, whose main burden should be lowered on labour and correspondingly raised on the use of natural resources. At the same time, the revenue of environmental charges could be used to promote innovation in the production process and to brush away the manifold obstacles that hinder the change to post-industrial society, whose main characteristic is the enlargement of the advanced tertiary sector, which provides positive effects on natural environment, energy savings, traffic volumes, generally on the functioning of public utilities and on social and cultural structure of the society.

This is the point of view already adopted in the Delors Report (European Commission 1993), where a shift of the main burden of taxation systems away from labour and towards natural resources is strongly suggested in order to promote at the same time an improvement in conditions of the environment and an increase in employment. This view should be enlarged since the whole tax system has to be screened so that most provisions with a negative impact on the environment can be removed, while those with a positive impact are strengthened. The use of the revenue must be scrutinised as well, since revenue neutrality means that the additional tax revenue could be targeted to cut the rates of distortionary taxes, to promote employment through a reduction in tax rates hitting the use of labour or to ease the road towards post-industrial society

with large beneficial side-effects on the environment. As has been underlined recently by the European Commission, progress in this area is urgently needed since current tax policy in the EU "has substantially contributed not only to maintaining distortions in the Single Market, but also--less visibly--to generating unemployment and even to creating opportunities for tax base erosion...When preparing and presenting proposals the Commission will take into account the important issue of the use of taxation instruments for other Treaty objectives. The efficiency criteria for taxation can accommodate policy objectives such as health, environment, energy, transport and others deemed worth by the Treaty" (European Commission 1996).

The Shift Towards New Instruments

In recent years a larger utilisation of environmental taxes has been on the political agenda in many European states in order to overcome, first, the limits of an environmental policy structurally based on command-and-control measures, and furthermore, to provide means enabling the Treasury to cut other taxes with distortionary effects on the economy, such as income taxes with very high marginal rates or social security contributions, mainly those levied on unskilled or low-skilled workers. This kind of manoeuvre could provide a double benefit to the economy, known in the literature as the double dividend (Pearce 1991, Bovenberg et al. 1994, Goulder 1995, Golub 1997).

The use of new economic instruments to replace, or augment, traditional command-and-control measures seems generally quite reasonable, especially in Italy where past environmental policy has shown considerable limits regarding its effectiveness in guaranteeing the conservation of natural resources and the improvement of environmental conditions. Environmental legislation is anchored in the Constitution (articles 9 and 32)--which requires safeguards for the national natural, historic and cultural heritage and recognises the right of individuals to health--and further elaborated through acts of the Parliament. The first example of environmental law regarded the provision of guidelines for air pollution control and prevention (Law 13 July 1966, n.615); it was followed ten years later by the Water Pollution Control Law, regulating the discharge of industrial and municipal effluents into surface and ground waters (Law 10 May 1976, n.319).

This legislation was promoted by domestic forces, having regard to the dreadful amount of polluting effluents cast out in the air and the water, mainly by the industrial system and by rapidly expanding urban traffic. But its effective implementation has been resisted by the industrial sector with the main

justification that Italy was on the way to catching up other European countries and that Italian firms were unable to cope with the costs of extended environmental protection without impairing their external competitiveness. Public opinion, for its part, was not forcefully in favour of more effective environmental measures since it was satisfied by the continuous expansion in the level of real national income and the attendant rise in living standards of both the middle class and workers. The possible trade-off between growth and environmental protection was fully exploited by the industrial sector in order to find the political support needed to avoid the costs of pollution prevention.

At the time, discussion about the possible use of economic instruments in environmental policy was limited within a restricted group of academics (Istituto di Finanza 1970), but this policy orientation was rejected not only by the industrial sector, but also by green groups, who were supporting the use of regulatory measures with a twofold argumentation: first, they assumed that the level of pollution prevention was uncertain when economic instruments were applied, since it was linked to the reactions by producers and consumers to price changes induced by the implementation of environmental taxes; second, the tax was rejected on ethical grounds, since it was considered equivalent to the attribution of a right to pollute.

The succeeding expansion of the overall body of environmental regulation in Italy has been mainly linked to the development of European legislation in this area. In 1982, three Decrees by the President of the Republic were issued: DPR 8 June 1982, n.470, implementing the EC Directive on bathing water quality, allocating responsibilities to Regions (mapping and planning) and local bodies (monitoring facilities); DPR 3 July 1982, n.515, implementing the Directive on the quality required for surface water intended for the provision of drinking water; DPR 10 September 1982, n.915, Waste Law, regulating waste collection, transport and disposal and implementing EC Directives 75/442, 76/403 and 78/319. Accordingly, the main body of environmental rules was established in Italy following the European standards. But this does not imply that there have been ensuing improvements in the level of environmental protection.

As a matter of fact, environmental laws provide formally a set of very stringent conditions, which represent a heavy burden for productive activity without any large positive impact on the environment, for two main reasons:

a) it is very costly and largely unfeasible--due also to the dreadful conditions of the public administration--to check a very large number of polluting emissions. It follows that the risk for the polluters to be punished is very limited and

certainly lower than the advantages flowing from not complying with the constraining normative provisions;

b) if the public authority tries to force compliance with the law, the firms are able in essence to blackmail public opinion, supporting the idea that a trade-off exists between environmental protection and economic growth since environmental protection necessarily implies a cost in terms of employment and output.

If this general remark is correct, it seems that there are good reasons to implement environmental charges in substitution of pre-existing distortionary taxes. The double dividend argument appears sufficiently well-founded, on the basis of the existing literature and specifically on empirical grounds (Majocchi 1996). In any case, it should be taken into account that the revenue from this source is substantially limited. Sweden is always--and rightly--quoted as a country that has been able to implement fiscal reform based on the lowering of marginal tax rates for income taxation, financed by a widening of the VAT tax base and by new environmental taxes. But in this country too the total revenue flowing from the environmental charges represents only about 6% of the global revenue accruing to the Treasury (Ministry of Finance 1991).

Even within these quantitative limits, environmental charges should be positively evaluated since, in contrast to other taxes, they do not cause new distortions, but rather:

- they remedy some distortions already existing in the economic system;
- they provide an incentive to firms to improve their productive choices, looking not only for the maximum profit, but for the "optimal" level of exploitation of environmental resources as well;
- they can be filled in progressively to give firms the possibility to comply gradually with the more constraining level of environmental standards;
- they provide revenue to the Treasury that could be utilised to cut other distortionary taxes.

From a political standpoint, the switch from regulations towards the use of economic instruments has occurred only recently and it has been inspired by domestic and European factors. In Italy, there has been a radical change in the attitude of the green groups, that have been largely disappointed by the poor

results following a long period of implementation of environmental regulations. This change has been further promoted by the new course of environmental policy at the European level. Particularly decisive has been the proposal put forward by the European Commission for an energy/carbon tax to curb emissions of carbon dioxide into the atmosphere and the following debate about the possibility to recycle the revenue of the tax back to the economy in order to cut the rates of existing distortionary taxes and to promote green fiscal reform.

Within the government and the traditional political groups, this idea appears largely convincing since the groups on the right appreciate the option of reducing the rates of income taxes, while on the left a cut in the level of social security contributions charged on top of wages seems to be able to promote effectively an increase in employment opportunities. The industrial sector, however, remains generally opposed to the use of economic instruments. But in some cases it has been possible to overcome this opposition--as in the case of the new landfilling tax (discussed below)--since the problems were clearly unmanageable with the existing rules and there was considerable pressure by public opinion to find new solutions for existing environmental problems.

The remainder of this paper explores the design and effectiveness of new environmental instruments as they have been applied in Italy. Particular attention will be paid to how revenue from new tools is used (fiscal neutrality, subsidies etc.) and to the extent of environmental improvement expected from the implementation of the new instruments.

New instruments in Practice

Revenue and Incentive Taxes

In Italy, there is only a limited number of true environmental taxes (Table 1) and these levies represent a very limited share of total revenue (Table 2). As will be seen in the following paragraphs, taxes are paid at the municipal level to cover the costs of the treatment of urban wastes, while charges are used to finance collection or recycling of particular wastes. Recently a new tax has been introduced on wastes disposal through landfilling and fees are paid for the use of water. These fees have been recently revised in the framework of the new rules established by the Law of 5 January 1994, n.36 (Galli Law) on the management of water resources, that provides for new charges on the complete water cycle. Some regional levies are levied also on quarries.

Table 1 - Environmental taxes and charges

<i>Sector</i>	<i>Type of tax</i>	<i>Objective</i>	<i>Basis</i>	<i>Collector</i>	<i>Payer</i>
Water	Waste water tax	Partial financing collection and treatment	Volume and quality of water	Local water company	User
	Tax on release of polluted water in the environment	Partial compensation of damage	Volume and quality of water	Local water company	Polluting enterprise
Waste^a	Municipal solid waste tax	Partial financing collection and treatment	Area of housing	Commune	User
	Plastic bag fee ^c (L100 per bag)	Reducing consumption of plastic bags	Number of units on the national market	State	Producer Importer
	Plastic containers and packagings for liquid charge	Financing recycling	Primary material produced or imported	National consortium	Producer Importer
Oil	Lubricating oil charge (LS/l)	Financing collection and recycling	Oil sale	Consortium for used oil	Enterprises
Batteries	Lead battery charge	Financing collection and recycling	Battery sale	Consortium for lead battery and lead waste	Producer Importer
Unleaded gasoline^b	Tax reduction	Promoting use of unleaded gasoline	Gasoline sale	State	Benefit to the consumer
Aircraft	Noise tax	-	Noise	State	Airline
CFC^d	Deposit/refund	Promoting collection and recycling or disposal of CFCs	CFC volume	Consortium for CFCs	Buyer of equipment

a) Waste exports to non-OECD countries can only take place after a deposit is made.

b) There are also taxes on motor fuels and on car registration.

c) Abolished in December 1993.

d) Created in December 1993.

Source: OECD (1994).

**Table 2 - Revenue flowing from environmental, energy and car taxes
(as a percentage of total tax revenue)**

	1993	1994
Environmental Taxes		
Tax on urban solid wastes	1.21	1.24
Fee on water treatment	0.25	0.25
Provincial charge for environmental protection	0.03	0.04
Contribution to the mandatory consortium for reuse and recycling	0.02	0.02
Other	0.02	0.01
Total environmental taxes	1.54	1.57
Energy and car taxes		
Tax on methane gas	1.23	1.28
Tax on electricity	0.57	0.58
Tax on petroleum gas	0.17	0.18
Municipal and provincial surtax on electricity	0.38	0.40
Car Taxes	1.79	1.82
Tax on mineral oil	8.60	8.98
Total energy and car taxes	12.74	13.23

Source: ISTAT (1995:332).

A fee was introduced in the past to limit the use of plastic bags, but it has been phased out and replaced by a charge on domestically produced or imported primary plastic material. This seems to be a good example of the difficulties of administrative management of an ecologically-oriented charge. The excise on plastic bags was first introduced on 9 November 1988, the rate was 100 lire for each bag not bio-degradable. The definition of bio-degradability proved highly controversial, and has entailed first an extension of the fee to all plastic bags, disregarding the degree of bio-degradability, then the mutation of the excise into a charge on virgin polyethylene films (the raw material from which the bags are produced) in order to finance the statutory consortium responsible for the recycling process. The decision to change the taxable basis of the fee was followed by the granting of a large number of exemptions: for instance, the Law of 28 December 1995, n.549 [Article 3(41)] granted a subsidy to agricultural producers who give back the residuals of used polyethylene films so that the disposal of wastes into landfilling sites could be reduced. Hence, the revenue has collapsed: from 92.4 billion lire in 1993, to only 11 billion in 1995. In any case, the tax had a positive impact on consumers' behaviour, obliging them to recognise that a plastic bag has an economic value and thus favouring a more effective use of the bags, through the provision of a real incentive in favour of their reuse or the adoption of more long-lasting containers.

Regarding municipal waste management, all capital costs for the construction of municipal waste treatment plants and landfills are currently funded by the central government. Operating costs for the collection, treatment and disposal of wastes are covered by a municipal solid waste tax, up to now calculated according to the surface area of the dwellings. But a change in this structure is now under way (see below).

Economic instruments are also used to support the recycling of plastic containers, lead batteries (with a charge that was reduced on November 1, 1996 to 200 lire for small batteries and to 1600 lire for large ones, allocated to the statutory consortium dealing with lead waste which recuperated a total amount of 153,000 tonnes in 1995) and lubricating oil (with a unit charge of 5 lire per litre also allocated to the relevant consortium dealing with used oil). The objectives of these charges are twofold: first, promoting an increased saving in the use of these materials; second, funding the functioning of these consortia that are charged with the recycling of the wastes. The same scheme has been recently adopted with the new rules implementing the EC Directive on packaging.

Six Regions have already introduced a charge on extraction of materials from quarries. Sometimes the charge is measured according to the market value of the extracted materials; sometimes the environmental impact is taken into account when establishing the amount of the charge, following the different impact on the territory and the environment. The total amount of the charge is due to the municipalities, which are obliged to use the revenue to fund reclamations of the sites and works of environmental improvement.

The only kind of taxation that is really important in the environmental field--also from the point of view of the revenue raised--is related to energy taxes. In Italy, excises are levied on all kinds of fuels except coal (Table 3). Quite clearly energy taxation has been implemented on revenue, not environmental, grounds. The main reason underlying this choice has been the very low elasticity of energy demand, which either minimises the excess burden of indirect taxation or provides a large amount of money to the Treasury. The revenue is very important from a quantitative point of view and is also relevant in an international comparison: according to a recent evaluation by the Central Institute of Statistics, the revenue flowing from this source--including car taxes--amounted to 13.23% of total revenue in the year 1994 (Table 2).

Table 3 - Energy taxes in Italy

<i>Mineral Oils</i>	<i>Methane</i>	<i>LPG</i>	<i>Electricity</i>
Excise on Mineral Oils	State Consumption Tax	Excise	State Consumption Tax
Regional Surtax on Gasoline ^a	Regional Surtax	Value Added Tax	State Surtax
Value Added Tax	Value Added Tax		Provincial Surtax ^b Municipal Surtax ^b Value Added Tax

^a In 1993 introduced only in Piemonte and Puglia

^b From 1994 the revenue flows to the Treasury. The removal of these surtaxes is forecast in the Financial Law 1997

It should also be noted that the per capita revenue from energy taxes varies widely according to regions. It is nearly twice as high in the North than in the South (Table 4). The reason is linked to climatic factors (heating is only significant in the North) and to existing differentials in the industrial structure (firms are mainly located in the North). Since the distributive impact of energy taxation is generally considered one the weakest features of energy taxation, this point is quite important since income levels are lower in the South than in the North. Following this high level of taxation, energy intensity in Italy is comparatively lower than in other industrialised countries.

**Table 4 - Energy taxes (without VAT)
Revenue distribution among regions**

	NORTH	CENTRE	SOUTH	ITALY
Electricity	1.211	.453	.472	2.136
Natural gas	3.944	.987	.352	5.283
Mineral oils	19.390	8.268	10.007	37.765
LPG	.401	.108	.224	.733
Total	24.946	9.916	11.055	45.917
Inhabitants (thousands)	25.550	11.012	21.184	57.746
per -capita revenue (thousands)	.976	.900	.522	.795

Source: Ministry of the Environment

While taxation of energy is normally justified by revenue purposes, tax differentiation between leaded and unleaded petrol has been introduced specifically for environmental purposes. The tax difference has varied in percentage between 6.9% and 10.6%, but it has been sufficient to increase the market share of unleaded petrol from 9.6% in 1992 to 33.8% in 1994 (Table 5). In this field the Italian policy has followed the implementation of EC laws. But, given the good result already achieved, it seems now that such tax incentives could be more effectively utilised to curb the amount of other pollutants included in petrol, for instance benzene.

Table 5 - Tax differentiation between leaded and unleaded petrol

year	leaded petrol tax Lire/litre	unleaded petrol tax Lire/litre	difference
1990	885.7	822.7	63.0
1991	917.9	854.8	63.1
1992	910.8	847.8	63.0
1993	942.7	853.0	89.7
1994	1019.1	911.0	108.1
1995	1097.8	989.8	108.0
1996 (January)	1111.5	1022.3	89.20

Source: Ministry of the Environment

The Carbon-Energy Tax

Following the approval by the European Commission of the proposal for a Council Directive introducing a tax on carbon dioxide emissions and energy (European Commission 1992), the debate in Italy about environmental taxation was fuelled by the presentation of the White Paper on fiscal reform by the Finance Minister in December 1994 (Ministero delle Finanze 1994). A few days later the government resigned. Consequently, there has been no official discussion within the Parliament of this document, but nonetheless the White Paper represents the climax of a lengthy political and cultural debate and can be considered an effective basis for a fruitful discussion about the future of the Italian fiscal system—even if the structure of the proposed reforms is sometimes controversial (Fossati et al. 1996).

This remark is particularly true when environmental taxation is directly taken into account. In the White Paper--for the first time in an Italian official document--a Pigouvian tax has been carefully considered as a mainstay of the fiscal system. In particular, the White Paper defines the three main goals of fiscal reform:

a) fiscal federalism. In Italy, starting from the fiscal reform of 1971 there has been a substantial centralisation of the tax system and local and regional authorities derive the majority of their funds from grants or revenue-sharing. The proposal is to shift a large amount of taxes from the centre to the periphery in order to enhance the efficiency of public expenditure and to promote the responsibility of local authorities;

b) limits on personal taxation. Due to the combination of a very progressive income tax and a high level of inflation in previous decades, the amount of revenue raised through direct taxation is now overwhelming. The proposal is to shift a large fraction of the tax burden away from personal income and to tax "goods" to a greater extent. In this context, environmental taxation is clearly included;

c) simplification. In Italy four taxes (personal income tax, VAT, excise on gasoline and the withholding tax on interests) provide with great efficiency and little equity some 72% of total revenue. Sixteen taxes, including these four provide some 97% of total revenue. The proposal is to call a halt to the Italian "one hundred taxes" (Tremonti et al. 1986) and to limit the complexity of the tax system, which favours extremely widespread tax evasion and represents a particularly negative feature of the current tax system.

The White Paper accepts the suggestion put forward in the Commission's proposal, to introduce an energy/carbon tax with a revenue amounting to about 10 trillion lire. This additional revenue could be recycled back to the economy by cutting the level of other tax rates in order to exploit a double dividend in the manner outlined by the Delors Report: the first dividend is provided by the curbing of the carbon dioxide emissions into the atmosphere, the second by the diminution of the *deadweight loss* associated with the existence of distortionary taxes.

The White Paper embraces the idea of recycling the revenue through a cut in personal income tax rates. Hence, households will be compensated for the increase in energy taxation, while firms will be obliged to face the increased burden of the new taxes targeted to enhanced environmental protection. The political reason lying behind this choice--which explains why the European

suggestion to use the revenue for cutting rates of social security contributions has not been adopted--probably is linked to the fact that the White Paper has been prepared by the Ministry of Finance, which is not responsible for the social security contributions and wanted to exploit the political dividend of cutting income tax rates.

The choice that has been adopted corresponds to the general goal of shifting the burden of taxation away from persons and onto goods. In the White Paper a suggestion is put forward to cut the highest tax rate from the current level of 51% to 40% or 45% according to different options, and to reduce the average rate for the majority of taxpayers to below 25-30%.

A revision of energy taxes is envisaged, following the general ideas prevailing in the European debate, according to the carbon content of each energy source, while ensuring that an effort is made to keep the relative tax burden between the different sectors, i.e. households, industry, transport, generally constant. In line with the overall inspiration of the fiscal reform project, existing energy taxes are included in a General Energy Tax that applies the same regime to all the different energy sources and is strictly co-ordinated with VAT.

The tax increase will be applied to the industrial sector only if a decision is taken at the European level to implement a common carbon/energy tax. This provision is considered unavoidable since a unilateral implementation of the carbon/energy tax will significantly weaken the overall competitiveness of Italian industry. Increasing existing energy tax rates would provide an additional revenue amounting to 10 trillion lire according to two different options that are considered in the White Paper, each of which calls for an increase in the price of energy of about \$7 for a barrel of oil equivalent, largely similar to the European proposal that results in a price increase of \$10 per barrel of oil.

The economic impact of this manoeuvre is different in the two scenarios (Majocchi 1996). In the first case, all the energy sources and all the sectors--households, industry and transport--would be charged by the new energy levy, shaped according to the carbon content of each energy source. In this case it is assumed that an agreement has been achieved at the European level for a harmonized implementation of the new energy tax. Furthermore, in the White Paper the new tax burden is modulated in a way that leaves substantially unmodified the relative prices in the different sectors and is equivalent to a price increase of 126 lire per liter of gasoline and 142 per liter of diesel.

In the first year following the implementation of the maneuver--and taking into account also the impact of the cut in income tax rates--GDP increases by 0.56%, while in the successive years it remains more or less stable. The consumption price level increases in the first year (+0.75%), but then the rate of growth diminishes rapidly, while the price impact on production costs in the industrial sector is more sensible in the first year (+1%), but in the following years it tends rapidly towards zero.

In the second scenario, where it is assumed that no harmonization takes place at the European level, industry is not charged and the new tax burden--that is shaped accordingly to the carbon content of each source--is concentrated upon households and transport, while the price changes following the maneuver are not proportional to the previous prices in the different sectors. In this case gasoline price increases by 161 lire per liter, while diesel price increases by 182 per lire.

The impact on consumption prices is very similar, while it is naturally different as far as industrial prices are concerned since industry is exempted in this case. But it is important to remark that the growth rate of GDP is practically the same as in the first hypothesis. Exemption of the industrial sector has no real impact on the growth of the economy.

These are the main economic changes that would follow from the implementation of this proposal of fiscal reform regarding the increase in energy taxes, whose revenue is targeted to a cut in income tax rates. The most important effect of this maneuver, however, will regard the environment, since it provides a very relevant impact on air quality. The combined index of air quality--including carbon dioxide emissions, SO₂, NO_x and particulates--declines from 97.1 in 1994 to 95.4 in the year 2000 in the reference scenario and to 92.6 taking into account the impact of the maneuver, while the rate of growth in the emissions of carbon dioxide drops from 110 in the reference scenario to 106.25 in the year 2000 (100 being the index level in 1990).

Recent Waste and Water Taxes

Up to now, there has been no specific follow-up to the proposals included in the White Paper. In any event, however, they have yielded one important result: the debate about the use of environmental taxes has been refuelled, and the limits of an exclusive use of regulations in the field of environmental policy have been largely recognised. As a result of this renewed consciousness that a more balanced mix of regulatory and economic instruments is needed in order to achieve a more effective policy, the Ministry of the Environment has been able

to suggest the inclusion of the proposal for a new landfill tax in the draft budget for 1996, which was approved by the Parliament in December 1995.

The goal of the tax is to eliminate one of the reasons which justify the adoption of this kind of waste disposal, that seems the most noxious to the environment. In particular, the Ministry of the Environment had identified two central problems with the current arrangements in the area of waste management: the costs of waste disposal faced by the individuals are not related to the amount of waste they discard, nor do they reflect the true economic or environmental costs of the waste disposal method; the lack of relationship between the waste produced and the price charged for collection and disposal represents a clear failure with respect to the implementation of the "polluter pays principle".

Landfill has traditionally been the favoured option for disposal in the EU. Five member states, including Italy, currently rely on landfill for more than 80% of their waste disposal. One solution becoming increasingly popular to halt this dependency is the landfill tax. By adding to the costs of landfilling, the tax modifies the relative prices among different waste management options, creating a disincentive to landfill relative to other waste disposal options, thus favouring a shift in waste management one step up the hierarchy, i.e. toward incineration with energy recovery. But even if this is a step in the right direction, it must be underlined that a landfill tax on its own is unlikely to achieve by itself an increase in the level of recycling.

The landfill tax was introduced in Italy by the Law of 28 December 1995, n.549 [Article 3 (24-40)]. The goal of these provisions is to favour a lower production of wastes at the source and the recovery of energy and raw materials from wastes. From 1 January 1996, landfilling site operators must pay the tax to the Regions and will, therefore, raise their charges to waste disposers. The taxable base is represented by the weight of wastes, and the tax rate is differentiated taking into account the environmental impact of different kinds of wastes. The rate for inert wastes can be chosen by the Regions between 2 and 20 lire for kg; for special wastes between 10 and 20 lire, for urban and assimilated wastes between 20 and 50 lire.

The expected revenue for the Regions in 1996 amounted to over 1 trillion lire. One fifth of it must be devoted to a special regional fund that could provide incentives to favour lower production of wastes, to recover energy and raw materials from wastes, to reclaim contaminated sites and to finance the creation and conservation of natural protected areas. The original idea was that a larger share of the revenue should be used to fund environmental improvements; but

this possibility has been excluded due to the pressure by the Treasury trying hard to cut the amount of the overall deficit in order to comply with the financial constraints established by the Maastricht Treaty.

One of the risks linked to the adoption of a landfill tax is the promotion of fly-tipping. In order to avoid the illegal disposal of wastes, the law establishes a shared responsibility--in the payment of the tax and the related fines--of the waste-disposers together with the user and/or the owner of the land where the disposal takes place, while keeping unchanged the criminal sanctions against this type of activity.

This tax was conceived as an important instrument to change relative prices of different kinds of waste disposal. The important point is that the tax must be seen as only a part of a general strategy to reduce the amount of wastes going to final disposal without any treatment. The decision to implement new economic instruments in this field has been backed by the promotion of voluntary agreements with important industrial sectors--mainly cement and electricity production--to use RDF as an alternative fuel. The use of this instrument--the carrot--has been successful since it was supplemented by the implementation of the tax--the stick.

This change in policy has led to adoption by the government of new legislation on wastes, which transfers into Italian law all the previous Directives approved by the European Union (91/156, 91/689, 94/62). One important point of this new legislation, approved by the Council of Ministers on 30 December 1996, is the adoption (Article 49) of a two-part tariff for the collection and treatment of urban wastes, in substitution for the pre-existing tax on municipal solid wastes: the first part of the tariff is targeted to cover the investment costs needed to provide the waste treatment, the second part is proportional to the amount of wastes produced and to the operational costs of the treatment.

The idea is to promote a reduction at the source of the amount of wastes produced and, at the same time, to support the industrial sector that should necessarily emerge in order to achieve the ambitious recycling target established by the new legislation. In particular, the six year target for municipal solid wastes is an amount equal to 35% of separate collection (Article 24); for packaging, the following five years targets (by weight) should be reached (Article 37): reuse as raw materials or for energy recovery between 50 and 65%, recycling between 25 and 45%, with a minimum established for each packaging material.

Finally, according to the provisions defined by the Law of 5 January 1994, n.36 (Galli Law about the management of water resources), a new tariff has been established for the use of water resources (Article 13). The new regulation of water tariffs was recently approved by the Italian Ministry of Public Works (Decree 1 August 1996, published in the Official Journal on 16 October 1996). This new regulation provides a sort of benchmark to define both the composition of total costs and water charges to be implemented. It is supposed to lead both to an increase of prices paid by consumers and to efficiency gains to the extent that a "price-cap" is also gradually introduced.

The new regulation should also break with a past where tariffs were mainly set according to macroeconomic and distributional aims--in order to keep water charges very low compared with those prevailing in the other countries of the European Union--and cost issues played a minor role. The composition of the new tariff is supposed to be defined following the decree of 9 April 1991, n.127, that in turn is based on EU Directives 78/660 and 83/149.² The new legislation is to be revised after incorporation in Italian law of Directive 91/271. The opportunity cost of water use is not considered, but this is firmly in the Italian tradition of price regulation made by lawyers and engineers, without intervention by economic analysts.

Promoting Green Tourism

Some interesting ideas are currently floating around about the possibility of using economic instruments to internalise the external costs generated by tourism and to promote sustainable tourism. Due to the existence of these external costs, tourism demand is too high since prices do not reflect true social costs. At the same time, it must be remarked that the benefits of tourism flow largely to the private sector, while the costs for the conservation of the artistic and natural estate are mainly borne by the public sector.

The concept of carrying capacity is highly relevant in planning for sustainable tourism development. It determines the limits of development and visitor use of an area without degrading its environmental quality or the visitor experience, and helps to establish the optimum use of tourism resources.

² The benchmark tariff in the new legislation has the following structure:

$$T_n = (C + A + R)_{n-1} * (1 + \Pi + k)$$

and is actually based on the notion of "Full Cost Recovery" as C are operation costs, A represents capital depreciation and R represents the return on capital investments. Prices increases are limited by Π : the rate of inflation and by K: the price cap, that, after the first year of implementation of the new legislation, will vary between 5 % and 10%.

Carrying capacity, in the general philosophy of a win-win strategy, is supposed to combine economic as well as environmental arguments. The aim is to find the optimal combination of both interests. This may lead to a compromise whereby from neither an environmental, nor from an economic point of view, is the best solution selected (DRI 1994).

In Italy 35.7% of total tourism is represented by international tourism, which is evenly divided between tourism from the European Union and from abroad. Italy suffers particularly from pressures on the urban environment caused by tourism. The implementation of a rigorous carrying capacity policy in historic cities will positively impact their future development. From this perspective it also seems relevant that pricing devices could be implemented with a twofold goal: to limit the level of demand and to provide financial means for conserving Italy's historic and artistic estate.

For many years Italy has implemented a form of taxation on tourism through the visitors tax, paid by people visiting a tourist site according to the number of nights spent in hotels. But this tax was cancelled in 1989 in order to promote tourism (disregarding its environmental impact) and is currently implemented only on a regional basis in Trentino-South Tyrol. The limit of this tax is that it hits only one kind of tourist services. A discussion is currently under way about the possibility of re-introducing this kind of taxation in the Italian tax system. A differentiation in the tax rates according to the different prices paid in hotels could be considered for equity purposes.

A proposal along these lines was included in the Draft Financial Law for 1997. Article 74 foresees that municipalities have the option to levy a tax on non-residents in the area who spend a night in hotels or other residential facilities, in this case only if the house has been rented through an agency in order to guarantee effective oversight and enforcement of the tax provisions. The tax could be varied according to the price of accommodation, with a maximum limit of 5%. But the possibility of using the visitor tax to promote sustainable tourism was rejected during the debate within Parliament, mainly for political reasons, since the Financial Law was already establishing a large increase in the amount of overall taxation and the Government did not want to be characterised as excessively taxation-prone. Hence, the topic is still on the political agenda and many Italian historic towns seem interested in adopting this kind of environmental tax.

A different solution is now under discussion in the Trentino-South Tyrol region. The idea is to bring in two different types of taxes:

- a tax on tourist services to be paid not only by the hotels, but also by the owners of other activities whose earnings are affected by tourism.³
- a visitors tax to be paid by people that use secondary houses in a municipality different from their own. Taxation of secondary houses is currently accomplished by increasing by one third the revenue flowing to the owner. However, since the income tax is levied on the average (normal) revenue, the disincentive effect on the ownership of secondary houses deriving from this provision is largely limited.

Conclusions

In conclusion, there has been a certain shift in Italian environmental policy towards a greater use of economic instruments. This change can be explained by two different pressures:

- a) the costs of the extensive but largely inefficient body of current regulations, that provide a huge burden for the Italian industrial structure without significant improvements in the state of the environment;
- b) the model of EU legislation, where a greater use of economic instruments is forecast.

This does not mean at all that this extension in the use of economic instruments is uncontroversial. The industrial sector is more opposed to new taxes and charges than to regulations, a position whose main justification lies in the assumed negative impact of environmental taxes on competitiveness. But a more positive view is now emerging, especially in the context of a greening of the tax system (Moret, Ernst & Young 1996), as suggested in the White Paper on Fiscal Reform. This is probably the main point emerging from an overview of the Italian experience. The level of taxation is currently considered too high and it is quite difficult to suggest the implementation of new taxes, even for environmental purposes. A larger use of economic instruments is conceivable only if the revenue flowing from these new taxes and charges--targeted to improving environmental conditions--is used to cut the rates of pre-existing

³ The tax base is represented by 100% of the turnover defined according to VAT rules for operators acting directly in the tourist sector, while the share of the turnover on which the tax is levied will be lower for other operators that are involved in activities that are not totally dependent on the tourist sector. The tax administration could be managed according to the rules defining the VAT tax base and the taxpayers could recoup their tax duties at the same time that they fill in their VAT form.

distortionary taxes. This means that the underlying philosophy must be similar to the one adopted by the European Commission's proposal for an energy/carbon tax or to the idea put forward in the Delors Report: a cut in the level of taxes levied on labour, funded by the revenue of environmental taxes.

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