

*EU - Fuel and vehicle  
tax policy*

5084

REPORT

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## Preface

The sustainable transport system is among the great challenges for society today - and tomorrow. A wide range of environmental problems have to be solved, at the same time compatible with environmental, social, and economic goals.

Within the transport sector already a fair amount of measures have been taken to lessen the burden on the environment. In order to achieve an environmentally sustainable transport system more action is needed. The integration of environmental concerns into policies and decision making processes has to be extended and deepened.

In a joint report back in 1996 eleven Swedish stakeholders within the field of transport and environment defined an environmentally sustainable transport system (EST) in terms of a number of goals. The stakeholders assumed that the goals could be reached within 25-30 years. The Swedish EST-project, *inter alia*, stressed the importance of international co-operation.

Acting on that conclusion, the Swedish National Road Administration, the Swedish National Rail Administration, the Swedish Civil Aviation Administration, the National Maritime Administration, the Swedish Institute for Transport and Communication Analysis, the Swedish Transport and Communication Research Board and the Swedish Environmental Protection Agency now have rejoined their forces and is jointly running the project *Euro-EST*.

The objective of the *Euro-EST* is to promote co-ordinated and integrated environmental actions in the transport sector with a view of achieving an environmentally sustainable transport system in Europe.

This report deals with fiscal instruments, including taxes on fuels, vehicles and infrastructure use, and their possible contribution to an environmentally sustainable transport policy for the EU. It analyses the various interests and processes underlying the development of such policy at the European level and the various obstacles to further exploring these instruments.

The report was written by Malcolm Fergusson at the Institute for European Environmental Policy in London. The author is responsible for the content of the report, as well as for the conclusions.

SWEDISH ENVIRONMENTAL PROTECTION AGENCY, Stockholm, June 2000

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## *Executive Summary*

This report addresses fiscal instruments, including taxes on fuels, vehicles and infrastructure use, which could contribute to an environmentally-sustainable transport policy for the EU. It analyses the various interests and processes underlying the development of such policy at the European level, explaining the existing state of play, the problems which are caused by current arrangements, and the various obstacles to further greening of the motor taxation system.

It finds that there are currently some significant disparities in the structures and rates of taxation on fuels and vehicles across the EU. Fuel tax rates vary considerably from state to state, with some states profiting from sales of cheaper fuel to outsiders, while others are inhibited from raising duty to desired levels because of this cross-border competition. Annual vehicle taxes are also very variable, not only in the level of taxation, but also in the criteria on which the tax is based. This distorts the market in vehicles across the EU, to the detriment of manufacturers and others.

Equally, the application of road user charging either on long-distance routes or in urban areas is very patchy and essentially in its infancy. In many cases, duty rates are graduated only loosely if at all to reflect environmental factors, and their effectiveness in promoting environmental goals is currently likely to be limited. Several European states now have more or less ambitious plans for road pricing at the national level, but an EU-wide scheme is still many years off.

Disparities in taxation practice arise from a very broad range of historical factors and different political priorities on the part of Member States. They may however have an adverse effect on the operation of the single market, and certainly cause a number of specific problems for Member States with high duty rates – notably with fuel tourism, fuel tankering, competitiveness of national road hauliers, and in some areas, smuggling.

It can also be argued that these problems will be exacerbated in a number of ways as the EU enlarges eastwards, and the inertia which leads to slow progress on internalising external costs will be greatly increased. More rapid progress on harmonisation of minimum duty rates is therefore highly desirable.

The polluter pays principle and the requirement to internalise external costs are now enshrined at the level of principle in EU policy, and a number of initiatives have been instigated in order to put them into practice. These have included moves towards fair and efficient pricing through road charging; harmonisation of minimum rates of VAT and fuel duty; further efforts to harmonise energy taxes; and the Eurovignette Directive. However, progress to date has been very limited and painfully slow. Fiscal harmonisation has been to the lowest common denominator, with some basic minimum rates, but inflation and policies towards higher fuel duty rates have rendered these essentially irrelevant in most Member States. Further progress is still possible, but appears far from certain. At the root of this lack of progress is the unwillingness of a number of Member States to cede any competence in fiscal policy matters to the Community, and the benefits which some derive from lower tax rates (Section 5).

It may be that monetary union will in the longer term exert pressure for harmonisation of fuel and other taxes. However, the report points out that this may lead to a 'race to the bottom' in terms of competitive taxation, and cannot be relied upon to produce an outcome which ensures a reasonable level of environmental protection. Other measures to foster environmental taxes are therefore needed as well.

Also, while some Accession States have already brought fuel duty rates up to levels comparable with those of their EU neighbours, others have not. Accession will force states to raise duties at least to the minimum levels required by the EU, but will also increase the inertia which blocks further harmonisation and internalisation of external costs. Early progress is therefore essential.

Accordingly, the report goes on to suggest ways in which the development of policy could be taken forward, emphasising that the accession of Sweden to the Presidency of the Council in 2001 comes at an important time to influence the development of environmental taxation policy towards motor vehicles and fuels.

The current IGC presents the first critical opportunity to progress changes towards a more workable voting basis for environmental taxation. The arguments for harmonisation here are far stronger than elsewhere, but have yet to be made effectively, or receive any serious attention, in the IGC. A blanket switch of all fiscal decisions to QMV is unimaginable; but without some changes, further moves on environmental tax harmonisation will move from difficult to virtually impossible. A number of possibilities exist which might help to shift these measures from unanimity to QMV voting. These include a close and limited definition of the measures to be covered; pursuing a change primarily to Article 175 rather than Article 93; and considering the application of 'super-QMV' to ecotaxation or other fiscal measures.

Further improvements to existing legislation on minimum duty rates should also be considered, as these are now pressing on the Community's legislative agenda. Possibilities include the index-linking of minimum rates, and linking progress on minima to each Member State's GDP per capita. More work is still needed to address the concerns of blocking states, notably Spain and Luxembourg, however.

Border and sectoral relief schemes offer relatively little scope for mitigating the effects of cross-border duty differentials. However, shifting the balance of motor taxes away from fuel tax might help to solve or mitigate some of the current problems.

An 'Eco-Schengen' initiative by like-minded states offers only limited advantages in pressing ahead with higher fuel taxes. It does not overcome the fundamental problems of border price competition, and would be better directed towards harmonisation of other types of motor taxation, such as circulation taxes .

Beyond currently-conceived measures, sectoral integration strategies in the Council of Ministers and the need for a more coherent climate strategy in the transport sector might

also present additional opportunities for further harmonisation of environmental taxation. Early resolution of all of the problems set out in this report cannot be expected, but there are opportunities for further progress.

## **1. Introduction**

This report builds on earlier work undertaken by the Swedish Environmental Protection Agency (SEPA) on an Environmentally Sustainable Transport System for Europe (SEPA, 1996). The Institute for European Environmental Policy London (IEEP) has already undertaken a study for SEPA as part of this programme (Skinner and Fergusson, 1999) and this report develops the work further.

In order to develop a sustainable transport system at the European level, it is important that the decision-making process allows the development and implementation of policies that could contribute towards the attainment of such a system. In line with the principle of subsidiarity, these should be developed and implemented at the most local level possible, which will, in many cases, be at the Member State or even local level. However, as some policies, such as those relating to the internal market and some environmental issues, are developed at the European level, in many cases, some degree of policy development relating to transport must also be undertaken at the European level. This may simply take the form of setting the framework to allow each Member State to implement its desired policy, or it may involve more specific and directive measures.

As outlined by Skinner and Fergusson (1999), there is a wide range of instruments that could contribute to a sustainable transport system, if they were implemented appropriately. This report focuses on fiscal instruments, including taxes on fuels, vehicles and infrastructure use, which would be an integral part of any such policy package. However, as the development of fiscal policy currently requires unanimity within the Council, the decision-making process can be slow, to say the least. The aim of this report is to look at the process underlying the development of such policy at the European level. It examines the existing state of play, including problems that are caused by the current system and obstacles to greening the system. It then suggests ways in which the development of policy could be taken forward.

The report is divided into eight sections. Section 2 provides a general background to the EU, existing policy principles and the range of potential instruments available. Section 3 summarises the existing situation in EU Member States in relation to the use of fiscal instruments and Section 4 examines the problems caused by differences in policies and prices. The following section summarises the efforts that have been made at Community level, both to harmonise and green the taxation of transport. Section 6 addresses some specific obstacles to further harmonisation and greening of the European transport taxation system, while Section 7 discusses a range of possible solutions or policy approaches that could be employed to overcome the existing difficulties. Section 8 concludes the report by summarising the principal conclusions and recommendations.

## **2. Background**

### *2.1 The Treaty of Rome, the Internal Market and the Common Transport Policy*

From its inception, the primary purpose of the European Economic Community was the promotion of trade as a means of uniting post-war France and Germany. This new internal market required not only the abolition of barriers to trade, common standards, etc, but also provisions for the free movement of goods. As such, transport was seen to be at the heart of the Treaty of Rome, which specifically provided for a 'common transport policy'.

In practice, however, progress was largely blocked until the coming into force of the Single European Act in 1987. Both France and Germany had a policy of defending their railways from competition by road and imposed quantitative restrictions on lorry movements. They therefore resisted the Commission's attempts to establish the 'common rules' called for by the Treaty to open the market for hauliers from other countries. Although this inactivity at the heart of the Community may have had benefits from an environmental point of view, it was seen as a serious failure of the Common Transport Policy (CTP), and hence of the Treaty.

As a result, the European Parliament took the Council to the European Court in 1982, and in a landmark judgement in 1985, the Court upheld the claim that the Council had failed to take necessary action to uphold the requirements of the Treaty in this respect. On the other hand, the Parliament failed to provide any definition of what course of action would have fulfilled the requirements. The Court therefore focused on the specific issue of the right of carriers to provide services in any Member State, finding that the arrangements as they then stood constituted a clear and specific breach of the Treaty. The Court therefore declared that all inland transport should be open to firms throughout the Community, without any discrimination: a judgement which gave fresh impetus to this particular aspect of the CTP. The judgement coincided with a Commission White Paper on the completion of the single market; and as a result the package of road freight liberalisation measures leading up to 1992 was introduced.

The point of this discussion is to emphasise that the CTP is in one sense a fundamental aspect of the Treaty of Rome, yet in another is still quite recent in its application and effects. Also, the Court's ruling gave impetus to one particular manifestation of policy – road freight liberalisation – arguably at the expense of others. There was for example little emphasis on the environmental implications of these measures at that time, and it was rather later before serious attention began to be paid to environmental policy.

## 2.2 *Enlargement of the EU*

It is now more than ten years since the destruction of the Berlin Wall heralded the spectacular political changes which were to sweep across the former communist states of central and eastern Europe. Although much has changed in this time, a new political and economic stability still appears to be a long way off for many countries in the region. This has given rise to a wide range of concerns amongst governments in western Europe.

As a result, enlargement of the EU to the east is now seen as a central and urgent priority for the EU, both by the Commission and by the Member States. This will be argued below to have important repercussions for future EU policy on transport taxation. On the other hand, it must be stressed that environmental considerations in general fall rather low in the list of geopolitical considerations which are motivating the accession process (with the notable exception of some processes taking place in the Baltic region).

From this perspective it might seem that eco-taxation would be a low priority for the accession process, and that long derogations might be allowed from minimum levels of duty. If, however, disparities in tax rates were considered to be sufficient to adversely affect the single market, then the Commission might take a more active stance in its accession negotiations with the countries of central and eastern Europe than it might with other 'environmental' measures.

## 2.3 *Sustainable Mobility and Internalisation of External Costs*

In the late 1980s, the argument was increasingly made that the completion of the single market would increase the volume of transport (particularly road transport) with major environmental effects. This was reflected in particular in the report (published in 1989) of the Task Force established by the Commission to consider the effect of '1992' on the environment, which modelled the increase in acid emissions which would result from the completion of the internal market.

Furthermore, successive revisions to the Treaty first established and then strengthened the requirements to integrate environmental concerns into other policy areas as from 1987. These pressures required a more holistic policy statement from the Commission, and resulted in the Green Paper and subsequent White Paper on sustainable mobility in 1992 (CEC, 1992e and 1992f). In the White Paper in particular, there is a marked emphasis on a balance between environmental protection and other social goals, but no clear indication as to how far those measures which were set out in the Paper would take the Community towards sustainable transport systems. There were on the other hand quite clear references to the scale of external costs incurred through transport use, and a strong emphasis on the need to internalise these costs as a means of improving environmental performance and redressing modal imbalances.

Indeed, Fergusson *et al* (1994) argued that, as realisation grew about both the scale of the environmental problems of the transport sector and the limitations of technical interventions, the internalisation of externality costs came to be viewed as a

'philosopher's stone' which would transform the Community's basic policy areas (economic growth; single market; social policy and environment) into a coherent strategy for sustainable mobility. This in turn led to the Green Paper on fair and efficient pricing (CEC, 1995) and the later White Paper on infrastructure charging (CEC, 1998).

The first of these set out the arguments that further internalisation of costs was needed, and outlined the range of policy options available. It also addressed the critical issue of when (or whether) Community action was needed in this area. Since it relates more closely to specific policy measures, the later White Paper initiative is described in greater detail in Section 5.1.

#### *2.4 Further Integration of Environmental Considerations into Community Policy*

As outlined above, transport policy was from the outset regarded as a central pillar of the treaty of Rome. The same cannot be said of Community environmental policy, however. Haigh (1999) outlines the limited legal basis and the rather late start (in 1973) of an environmental policy proper in the Community. Even then, the focus remained on 'mainstream' environmental legislation. Weaknesses in the wording of the Treaty contributed to – or perhaps reflected – the very limited extent to which environmental concerns were being integrated into the policy process in areas outside of 'mainstream' environmental policy.

The Council eventually began the process of integrating environmental concerns into other areas of Community policy at the Cardiff European Council of June 1998. The process was based on a Swedish request put forward at the Luxembourg Council of December 1997 to draft a strategy to implement the commitment in the Amsterdam treaty, which came into force in May 1999, to integrate environmental requirements into all of the Community's policies and actions. The Cardiff Council asked three Council formations, including energy and transport, to start the process and to present initial integration strategies to the Vienna Council of December 1998.

As with the other strategies presented at Vienna, the Transport Council's report was disappointing, and represented little more than an outline of a possible strategy. Reflecting the limited progress made, the three formations were asked to further develop their strategies with a view to presenting them at the Helsinki Council in December 1999. The Vienna Council also called on the development, internal market and industry Councils to develop strategies and interim versions of these were also presented in Helsinki. In a report on the revised versions of the first three strategies as presented at Helsinki, the Commission concluded that the transport strategy was 'well advanced', but the energy one merely reflected existing commitments.

In the interim, the Köln Council of June 1999 increased further the number of Councils of which an integration strategy was required, to include the Economic and Financial Questions Council (ECOFIN). ECOFIN has yet to produce any reports, although it has to report back to the European Council in the course of 2000. Developments in the integration process are considered further in Section 7.

## 2.5 *Fiscal Policy Instruments*

A wide range of fiscal instruments is applied to the use of road transport in the European Union. The main categories of these are as follows:

- Vehicle purchase taxes (VAT and others);
- Circulation taxes (annual registration tax);
- Scrappage incentives;
- Fuel duties (VAT and others);
- Road use charges (road or bridge tolls, Eurovignette, weight-distance taxes, urban road pricing, etc).

All of the above are in use, or have been used, in some or all of the EU's Member States. Additional measures have been discussed or may be used in the future, such as tradeable credits on vehicle purchases, more advanced distance charging systems, etc. In all of these cases, the measures may be used to ecological advantage by imposing higher charges on environmentally damaging vehicles, fuels or activities in order to discourage them, or differentiating charges to favour environmentally 'greener' options.

In some cases (notably vehicle circulation taxes and fuel duties) a degree of differentiation is now virtually universal; with others, less so. However, even in cases where there is a clear environmental element in taxation, measures have developed in different ways in different countries, and at different times. As a result, there are significant differences in both the degree and structure of environmental taxation of road transport across the EU. Furthermore, some of the differentiation which does occur is not primarily for strictly environmental purposes (for example, to reflect road damage costs, to promote alternative fuel supplies, or to encourage or discourage particular types of vehicle).

The purpose of this report is to outline the differences in these approaches, indicating some of the problems these cause, and some possible approaches to solving them. For practical purposes, this analysis focuses mainly on annual vehicle and fuel taxes, as at present these are the most important, most widespread and best established forms of transport tax. Equally, the issues which are encountered in improving the environmental effectiveness of these particular taxes will often be similar to those which may arise in the future with other taxes and duties.

### **3. Current State of Motor Taxation in EU Member States**

At the moment each of the fifteen EU Member States has a different set of policies towards the taxation of transport. This is based on a range of historical, social and economic reasons, which are discussed in Section 4.1. The differing approaches to the taxation of transport inevitably leads to different prices in each Member State for fuel and for vehicles. Increasingly, with ever closer integration and national borders becoming increasingly insignificant in terms of the internal market, consumers are taking advantage of the price differentials between different countries to the detriment of the home markets, as described in the next chapter.

The Chapter begins by addressing the existing differences between Member States in relation to fuel and vehicle taxation (Sections 3.1 and 3.2, respectively) and road user charges (Section 3.3). Section 3.4 discusses the comparative situation in the countries of central and eastern Europe (CEE) that are in line for accession to the European Union in the course of the next decade or so. Section 3.5 presents some concluding remarks.

#### *3.1 Fuel Taxation Rates*

Fuel prices vary significantly between Member States as can be seen in Table 1, which shows average fuel prices for both petrol and diesel in each country. Both petrol and diesel are most expensive in the UK and cheapest in Luxembourg and the Cohesion countries (Greece, Spain, Portugal and Ireland - the latter for petrol only).

The high cost in the UK is a result of the so-called 'fuel duty escalator' under which the price of fuel rose by a fixed percentage above the rate of inflation each year from 1993 to 1999. When the policy was introduced by the former government, duties rose annually by 3 per cent above the rate of inflation, but this subsequently rose to 5 per cent and then to 6 per cent. However, these automatic increases have now been abandoned, as described below.

To some extent the lower cost in the Cohesion countries is to be expected, as these countries are poorer than other Member States, although in the case of Ireland the position has now changed on account of its rapid economic growth. This in turn is reflected in that country's position in Table 11 (Section 7.2 below). The low fuel prices in Luxembourg, on the other hand, are an anomaly caused by the country's desire to remain a low tax country, through which it can attract custom from its neighbours. In between, fuel prices in Sweden, the Netherlands, Italy, France and Finland, are generally higher than those in Belgium, Denmark, Germany and Austria.

**Table 1: Fuel Prices and Rates of Taxation in EU Member States**

Country	Petrol				Diesel				VAT
	Price EUR/litre	Duty	Duty Per cent of price	VAT Per cent	Price EUR/litre	Duty	Duty Per cent of price	VAT Per cent	Rate*
Austria	0.78	0.41	52%	17%	0.60	0.28	47%	17%	20
Belgium	0.88	0.51	58%	17%	0.61	0.28	47%	17%	21
Denmark	0.84	0.45	53%	20%	0.64	0.31	48%	20%	25
Finland	0.93	0.56	60%	18%	0.64	0.30	47%	18%	22
France	0.92	0.59	64%	17%	0.65	0.36	56%	17%	20.6
Germany	0.82	0.49	60%	14%	0.60	0.31	52%	14%	16
Greece	0.66	0.33	51%	15%	0.50	0.24	49%	15%	18
Ireland	0.71	0.39	55%	17%	0.67	0.33	50%	17%	21
Italy	0.92	0.53	57%	17%	0.72	0.38	53%	17%	20
Luxembourg	0.65	0.35	53%	11%	0.53	0.25	48%	13%	15 <sup>(1)</sup>
Netherlands	0.96	0.57	59%	15%	0.67	0.34	50%	15%	17.5
Portugal	0.77	0.47	60%	15%	0.54	0.28	51%	15%	17
Spain	0.67	0.36	54%	14%	0.56	0.26	47%	14%	16
Sweden	0.94	0.51	54%	20%	0.73	0.31 <sup>(2)</sup>	42% <sup>(2)</sup>	20%	25
UK	1.00	0.66	66%	15%	1.01	0.68 <sup>(3)</sup>	67% <sup>(3)</sup>	15%	17.5

Sources: Eurostat, 1999, except \* Kågeson, 1999.

Notes: (1) Luxembourg has a VAT rate of 12 per cent for petrol; (2) Low sulphur diesel, which attracts a duty 15 per cent lower than that for standard diesel, dominates the Swedish market; (3) ULSD is now virtually universal in the UK diesel market, and attracts the same duty rate as unleaded petrol.

The principal cause of the range of prices is the different levels of duty that drivers in each country must pay on each litre of fuel purchased (eg see Table 5). While in 1999 the petrol user in the UK paid on average EUR 0.66 in duty for every litre of petrol and those in Sweden, the Netherlands, Italy, France, Finland and Belgium paid over EUR 0.50 per litre, duty rates in Greece and Luxembourg remained at EUR 0.35 per litre or less. With respect to diesel, the contrasts between most countries (apart from the UK) were less great, with drivers in Greece paying EUR 0.24 per litre, while at the other extreme Italians paid EUR 0.38 duty per litre.

In the UK, which is the only country where diesel costs more per litre than petrol, drivers of diesel vehicles pay a duty of EUR 0.68 per litre of diesel. This is 76 per cent higher than in Italy, which is the second most expensive country in this respect, and makes UK diesel prices the most expensive in Europe by more than 40 per cent. Such a large differential has been felt by UK drivers, especially road hauliers who protested against the most recent increases, and played a part in the recent abandonment of the automatic escalator by the UK government.

The level of value added tax (VAT) charged in each Member State also contributes to the difference in prices between countries. For example, in the Scandinavian countries, the VAT charged on fuel amounts to between 22 and 25 per cent, which contributes to the higher prices in these countries. On the other hand, in Luxembourg, VAT is 15 per cent for diesel and only 12 per cent for petrol, while in Germany and Spain it is 16 per cent for

both fuels. So, while variations in fuel duty levels account for the majority of differences in fuel prices between countries, differences in VAT also play their part, especially as countries with higher fuel duties often have higher VAT rates.

The fuel duty escalator is not the only policy decision that contributes to higher diesel prices in the UK. The duty on diesel in the other fourteen Member States is lower than that on petrol as diesel has generally been favoured over petrol for a range of reasons. These are often concerned with the protection of road haulier or public transport interests, but environmental considerations have, in some cases, played a part in this. On average, a diesel car travels farther per litre of fuel used, and consequently, it is more fuel-efficient and emits less CO<sub>2</sub> and other gases per kilometre than petrol. However, there is increasing concern about the adverse effects on human health of particulate emissions, which are emitted from diesel engines in larger amounts than from petrol engines. As a result of such concerns, the UK government decided that there was no justification to differentiate fuel duties in favour of diesel over petrol and instead increased duties on diesel to a level higher than those on petrol. This decision, as well as the fuel duty escalator, has contributed to UK diesel prices being much higher than those of other EU countries.

The high fuel prices in the UK, and the subsequent adverse reaction, is a clear result of a single Member State pursuing policies for environmental reasons in isolation to taxation decisions being made in other Member States. Indeed, if the UK were not primarily an island state, it is highly questionable whether the duty escalator policy could have been maintained for as long as it has been.

The UK fuel duty escalator was the country's primary domestic measure to limit CO<sub>2</sub> emissions from the transport sector. Its abandonment has therefore raised questions concerning the ability of the UK to limit its transport emissions. Elsewhere in the EU, countries are struggling to limit their own transport emissions and many are introducing fiscal measures in an attempt to limit the growth in road transport (Skinner *et al*, 1999). Ironically, while the UK has now abandoned its automatic 6 per cent per annum duty increase, Germany and Italy have both recently introduced a similar measure. In Germany, the tax on motor fuels will increase by EUR 0.03 per litre each year until 2003, while in Italy, fuel duties on petrol and diesel will rise gradually but progressively until 2005, by which date they will have increased by 7 and 12 per cent respectively on 1999 levels. The intention in Italy to increase the duty on diesel more than that on petrol is reflected in other countries, such as France, which is also reducing the differential between the two fuels.

### 3.2 *Vehicle Taxation*

It is not possible to characterise the criteria used for applying circulation taxes (referred to in the UK as vehicle excise duty or VED) at all accurately in the space available. A range of criteria relating to engine capacity, size or power are applied in different Member States, and increasingly, differential rates are also charged for cars meeting different Euro emissions standards. In some countries, moreover, rates vary from one

administrative district to another. Kågeson (2000) summarises the bases of annual circulation taxes as set out in Table 2 below.

**Table 2: Basis of Annual Car Taxes in EU Member States plus Norway**

<b>Country</b>	<b>Tax Basis</b>
Austria	Power rating
Belgium	Cylinder capacity (progressive rate)
Denmark	Fuel consumption + weight
Finland	FIM 500-700
France	Cylinder capacity + age + district
Germany	Cylinder capacity + exhaust emissions
Greece	Horsepower
Ireland	Cylinder capacity
Italy	Power rating (in kW)
Luxembourg	Horsepower
Netherlands	Deadweight + province + fuel consumption
Portugal	Cylinder capacity
Spain	Horsepower + region
Sweden	Weight
UK	Flat rate, with reduction for cars <1100cc cylinder capacity
Norway	Flat rate

*Source: Based on Kågeson (2000)*

*Notes: UK will raise the threshold for discounts on existing cars, and introduce a system based on CO<sub>2</sub> emissions for new cars, from 2001. Similar changes are under consideration in several other EU Member States.*

Thus the selection of tax rates given in Table 3 is necessarily a simplification, and is purely indicative. It does however illustrate the point that the levels of duty applied to a given car, and the degree and nature of the gradation for different car types, currently vary enormously from state to state, and even sometimes within states as well.

**Table 3: Annual Car Taxation Levels in Various EU Member States**

Country	Petrol				Diesel		
	Small	Medium	Large	Very Large	Small	Medium	Large
Ireland	£95	£240	£330	£680	£195	£425	£505
Italy	£50	£120	£150	£325	£350	£440	£555
Luxembourg	£30	£55	£70	£110	£50	£70	£90
Netherlands	£200	£410	£520	£690	£480	£815	£980
Portugal	£10	£30	£80	£130	£10	£20	£30
Belgium	£80	£160	£235	£450	£190	£345	£580
Denmark	£250	£335	£435	£605	£250	£435	£605
Germany	£95	£150	£185	£280	£240	£320	£400
Greece	£55	£90	£200	£265	£90	£200	£265
UK	£150	£150	£150	£150	£150	£150	£150

*Source: HM Treasury, 1998*

*Note: All figures are in £UK, at 1996 levels*

The story with respect to vehicle taxation is complicated further as some countries impose purchase or initial registration taxes on vehicles over and above VAT, as well as annual taxes such as those given in Table 3. For example, the purchase tax on cars in Denmark can amount to 218 per cent of the vehicle's pre-tax price, whereas in other countries, such as Luxembourg and the UK, there is no tax to be paid upon the purchase of a car other than VAT (European Voice, 1999). Some countries including Italy have only one flat rate of purchase tax (Italian Government, 1998), while others, such as Belgium and Norway, differentiate on the basis of a range of criteria relating to engine features, such as its capacity and power (Belgian Government, 1997; Norwegian Government, 1997).

For heavy commercial vehicles, there are similar differences in vehicle taxation across the EU and its neighbouring countries. Again, in each country the range of vehicle taxation rates varies significantly according to vehicle weight, number of axles and other criteria, so the selection of figures given in Table 4 is for a typical 40 tonne vehicle. In the UK, for example, the duty level has been heavily differentiated according to axle weight in order to reflect road track costs by penalising the most damaging types of truck. Five Member States also have a registration or sales tax for HGVs (Kågeson and Dings, 1999).

**Table 4: Vehicle tax in EU Member States, Norway and Switzerland, in June 1998  
(17 tonne truck plus 23 tonne trailer, Euros per year)**

	<b>Truck/trailer</b>	<b>Comments</b>
<b>Austria</b>	2723	
<b>Belgium</b>	1070	25 per cent reduction for trucks less than 5 years old. 10 to 40 per cent reduction for more than 3 trucks
<b>Denmark</b>	702	EUR 516 for trucks with air suspension
<b>Finland</b>	1541	
<b>France</b>	213	
<b>Germany</b>	2641 2386 1876 1519	For 'old' trucks G1 trucks S1 Trucks (ie those that meet Euro 1 standards) S2 Trucks (ie those that meet Euro 2 standards)
<b>Greece</b>	429	
<b>Ireland</b>	1028	
<b>Italy</b>	705	Regional differences. Discount for air suspension
<b>Luxembourg</b>	693	EUR 510 for trucks with air suspension
<b>Netherlands</b>	447	
<b>Portugal</b>	439	EUR 423 for trucks with air suspension
<b>Spain</b>	534	Medium value. Large local differences
<b>Sweden</b>	991	
<b>UK</b>	2648	38 tonnes domestic weight limit
<b>Norway</b>	1099	
<b>Switzerland</b>	1646	28 tonnes domestic weight limit. Regional differences

*Source: BGL (1998), reproduced in Kågeson (1999)*

*Notes: Exchange rates of June 98 used between national currencies and DEM and of September 1998 between DEM and Euros.*

These various arrangements reflect a range of environmental and other costs, but only loosely so, at best. To date, a detailed analysis of the extent to which individual vehicles internalise their external costs through the tax and duty system is lacking, and the figures which are available remain highly controversial.

It can, however, be argued that a greater degree of harmonisation of annual duty rates (and indeed purchase taxes) would be desirable for a number of reasons. It would, for example, improve the working of the internal market in vehicles, because similar rates would avoid the current situation in which different types of vehicle are favoured by the tax systems in different countries. Equally, more closely harmonised rates for heavy trucks would avoid the sort of harmful distortions of competition which are discussed in Section 4.4 below.

It should be added that harmonised criteria and tax levels would be welcome to vehicle manufacturers and other sectors of industry for internal market reasons as outlined above – although in most cases they would prefer such taxes to be harmonised at a rather low level (European Voice, 1999).

### 3.3 Road User Charges

This section addresses nationally (or bilaterally) imposed road charges within and around the EU. The EU's Eurovignette system is covered separately in Section 5.4.

Tolls on specific sections of infrastructure, eg motorways and bridges, exist in a number of European countries, but these are generally aimed at raising revenue to pay for or maintain the section of infrastructure. In particular, many Member States have tolls on specific sections of infrastructure, such as bridges, tunnels or mountain passes, which constitute particular 'bottlenecks' which have been addressed through special new infrastructure investments.

Five Member States have broader based tolls on roads other than bridges and tunnels (Kågeson and Dings, 1999). These typically relate to a relatively sparse network of major trunk roads, such as the system operated in France. As the geographical coverage and levels of charging on different stretches of roads vary so considerably, it is difficult to characterise the average levels of charge incurred with any accuracy. However, recent evidence cited in the UK (Ernst & Young, 1999) suggests that a haulier working mainly in France might typically pay something approaching EUR 10,000 per truck per year in road tolls. This would represent about 12 per cent of operating costs.

This estimate is consistent with the recent report of the German commission addressing the country's plans for a distance-based charging scheme (discussed below). This report estimates the average charge in France at EUR 0.14 per kilometre, with those in Italy ranging from EUR 0.10 to 0.15.

Although not strictly a charging system, the Austrian 'Ecopoints' system should be mentioned here for completeness. In fact this is more like a system of rationing, in that it allocates points to EU Member States to achieve a given level of pollution emissions from freight transit traffic in the Alpine passes. Austria is required to phase out this system under the terms of its accession to the EU, but tensions over the levels of traffic and pollution in the Brenner Pass remain a particularly sensitive issue.

Owing to the particular environmental characteristics of heavy goods traffic (ie emissions, noise and vibration, danger of accidents and road damage), there is also growing interest in systems which tax freight traffic on a per-kilometre basis. Such systems are attractive because they would also be able to differentiate the level of tax according to lorry weight and other environmental characteristics, allowing them to reflect externality costs more accurately and realistically. However, these systems require much more sophisticated technology than more conventional taxes and duties, and this has to date hampered their introduction. Freight distance charges are discussed further in Section 5.4 below.

### *3.4 The Eastern Dimension*

It is essential in this discussion to consider the additional dimension on transport taxation which is presented by the future accession of additional states from central and eastern

Europe (CEE). Kågeson (1999) has recently examined the differences in fuel duty levels between CEE countries and those of the EU. Comparative duty levels and VAT rates for a range of European countries, including EU states and CEE countries, are set out in Table 5.

**Table 5: Fuel duty and VAT rates for EU and CEE countries**

	<b>Unleaded petrol (EUR/1000 litres)</b>	<b>Diesel (EUR/1000 litres)</b>	<b>Vat rate (per cent)</b>
<b>Austria</b>	410	287	20.0
<b>Belgium</b>	502	287	21.0
<b>Denmark</b>	448	304	25.0
<b>Finland</b>	557	303	22.0
<b>France</b>	584	368	20.6
<b>Germany</b>	496	314	16.0
<b>Greece</b>	330	242	18.0
<b>Ireland</b>	386	336	21.0
<b>Italy</b>	526	385	20.0
<b>Luxembourg</b>	344	250	12.0/15.0
<b>Netherlands</b>	569	336	17.5
<b>Portugal</b>	464	279	17.0
<b>Spain</b>	363	263	16.0
<b>Sweden</b>	513	307	25.0
<b>UK</b>	663	678	17.5
<b>Norway</b>	565	439	23.0
<b>Switzerland</b>	470	489	6.5
<b>Bulgaria</b>	220	67	22.0
<b>Czech Republic</b>	275	185	22.0
<b>Estonia</b>	159	122	18.0
<b>Hungary</b>	311	273	25.0
<b>Latvia</b>	206	147	18.0
<b>Lithuania</b>	294	100	18.0
<b>Poland</b>	354	189	22.0
<b>Romania</b>	191	110	22.0
<b>Slovakia</b>	258	197	23.0
<b>Slovenia</b>	No information	No information	No information

*Source: Kågeson (1999), but rates for EU countries are almost identical to those given in Table 1. Data are for September 1998.*

Kågeson makes the point that duty levels in CEE are generally below those in the EU, but not invariably so. In particular, petrol duty in Poland and diesel duty in Hungary are above the respective levels levied in Luxembourg and Greece. A similar pattern can be observed in relation to pump prices for diesel, although pump prices for petrol appear consistently higher in the EU.

Interestingly, the rates of VAT levied on fuel in the CEE countries is higher on average than those levelled in the richer western European countries. All the CEE countries, other than the three Baltic states, levy a rate of VAT of 22 per cent or more on fuel, a rate that is only equalled or exceeded in the four Scandinavian countries. The rate in non-EU member Switzerland, on the other hand, is significantly lower than anywhere else in Europe.

### 3.5 *Summary*

In short, it can be seen that there are currently some significant disparities in the structures and rates of taxation on fuels and vehicles across the EU. Equally, the application of road user charging either on long-distance routes or in urban areas is very patchy and essentially in its infancy.

In many cases, duty rates are graduated only loosely if at all to reflect environmental factors, and their effectiveness in promoting environmental goals is likely to be limited. In the next chapter, it will be argued that these disparities may have an adverse effect on the operation of the single market, and certainly cause a number of specific problems. It will also be argued that these problems will be exacerbated in a number of ways as the EU enlarges eastwards.

## 4 Some Issues Arising in EU Motor Tax Policy

The previous section has demonstrated that wide disparities in taxes and duty levels exist across Europe, and that to date, efforts to tackle these have had limited effect. As fuel duty in particular is usually a very large proportion of the final price to consumers, this in turn creates significant fuel price disparities.

### 4.1 *Conflicting Priorities*

The disparities discussed above reflect a range of different circumstances and attitudes to taxation levels, some of which are now briefly characterised and illustrated below. This information is drawn from a wide range of sources, including Schlegelmilch (2000) and personal communications.

- It should be pointed out from the outset that fuel taxes in western Europe are in general quite high, in relation to those in the US, for example (Schipper and Myers, 1992). This is not primarily for environmental reasons, but reflects the simple fact that motor fuels have been an easy target for taxation. This generalisation applies principally to petrol, however, as greater caution has generally been applied to diesel because of its use in haulage and public transport. In the US by contrast, the long distances between centres and population and a perception of plentiful supplies have led to an expectation of far lower tax rates.
- Concern over lack of indigenous oil supplies has motivated some countries to apply high levels of tax to limit imports, and/or to encourage alternative gaseous fuels. Italy and the Netherlands provide good examples of this approach. France in contrast has used fiscal incentives to promote biofuels, as this favours its large agricultural sector as well, and electric vehicles on account of its night-time oversupply of nuclear electricity.
- Some states have used taxation policy to support their active promotion of surface public transport modes, either by raising the relative price of car or truck transport, or by using the tax revenues directly to subsidise public transport.
- In contrast, concerns over inflation and any measure that might impede the growth of GDP have served as a brake on the taxation of motor fuels in some of the poorer and less developed states of the EU, as shown above. Regional development is also a specific concern in many Member States.
- Specific political commitments can often influence national policy towards Community proposals. For example, a commitment to avoid tax increases is apparently one reason for the Spanish government's opposition to energy taxation proposals in general, and the UK only relaxed its opposition to the energy products proposal (see Section 5.3) when it was made compatible with its own promise not to tax domestic heating fuels.
- More generally, changes of government can lead to changes in Member States' attitudes to ecological taxation. Elections in France and the UK, for example, led to a more constructive attitude from these two countries from 1997 and 1998 respectively.

- Concern over local air quality issues has led to increasing differentiation of fuel duty rates through the 1990s in a wide range of EU Member States. Vehicle taxes are also differentiated on the basis of emissions levels in a number of states.
- More recently, climate change concerns have led to increases in fuel prices in several states (eg UK, Germany, Denmark and Italy). Sweden has announced diesel tax increases in its budget for 2000.
- Existing road toll structures are likely to condition the extent to which countries wish to pursue an EU-wide freight charging system, or their views on the appropriate level of fuel taxation.
- Ecosystems sensitive to transit traffic have attracted a high level of attention, and led to specific measures being taken, particularly in the Alpine regions of Austria and Switzerland. As well as the particular sensitivity of the area in question, the fact that much of the environmental pressure derives from non-domestic traffic appears to be a significant political factor here.
- A desire to protect the interests of national car manufacturing industries has historically influenced the fiscal and regulatory approaches of a number of EU Member States – most obviously the UK, Germany, France and Italy. However, experience in the UK suggests that, over time, the changing structure of the industry may weaken national political alignments towards the domestic motor industry, to some extent at least.
- As explained elsewhere, relations with neighbours are a significant factor in tax policy. Luxembourg is unique in the extent to which it profits financially from its low fuel tax policy relative to its neighbours, but a much larger number of states have been reported to be inhibited in raising taxes by lower rates nearby. It is clear that both Austrian and Danish policy have been heavily influenced by developments in Germany, for example.

The above list is intended to illustrate simply that a wide range of conflicting priorities contributes to the positions of the various Member States, and this makes progress difficult. It was recently pointed out that, since the first Community energy tax proposal was made by the Commission, every Member State except Sweden has held the Presidency at least once, and all have failed to one extent or another to progress the proposals successfully (Heinrich Böll Foundation, 2000).

#### 4.2 *Is Competition in Fuel and Vehicle Tax Rates Harmful?*

The experience of the UK in relation to the fuel duty escalator, struggling with both border disparities and domestic opposition, shows the desirability, from some perspectives at least, of a more co-ordinated or harmonised approach at the European level to the taxation of fuel. However, this argument is not yet widely accepted.

Aside from the reluctance of many Member States to accept measures which risk increasing Community competence in taxation matters, there are some liberal economists who would dispute that *any* form of tax competition was harmful. From this perspective, all taxation is regarded as undesirable, and competition in tax rates, like competition on price, is simply a mechanism to keep down prices for businesses and consumers.

There is now some consensus in Europe that certain forms of international tax competition are harmful, particularly as they encourage low taxes on highly mobile resources (notably capital and highly skilled labour), and much higher taxes on immobile resources such as land and unskilled labour (see for example, Select Committee on the European Communities (1999) and Ussher (2000)). At the time of writing, however, the definition of ‘harmful’ tax competition being addressed within the ECOFIN Council is rather narrow and is focused on the direct taxation of business.

While the Commission is keen to keep energy taxation on the Council’s agenda, wider ecotaxation arguments do not yet appear to have received much attention in this area. There are however obvious arguments which could be made that competition in motor taxation is harmful if it impedes full internalisation of external costs – not only is the polluter pays principle enshrined in the EU Treaty, but also, lack of internalisation clearly results in poor economic performance overall and unsustainable use of resources.

In the Sections which follow, three specific problems which arise from fuel duty differentials in particular are described in greater detail.

#### 4.3 *Fuel tourism*

With respect to passenger transport, one of the principal problems that arises from the fuel price differentials between neighbouring countries is fuel tourism. This is of particular concern in smaller more densely populated countries that have a border with a neighbour where fuel prices are significantly different. For example, in the Danish action plan to reduce CO<sub>2</sub> emissions from the transport sector, the use of fiscal mechanisms to reduce emissions is set out as a policy option (Ministry of Environment and Energy and Danish EPA, 1997). However, it states that these must be increased in accordance with prices in neighbouring countries, which in Denmark’s case is principally Germany, so as not to encourage cross-border trade. Similarly the Netherlands has included raising fuel duties in its reserve package of measures to combat climate change (VROM, 1999), but again it states that any fuel increases will be dependent on those of its neighbours (again principally Germany).

This issue was also the subject of a recent inquiry by UK Members of Parliament, which was prompted by concerns regarding the effect that the price differential between the Republic of Ireland and Northern Ireland was having on that part of the UK (Northern Ireland Affairs Committee, 1999a). The report concluded that the differences in prices on either side of the Irish border had had serious consequences for fuel suppliers and for road hauliers.

**Table 6: Border differentials in fuel duties (EUR per litre)**

<b>Petrol</b>	<b>Fuel price</b>	<b>Excise duty</b>	<b>Diesel</b>	<b>Fuel price</b>	<b>Excise duty</b>
UK – Ireland	0.29	0.27	UK – Ireland	0.34	0.35
France – Luxembourg	0.27	0.24	France – Luxembourg	0.12	0.11

France – Spain	0.25	0.22	Italy – Austria	0.12	0.10
<b>Belgium – Luxembourg</b>	<b>0.23</b>	<b>0.16</b>	France – Spain	0.09	0.10
Germany – Luxembourg	0.17	0.15	<b>Sweden – Finland</b>	<b>0.09</b>	<b>0.01</b>
Italy – Austria	0.14	0.12	Belgium – Luxembourg	0.08	0.03
<b>Netherlands – Germany</b>	<b>0.14</b>	<b>0.07</b>	Germany – Luxembourg	0.07	0.06
Portugal – Spain	0.10	0.10	Netherlands – Germany	0.07	0.02
France – Germany	0.10	0.09	Italy – France	0.07	0.02
Netherlands – Belgium	0.08	0.06	Netherlands – Belgium	0.06	0.05
Belgium – Germany	0.06	0.01	France – Germany	0.05	0.05
Germany – Austria	0.04	0.09	France – Belgium	0.04	0.08
France – Belgium	0.04	0.08	Denmark – Germany	0.04	-0.01
<b>Denmark – Germany</b>	<b>0.02</b>	<b>-0.05</b>	Spain – Portugal	0.02	-0.01
<b>Sweden – Finland</b>	<b>0.01</b>	<b>-0.05</b>	Belgium – Germany	0.01	-0.03
<b>France – Italy</b>	<b>0.00</b>	<b>0.06</b>	Germany – Austria	0.00	0.03

Source: Derived from the same Eurostat data as Table 1.

Notes: Pairings listed in descending order, ie the pairing with the largest price differential is listed first. The first country in each pair has the higher price; Price differentials of the pairings in **bold** cannot be explained primarily by differences in duty (ie price differential exceeds fuel duty differential by more than EUR 0.05).

The extent of border fuel price differentials in the EU can be seen from Table 6. The order of the pairings in this Table is similar to the ranking in an equivalent table in the UK MPs' report (Northern Ireland Affairs Committee, 1999a). Interestingly, the two countries that raised the concern with respect to prices in neighbouring countries when considering their own policy towards increasing fuel duties, Denmark and Netherlands, do not figure prominently in Table 6. The highest mention of either is the differential on the German-Dutch border, which lies at seventh in the petrol list. In both the case of petrol and diesel, it is on the Irish-UK border where the largest differential occurs.

After this, the most problematic borders are those that Luxembourg shares with its French, Belgian and German neighbours. The effect of this differential can be seen from Eurostat statistics on deliveries of road fuels, which for Luxembourg are nearly five times the EU average per head of population (Eurostat, 1999). This reflects the very high levels of fuel tourism in Luxembourg, but also the very large significance of fuel duty as a source of revenue for the Grand Duchy. As a result, Luxembourg is now in a position where any move to raise fuel duty rates to those of the surrounding countries would result in very substantial loss of revenue for such a small country, and would therefore be very strongly resisted.

Some of the borders that appear high up on the list will cause less of a problem in terms of petrol tourism as a result of the nature of the border area. For example, the mountainous and therefore less populated nature of the border areas between Italy and Austria and between France and Spain will reduce the possibility of such tourism, as would the sparsely populated territory along the border between Finland and Sweden. It is also worth noting that there is a significant difference (more than 12 per cent) between petrol prices in France and Germany, indicating potential problems along this border.

Consequently, a solution to the problem of petrol tourism, which would mainly affect passenger vehicles, should be concentrated on the northern countries (Benelux, France, Germany and Denmark) and on the UK-Irish border.

#### *4.4 Road haulage Competitiveness and Fuel Tankering*

For long distance haulage, significant differences in pump price will also encourage hauliers to 'tanker' fuel by filling up their tanks in countries with cheap fuel before entering those where fuel is more expensive. This practice is clearly rather inefficient, in that it can encourage hauliers to carry more fuel than is necessary, and in some cases to take a longer route to benefit from cheaper fuel. The practice also entails a revenue loss to the Member State with the higher rate of duty, although the degree of loss is likely to vary considerably from place to place.

Perhaps more importantly, there is also the potential for competitive distortions if hauliers from one state can benefit at the expense of those from another. As noted above, UK road hauliers protested bitterly prior to the year 2000 budget about duty differentials between the UK and its neighbours, but this complaint relates as much to vehicle excise duties as to fuels. One recent analysis by a major management consultancy appeared to show a cost disadvantage of over 20 per cent for UK hauliers relative to those in Belgium, Luxembourg and France (Ernst & Young, 1999), and raised the possibility that many might consider 'flagging out' their fleets to avoid higher UK taxes.

This analysis was based on the category of truck which attracts by far the highest level of duty in the UK on account of its high potential for road damage, so it is not entirely a representative comparison. Other factors (notably differences in the overall tax burden) also suggest that the overall differences are rather less than these figures show, and anecdotal evidence indicates that there have not been a huge number of firms moving from the UK as feared. The possibility nonetheless remains, and has exerted considerable pressure on the UK government, resulting in substantial circulation tax reductions for some classes of truck in the 2000 budget.

Hauliers in several other EU states are also protesting about tax levels and competitive disadvantage, but it is difficult to establish the true competitive position without a comprehensive analysis of all taxes and other costs to industry. The analysis which has been undertaken does not suggest huge disparities between neighbouring states aside from the UK, but pressure to freeze or reduce the tax burden will doubtless continue.

In terms of marginal costs, there should in principle be little or no competitive advantage generated between hauliers from different countries when operating a comparable international route, as both have similar opportunities to tanker fuel between the two. However, a greater problem may arise where an international haulier can benefit from cheaper fuel when running cabotage operations in competition with domestic hauliers within a state. Given the relatively recent introduction of full cabotage rights within the EU, it does not appear easy to assess the full impact of cabotage on domestic hauliers, far

less of the competitive distortion caused by fuel price differentials. Further research in this area may be desirable.

It should also be noted that Directive 94/74/EC (amending the Mineral Oils Directives; CEC, 1994) only allows fuel contained in 'standard tanks of commercial motor vehicles' to be carried across borders without being subject to national duty rates. This provision, if narrowly interpreted and strictly enforced, has the potential to impose some limit on the quantity of fuel tankered.

#### *4.5 Smuggling*

A further point that requires consideration is that high fuel price differentials are a strong inducement to smuggling and other illegal manipulations of the taxation regime. This point is clearly demonstrated by the degree of cross-border smuggling, which is now suspected between the Republic of Ireland and Northern Ireland. A recent report by a Select Committee of UK Members of Parliament (Northern Ireland Affairs Committee, 1999a) commented that:

'There is no doubt that the differential in fuel prices across the land border in the island of Ireland is a difficult issue and one that has serious consequences for fuel suppliers and road hauliers. It is also a wider problem in that, besides distorting trading patterns, it appears to have become a means of funding for paramilitaries and racketeers. It is therefore damaging the social fabric of Northern Ireland.'

The situation in Ireland is of course unusual in a number of respects, but this problem is argued below to be of particular importance in relation to EU Enlargement as well, as smuggling and tax evasion in relation to fuel are already very widespread in many CEE countries.

#### *4.6 Concluding Remarks*

Thus it can be seen that the wide variations in tax rates and structures derive from a wide range of historical and economic circumstances, including differing objectives and political positions.

This gives rise to some specific problems in certain sectors and in border areas between countries with differing levels of tax. This in turn acts as a disincentive to some countries which might otherwise wish to pursue higher tax levels in order to pursue their environmental objectives. It is a matter of dispute whether these constitute a sufficiently major distortion of the market to justify action at Community level, but it is clear that they have adverse environmental consequences and cause unnecessary traffic.

## 5 EU Initiatives

### 5.1 Commission Policy – Fair and Efficient Pricing

In July 1998, the Commission published its White Paper on charging for transport use, entitled *Fair payment for infrastructure use: A phased approach to transport infrastructure charging in the European Union* (CEC, 1998). This had as its central recommendation that the price faced by transport users should cover the marginal social costs of constructing and maintaining the infrastructure, plus the ‘external costs’ caused by its use.

The inclusion of the latter is intended to reduce pollution, congestion and accidents by including the cost of these in the price which the driver pays for use of road transport infrastructure. In this the White Paper followed the argument set out in the corresponding Green Paper published in 1995 (CEC, 1995). In some respects it went further, however, in that it explicitly acknowledged the global dimensions of air pollution and emphasised the need to incorporate the costs of climate change into the marginal cost element.

Crucially, the Paper emphasised the need to harmonise the pricing system across Europe in order to remove distortions which currently exist between countries and between different transport modes, including the different costs faced by hauliers and the varying levels of port charges. While it referred to all modes of transport, it avoided detailed treatment of the question of charging passenger transport for road use. Instead it concentrated on commercial road freight transport, seeing this as its most powerful argument for legitimising a Community role in setting taxes or duties.

For the longer term, the Commission argued for the introduction of a tax relating to the direct usage of a road according to time and location (as well as characteristics of the vehicle). This would require a fairly sophisticated EU-wide electronic charging system. In the interim, therefore, it took a pragmatic and cautious stepwise approach by seeking to encourage the harmonisation of existing taxes by Member States. This set out a logical sequence of events and a framework for action, but had no means to impose this upon the Member States.

It also proposed that guidelines be drawn up by an expert panel to ensure that the charges and taxes levied only cover the real costs of infrastructure construction, maintenance and external costs. This was another important development on the preceding Green Paper, and the Commission’s High Level Working Group has since produced a considerable volume of work on the key issues. Some of its conclusions have proved controversial and have attracted some criticism from, amongst others, environmental NGOs and some independent analysts.

Perhaps more important, however, is the lack of engagement from those Member States which are most anxious to defend their fiscal independence, or are reserving their positions until a final conclusion is reached. In general this process can be characterised as being rather closed, and has provoked relatively little debate or reaction so far. As

such, its long term impact remains unclear; but a commitment to fair and efficient pricing is now clearly an element of the Transport Council's strategy on integration (see Section 7.5 below), so some engagement from the Member States in the near future will be virtually unavoidable.

## 5.2 Fiscal harmonisation to date: Mineral Oils Directives and VAT

Even though it has been difficult to pass European fiscal legislation for environmental reasons, a number of Directives have been adopted that relate to the harmonisation of taxation frameworks in Member States. For example, the so-called Mineral Oils Directives (92/81/EEC and 92/82/EEC; CEC, 1992a and b) provide a harmonised framework, and set minimum rates of excise duty, for a range of mineral oils including those used in transport (see Table 7). The rationale behind the measures was to facilitate the proper functioning of the internal market, rather than to affect fuel consumption or emissions.

However as the Directives were agreed using unanimity they reflect the lowest common denominator in terms of the minimum rates to be applied. Consequently the fuel duties in the majority of Member States are significantly above the rates set out in these Directives as can be seen from a comparison of Table 5 (in Section 3.4) and Table 7. However, of the CEE countries only Hungary, Poland and Lithuania (the latter two for petrol only) have rates in excess of the minimum levels as set out in Directive 92/82/EEC. Consequently, on accession, fuel duties in these countries will have to rise.

**Table 7: Minimum rates of duty on transport fuels  
(applicable from January 1 1993)**

Fuel	Duty (EUR/1000 l or kg)
Leaded petrol	337
Unleaded petrol	287
Diesel	245
Liquid petroleum gas	100
Methane	100
Kerosene	245

Source: CEC, 1992b

Note: Excludes kerosene for civil aviation purposes

The EU also has a common system of value added tax (VAT) which was introduced in the early 1970s as a result of Council Directive 67/227/EEC (CEC, 1967). This Directive aimed to harmonise legislation on VAT rather than harmonise rates and exemptions. Amendments to the sixth Directive (77/388/EEC) on the harmonisation of the VAT laws (CEC, 1977) have attempted some degree of harmonisation of Member States' VAT rates. A minimum standard rate of VAT has now been set at 15 per cent, while rates of 12 per cent are authorised for some goods and services. However, as with the Mineral Oils Directives the rates reflect the lowest common denominator, consequently some Member

States have rates significantly higher than required (eg see Table 5). As a result, different rates of VAT still contribute to price differentials between different countries.

In 1997, the Commission published a Communication on improving tax co-ordination in the EU (CEC, 1997a). The Communication proposed a range of measures, including a number aimed at indirect taxation, such as VAT and the taxation of energy products. The indirect taxation of passenger transport was also included as an area that needed further examination as a result of the concerns of a number of Member States. The proposals were discussed by ECOFIN, which asked the Commission to refine them. The resulting Communication (CEC, 1997b), which set out a package of measures that are still the subject of disagreement in ECOFIN, did not include any measures to address the disparities in indirect taxation, so the proposal to examine passenger transport was effectively dropped. However, the proposal to harmonise the taxation of energy products has been taken forward outside this policy package (see Section 5.3).

### *5.3 The Carbon/Energy Tax Proposal and Subsequent Developments*

The use of economic instruments to address environmental problems at the European level came to the fore with the increased concerns about global warming in the early 1990s (Haigh, 1999). The conclusions of a joint environment and energy Council in 1990 noted that such instruments could play a useful role in the energy sector in limiting CO<sub>2</sub> emissions. The Commission accordingly published its first proposals for a carbon/energy tax in June 1992. The proposal was one part of a four part strategy to tackle climate change through improving energy efficiency (CEC, 1992c). The others – a framework Directive on energy efficiency within the SAVE programme; a Decision concerning the promotion of renewable energy (the ALTENER programme); and a Decision on a mechanism to monitor CO<sub>2</sub> emissions - were relatively uncontroversial. However, the carbon/energy tax proposal was met with significant opposition by industry and a number of Member States. As the proposal was primarily of a fiscal nature, it needed unanimity in the Council for the decision to be taken forward, so was eventually dropped when no compromise was possible.

The Commission then published an alternative proposal on establishing an EU framework for the taxation of energy products in early 1997. The new proposal was designed to address some of the perceived shortcomings of the original carbon/energy tax scheme, which it effectively supersedes. The new scheme would instead extend the principle behind the Mineral Oil Directives – that of setting minimum levels of duty - to other energy products.

In formal terms, this new proposal would constitute the two-yearly review of the Mineral Oils Directive 92/82 (see below), and would supersede this as well. The proposed Directive would raise the previous minimum levels of duty on mineral oils. The proposal also emphasises the range of potential beneficial effects from this approach, as it states that the framework should contribute to the objectives of EU employment, environment, energy and transport policies.

The proposal would impose minimum tax rates on all energy products, and the intention was that base rates would be stepped up incrementally in 1998, 2000 and 2002 (see Table 8). To ensure EU industry remains competitive, tax neutrality was a principle underlying the proposal, so any revenue raised would go towards reducing labour taxes and thereby stimulating employment. Allowances would be made for industries whose energy costs are higher than 10% of total production costs.

**Table 8: Proposed minimum levels of taxation applicable to motor fuel**

From:	January 1 1998	January 1 2000	January 1 2002
Petrol (EUR per 1000 l)	417	450	500
Diesel (EUR per 1000 l)	310	310	393
Kerosene (EUR per 1000 l)	343	343	393
Liquid petroleum gas (EUR per 1000 kg)	141	174	224
Natural Gas (EUR per gigajoule)	2.9	3.5	4.5

*Source: CEC (1997c)*

*Note: Excludes kerosene for civil aviation purposes*

Kågeson (1999) calculates that eight Member States would need to increase existing petrol duties in order to comply with the proposed level for petrol duty for 2002. For some of these countries the increase required would be minimal. However four countries would have to increase rates by between 30 and 52 per cent, which would amount to an annual average increase on 1998 prices of around EUR 0.03 per litre for Ireland and Spain (which is equivalent to the commitment made by Germany; see Section 3.1) and EUR 0.04 per litre for Luxembourg and Greece. All Member States other than the UK would have to increase their duty on diesel to comply with the proposed minimum level for 2002 and all but three of these would need increases of at least 25 per cent on 1998 prices. This would be equivalent to an average annual increase of at least EUR 0.02 for these eleven countries.

Of course the CEE states would require even larger increases in percentage terms to meet the proposed levels for 2002, ranging from an increase of 41 per cent in petrol duty for Poland to an increase of 487 per cent in the level of duty levied on diesel in Bulgaria. Interestingly, if these states are given until 2010 to comply with the proposed minimum levels of duty, the annual increase required on 1998 figures would range from EUR 0.01 to around EUR 0.03, which is less than the annual increases required in some existing EU states by 2002.

However, like its predecessor, the proposal has not had an easy legislative passage so far. Indeed, it is still far from certain that it will eventually be approved in a form that would have any significant impact. Initial discussions on the proposal began in the first half of 1997, but it was then put on hold until it was revived by the German Presidency in early 1999. As unanimity is required for the adoption of the proposal, negotiations in the

Council of Ministers have been slow and difficult. Southern EU states have been concerned with the increase on energy taxes that the proposal implies, while other states, such as the UK and France have opposed it for different reasons. Many concessions have been made, eg the UK has won the right to exempt domestic fuel, to the extent that some Member States are reported to be concerned that the original proposal has been watered down too much. Thirteen Member States now support the proposal in its present amended form and it is reported that Ireland's opposition to the proposal is softening, leaving Spain in primary opposition. Madrid was reported to be adamantly opposed to any harmonisation of energy taxes, arguing that the measure would be inflationary.

In the face of continued Spanish opposition to the proposals, in June 1999 the Dutch Government proposed that some countries might proceed on their own if the wider negotiations prove to be unsuccessful. This approach has been dubbed 'Eco-Schengen' after the Schengen agreement that set up a passport-free area between a number of Member States (see Section 7.4). The European Parliament's Environment Committee subsequently took up the idea, as did Finnish Environment Minister Satu Hassi. In October 1999, she told the EP's Environment Committee that she supported the idea and had already discussed it with the Commission, although the implications for the internal market would need to be clarified.

In the event, the Finns failed to take forward the proposal to any great extent. Instead they directed their efforts to circulating a questionnaire to clarify in detail the positions of Member States on various aspects of the energy products proposal. This may provide useful information for future progress, but in practice the Finnish Presidency failed either to make any headway against Spanish opposition or to forge an alternative approach.

If Spain continues to block the proposal, reports have suggested that northern Member States will push for an increase in minimum duties on petrol and diesel only, as part of a review of the 1992 Mineral Oils Directives. This is justified under Article 11 of Directive 92/82, which provides that the Council should review duty rates every two years on the basis of a report and, if appropriate, a proposal from the Commission. The new proposal was supposed to have replaced the need for such a review, which is already long overdue, but in the absence of an agreement on the broader energy products proposal, a more limited review might be the best way of taking the matter forward for the transport sector at least.

#### 5.4 *Eurovignette Directive*

While the Mineral Oils Directives set minimum charges for diesel duties, the aim of the 'Eurovignette' Directive is to address other taxes on HGVs, such as vehicle taxes, tolls and road user charges. The Eurovignette Directive (1999/62/EC; CEC, 1999a) harmonises HGV charges in Member States and replaces an earlier Directive 93/89/EEC (CEC, 1993), which was annulled in 1995 by the European Court of Justice as a result of procedural errors. Even though the Directive was annulled five Member States (Denmark, Germany and the Benelux) introduced user charges for heavy vehicles from 1 January

1995, and these were later joined by Sweden when that country acceded to the EU. The new Directive sets minimum tax rates for heavy duty vehicles weighing over 12 tonnes depending on their weight and number of axles and maximum rates of road user charges dependent on a vehicle's emissions (see Table 9). All these charges should come into force from July 1 2000.

**Table 9: Maximum road user charges (EUR), including administrative costs**

<b>Annual</b>	<b>Maximum three axles</b>	<b>Maximum three axles</b>
<b>NON-EURO</b>	960	1550
<b>EURO I</b>	850	1400
<b>EURO II</b>	750	1250

*Source: CEC, 1999a*

*Notes: Monthly and weekly charges should be in proportion to the duration of the use of the infrastructure. Daily charge is EUR 8*

With regard to tolls and road user charges, the Directive sets out the conditions which Member States need to fulfil if they want either to maintain existing regimes or introduce new ones. The Directive only allows the use of tolls and road user charges on users of motorways (or multi-lane roads with similar characteristics), bridges, tunnels and mountain passes. The Directive also sets out minimum rates for vehicle taxes that have to be applied in Member States.

The agreement on the Eurovignette Directive was achieved after, in the words of the relevant Council conclusions, a 'tortuous discussion' (Council of the European Union, 1998) and was concluded in parallel to an agreement with Switzerland on removing its ban on HGVs over 28 tonnes. The two negotiations, while initially separate, were dealt with together due to Austrian concerns that the amount of trans-Alpine traffic using its roads would increase as a result of the policies of non-EU member Switzerland. The Swiss agreed to phase out their ban to allow limited access for HGVs up to 40 tonnes from 2000 and unlimited access by 2005. The Swiss will also phase in their own charging system, which will vary according to emission standards (see Table 10).

**Table 10: Maximum permissible charge rates for Switzerland for a 40 tonne HGV (Euro per km)**

<b>Year</b>	<b>NON-EURO</b>	<b>EURO I</b>	<b>EURO II</b>	<b>Average</b>
<b>2001-2002</b>	0.52	0.44	0.37	0.43
<b>2003-2004</b>	0.62	0.50	0.44	0.50
<b>2005-2007</b>	0.73	0.59	0.52	0.60
<b>From 2008</b>	0.82	0.66	0.58	0.67

*Source: Kågeson and Dings (1999)*

*Note: Based on an exchange rate of Swiss francs to Euros of 0.642*

Kågeson and Dings (1999) undertook a full investigation of road user charging for HGVs in Europe and here we only highlight the policy aspects of their study. The Swiss system is unique in Europe as it is the only system that will cover the entire distance travelled by

goods vehicles in the country, rather than traffic only on motorways and other specific pieces of infrastructure as in the EU. Further it will apply to all HGVs weighing over 3.5 tonnes, rather than only for those over 12 tonnes, as allowed for under the Eurovignette Directive. Only those vehicles weighing over 28 tonnes will be charged the maximum permissible amount.

Both Germany and Austria have announced their intention to introduce a kilometre charge for HGVs by 2002. The German proposals, which would apply to kilometres travelled on motorways by HGVs weighing over 12 tonnes, are not that well-advanced and there are concerns that they will not be up and running by 2002 as claimed: but a tender for development work has recently been issued. The Austrian proposals would apply to kilometres travelled on 'high performance' roads, which includes motorways and some other fast roads, by HGVs over 3.5 tonnes. The system will replace the Ecopoints system (see Section 3.3), which the Austrians were allowed to keep for a limited period after their accession to the EU but which should be abolished in 2003. The charge levels will depend on the number of axles (2,3 or 4 or more) and will be set at EUR 0.09, EUR 0.12 and EUR 0.15. Currently there are no proposals for differentiation on environmental grounds.

### *5.5 Urban Road Pricing and Congestion Charging*

Congestion charging is gaining increasing prominence in order to address the problem of urban traffic congestion. However to date, no true congestion charging scheme has been introduced in Europe. Three Norwegian cities (Trondheim, Oslo and Bergen) introduced toll rings in the late 1980s/early 1990s, but these were primarily aimed at raising revenue to fund new road construction (Oscar Faber, 1999). However proposals are being developed to turn these schemes into urban congestion charging schemes.

Elsewhere in Europe, one of the most advanced urban road pricing schemes is being developed for the Randstad area (Amsterdam, Rotterdam, The Hague and Utrecht) which is due to be introduced in 2001. There are also significant moves to introduce road pricing elsewhere. For example, in the UK, legislation is now before Parliament to allow local authorities to introduce road pricing schemes and a number of cities, such as Edinburgh, Leeds, Leicester and Bristol, are interested in introducing such schemes. Trials, or studies into the feasibility, of introducing road pricing have undertaken in a number of European cities.

### *5.6 Concluding Remarks*

The polluter pays principle and the requirement to internalise external costs are now enshrined at the level of principle in EU policy, and it can be seen from the above that a number of initiatives have been instigated in order to put them into practice. However, progress to date has been markedly limited and painfully slow.

Fiscal harmonisation to date has been to the lowest common denominator, with some basic minimum rates set which have now been overtaken by fuel duty increases in most Member States. Further progress is still possible, but appears far from certain. At the root of this lack of progress is the unwillingness of a number of Member States to cede any competence in fiscal policy matters to the Community.

## **6 Other Relevant Issues at EU Level**

### *6.1 The Single Market and Monetary Union*

Some fiscal experts consider that ever-closer monetary union itself creates long term pressures for tax rate convergence between Union members. In simple terms, the argument is that ever-greater mobility of money between states will force tax rates and structures to be harmonised to avoid an increase in damaging tax competition. However, this in itself suggests that rates may converge towards the low end of the spectrum unless decisive action is taken to establish a minimum below which they cannot fall. This may in the long run create a stronger impetus towards harmonisation measures, but recent experience demonstrates that particular national interests combined with the unanimity requirement can still present a very powerful block to progress on any particular measure.

In the shorter term, monetary union has already had unexpected and negative impacts on transport and energy taxation. That is, Spain and Italy temporarily reduced road tolls and CO<sub>2</sub> taxes respectively as counter-inflationary measures during 1999. These reversals of previous increases were introduced specifically in order to meet the inflation targets imposed on members of the Euro zone. It is difficult to predict whether this pattern of events will persist, but if it does, it is a rather separate issue from the question of the perceived inflationary effects of ecotaxation itself.

### *6.2 Positions of the Commissioners*

The Commissioner responsible for Transport and Energy Commissioner Loyola de Palacio has indicated that she did not support increasing environmental taxes. Her comments appeared in her submission to the European Parliament, which was part of the Parliament's scrutiny of the proposed Commission. She is reported to have said that even though she felt that environmental taxes did help to internalise external costs, she doubted whether they contributed to maintaining industrial competitiveness and securing energy supply - the other two key objectives of EU energy policy.

The views of de Palacio, who is from Spain, could be seen to be in line with that of her national government which has been the most vocal opponent of the existing proposals for tax harmonisation (see Section 5.3). These views are clearly not particularly helpful in relation to the prospect of further progress on tax harmonisation, and should be investigated further. It seems in principle that her concerns about competitiveness could and should be challenged through the research which has already been undertaken on ecotaxation - that is, the argument that shifting taxation from 'goods' such as labour to 'bads' such as pollution can have a net positive effect on economic growth. Equally, it is difficult to understand how energy taxation can work against the security of energy supply, as it curbs demand and thereby makes supplies last longer and encourages them to be used more efficiently.

On the other hand, Margot Wallström and Frits Bolkestein, the Commissioners responsible for the environment and fiscal policy respectively, supported the energy tax

proposal in their submissions, but feared it had already been excessively watered down as a result of the many concessions that have already been made.

### *6.3 Inter-institutional relations*

Historically, the European Parliament tends to push for tougher environmental standards across a range of areas, relative to either the Commission or the Council of Ministers. The Parliament has, for example, called on the Commission to make the proposals on the minimum rates of taxation on energy products greener by exempting renewable energy from the tax and eliminating the automatic exemptions for energy-intensive industries.

It is not however clear exactly how the 1999 elections have affected the environmental priorities of the Parliament. It is particularly notable in this context that the new Parliament has not clearly endorsed proposals for energy taxation. However, it should be stressed that the position of the Parliament is not currently very important, as it has little influence in tax-related matters. The question of changing the decision-making process is addressed below in Section 7.1.

### *6.4 The Impact of Enlargement*

The timetable for enlargement to the east of the Union adds urgency to the question of transport taxation. As shown above, the applicant states typically have lower rates of taxation than those of the existing EU Member States. Therefore, the influx of a new group of relatively poor and quite diverse states can only add to the existing difficulties in reaching a political consensus. Also, as explained in the next section, the inclusion of additional members will inevitably make any process requiring complete consensus more and more difficult to achieve. This comment applies not only to specific taxation measures (under current rules), but also to any further Treaty changes once enlargement is under way.

This is not intended to imply that all applicant countries will automatically adopt the same attitude towards motor taxation. On the contrary, Poland, Hungary and the Czech Republic have all taken significant steps to push up motor fuel taxes to levels broadly similar to those further west, as Table 5 illustrates. However, the economic position of most accession states is likely to lead to objections similar to those encountered in the current Cohesion countries. Equally, their proximity to states of the CIS where tax rates remain low are likely to cause difficulties for them in turn by creating new cross-border differentials.

Regardless of this, applicant countries are automatically required to adopt whatever EU legal framework for taxation is then in force, either at or soon after their date of accession. As noted above, the existing Mineral Oils Directives would have some value in forcing a higher level of duty in some states and hence reducing the degree of disparity, but a more ambitious new framework would obviously have a greater impact in the medium term, even if longer derogation or transition periods were allowed initially.

## 7 Possible solutions and alternative policy approaches

### 7.1 *The Forthcoming Inter-Governmental Conference*

Article 93 of the Treaty of Rome as amended by the Treaty of Amsterdam states that all legislation of a fiscal nature must be adopted by a unanimous vote in the Council of Ministers, and Article 175 makes it clear that this remains the case for ecological taxation, in that environmental measures ‘primarily of a fiscal nature’ fall outside the scope of qualified majority voting (QMV). One might in theory argue that ecotaxation measures were not *primarily* of a fiscal nature because their objective is an environmental one; but it is inconceivable that ECOFIN would accept this approach in current circumstances.

As a result, any single Member State retains a veto over legislation on fuel or vehicle taxes. This requirement has been perhaps the main obstacle to passing Community measures to harmonise taxation measures as described in earlier sections. It led to the collapse of proposals for a carbon/energy tax; resulted in a weakening of the minimum duty rates set under the Mineral Oils Directives; and continues to delay the more recent proposal on taxation of energy products.

The Helsinki Summit of December 1999 demonstrated once more how intractable tax harmonisation measures (in this case in a rather different area) continue to be, with a small minority comprised of the UK with the tacit support of Luxembourg able to block the so-called withholding tax. At the same time, the Helsinki Summit broadened the EU Enlargement process significantly, bringing the number of applicant countries to thirteen. There is now a broad consensus that radical overhaul of the EU’s institutions is essential to cope with a Union of up to thirty states, and the process of overhaul began with a new Intergovernmental Conference (IGC) established in February 2000 under the Portuguese Presidency. The IGC is scheduled to finish in December under the French Presidency, but on past experience this appears optimistic. It is thus likely that Sweden will also have a key role to play during its own first Presidency of the Council in the first half of 2001.

The precise scope of the IGC remains open, but at the very least, it will have to tackle the remaining policy areas of unanimous voting in the Council, since this is one of the unresolved issues from the Amsterdam Treaty. It is increasingly clear that achieving unanimity will become virtually impossible in a further enlarged EU. A recent report to the Commission by three influential commentators (Weizsäcker, Dehaene and Simon, 1999, sometimes referred to as the Dehaene Report) argued that

‘The need for qualified majority voting to be the rule in an enlarged Union, if decision making is to remain effective, is self-evident. When unanimity is required, the risk of blockage increases in due proportion with the number and diversity of participants. On the other hand, the experience of the Community itself shows that qualified majority voting creates a dynamic decision making process, leading to consensus, even if very few votes are effectively taken.’

Since that time the Commission has published its own, more detailed proposals on the IGC (CEC, 2000b). These adopt a similar approach, arguing that unanimity should in future be confined to taxation measures ‘not related to the operation of the single market’. This might seem to bring most foreseeable vehicle or fuel tax proposals within the scope of QMV, but again definitions are not straightforward. Most if not all tax harmonisation measures can be argued to be related in some way to the single market, in which case, some Member states would certainly oppose such a broad definition.

The logic of this argument does not mean that a change to QMV on tax matters will be easily achieved. On the contrary, many Member State governments and their finance ministries in particular remain strongly opposed to ceding their right of veto over tax matters. At the time of writing, outright opposition comes primarily from Germany, Greece, Spain, Italy and the UK, which represents a powerful coalition. This means that a wholesale switch to QMV seems highly unlikely at this IGC, and even NGOs keen to promote ecotaxation appear to accept this view (BirdLife International, 1999).

Changing the Treaty basis for fiscal measures is nonetheless a vital element in ensuring progress on some ecotaxation measures such as harmonised fuel duties. This can however be viewed as an opportunity as well as a problem, in that environmental measures might be taken as a vital ‘testing ground’ for applying QMV to a broader range of fiscal measures in the future. It is noteworthy that Ussher (2000) for example, while rejecting most of the arguments raised for tax harmonisation, does accept the rationale for harmonising minimum duty rates for environmental reasons.

With this in view, it is worth considering what fallback options are available to ensure that ‘green’ fiscal measures at least escape from the unanimity rule in the forthcoming IGC. Some of the possibilities are outlined below.

- It could be established that majority voting would apply only to certain categories of taxation measure, such as minimum standards required to pursue harmonisation.
- It might be possible to limit the scope of majority voting with specific criteria relating to the need to internalise external costs and avoid distortions in the single market. Other principles established in the Treaty (eg proportionality, subsidiarity, and the precautionary principle) would also apply to any future legislative proposals.
- Clearly confining the switch to QMV to ‘environmental’ measures would increase the possibility of support. There appears already to be rather more support for a change to Article 175 (ie removing the fiscal exemption under environmental measures) than there is for a change to Article 93 (where most Member States appear to support a retention of the veto).
- An amendment to Article 93, explicitly applying QMV to measures ‘with an environment purpose’ [sic] has been proposed by NGO groups (BirdLife International, 1999). This however seems likely to be problematic without a far clearer definition of what is *primarily* an environmental measure, and hence which article should be applied to an ecotaxation measure. It should be recalled that the Mineral Oils Directives were enacted to protect the single market more than to protect

the environment, for example, and might well not qualify for QMV under this approach.

Weizsäcker, Dehaene and Simon (1999) argue that all areas of Community affairs subject to QMV should also in future be agreed under the co-decision procedure between Council and Parliament. This is an important principle to ensure democracy and transparency in the Union, but two caveats should be made. The first is that co-decision is still a relatively new procedure, and some consider that it has not always worked well or efficiently in practice. The second is that, if it were to be applied immediately (along with QMV) to new areas of decision-making such as fiscal matters, it would represent an enormous increase in the powers of the Parliament, and hence a further erosion of the powers of the individual Member States. For both these reasons, this proposal would be likely to further increase the resistance of some Member States to an extension of QMV, and might be best deferred for the present.

It has previously been suggested that, if there were too much resistance to an extension of QMV to sensitive policy areas, unanimity might instead be replaced by a 'super-QMV' voting arrangement. This would require a larger majority than that specified for QMV, but could still allow small blocking minorities to be overruled. This too provides a fallback option that might allow progress to be made on fiscal harmonisation.

Conversely, it is also worth bearing in mind that the inevitable reweighting of votes in the Council will also have a bearing on the degree to which QMV is likely to be accepted for any area of taxation policy. Previous revisions of the Treaty have reduced the size of the qualified majority required, and this process may continue. Indeed, the Commission now favours a 'double simple majority' under which a measure could be passed by QMV when both a majority of Member States, and sufficient states to constitute a majority of the population, were in favour. The larger Member States (notably France, Germany and the UK) are accustomed to being able to form at least a blocking minority in the Council relatively easily, and will naturally be nervous of the extent to which this power will diminish in the future. Therefore their willingness to extend QMV is likely to be proportional to the size of the majority required to achieve a qualified majority.

There are other, broader aspects of institutional reform which are potentially of relevance to future fiscal harmonisation – most notably, a restructuring of the Treaty texts. As change on this scale is considered unlikely for the year 2000, and as no firm proposals have yet been tabled, these possibilities are not discussed here.

## 7.2 *Future Legislative Approaches*

As noted above (see Section 5.3), there are two possible upcoming developments which might represent a move towards harmonisation of minimum fuel duty levels – one being a new and broad-based agreement on energy products, and the other, a more limited update to the Mineral Oils Directive to raise the minimum rates specified. In effect the latter is a subset of the former, and a possible fallback position if a broader measure on energy products cannot be agreed. Either would be similar in effect in relation to road fuel duties, but either would continue to face formidable obstacles in the light of the continuing requirement for unanimity in the Council of Ministers. Raising minimum rates under the Mineral Oils Directives at least has the benefits of a precedent and a fairly obvious rationale, and may be less unpopular amongst the Cohesion states and others than a significant broadening of energy taxation.

Owing in part to its high fuel duties and its difficulties in Northern Ireland, the UK has now joined the number of ‘progressive’ Member States that are in favour of the minimum road fuel duty provisions of the proposal on taxation of energy products. However, owing to the difficulties set out above, it is anticipated that adoption of a new Directive is still far from certain, and will not occur in the near future. The sections that follow therefore outline some changes that might enhance the effectiveness and/or acceptability of a revised measure.

### *Linking minimum duty rates to per-capita GDP*

A major weakness of establishing a uniform minimum fuel duty rate across the Community is that, at best, it will only have an influence on those few states with the lowest rates in force – that is, it establishes only a ‘lowest common denominator’. As such, it has only a very indirect influence on rates in the majority of states, and, as the discussion above illustrates, it does not deliver a sufficient degree of harmonisation to avoid acute boundary conflicts between disparate duty rates.

As discussed in Sections 3.1 and 5.3, it is the poorer EU states that tend to have lower fuel duties and which are opposed to raising the minimum duties for fuel. One possible way around this, and a way which would arguably be more equitable, would be to link duty rates to per capita GDP. As Table 11 demonstrates, this would have the effect of reducing some of the disparities with respect of more peripheral countries. This point is of particular importance with regard to Portugal, which actually levies a relatively high rate of duty in relation to its GDP, and, at 3.91 per cent, generates the highest proportion of revenue from fuel taxes in relation to GDP (Kågeson, 1999).

**Table 11: Relating duty rates to per capita GDP**

<i>Petrol</i>	<b>GDP per capita/price (divided by 100)</b>	<i>Diesel</i>	<b>GDP per capita/price (divided by 100)</b>
Luxembourg	5.4	Luxembourg	6.7
Denmark	3.1	Denmark	4.1
Austria	2.9	Austria	3.8
Ireland	2.9	Belgium	3.8
Germany	2.7	Germany	3.7
Belgium	2.6	Netherlands	3.3
Spain	2.4	France	3.3
France	2.3	Ireland	3.0
Italy	2.3	Italy	3.0
Netherlands	2.3	Finland	3.2
Finland	2.2	Spain	2.9
Sweden	2.2	Sweden	2.8
Greece	2.1	Greece	2.8
United Kingdom	2.0	Portugal	2.7
Portugal	1.9	United Kingdom	2.0

*Source: Derived from Eurostat and OECD data*

The table highlights particularly the anomaly that Luxembourg has the highest GDP per capita in the EU, yet has the lowest fuel taxes. Linking taxes to GDP also suggests that other relatively wealthy countries such as Denmark, Austria, Germany and Belgium should also consider raising taxes in order to make these taxes better relate to their GDP. On the other hand, Table 11 suggests that the fuel duties in countries such as the UK, Sweden, Greece, Portugal and Finland are all roughly in line with each other when fuel duties are linked to GDP. The position of Ireland is notable, especially in the petrol table, which illustrates that Irish objections to increasing minimum fuel duties can no longer be justified on the basis of the country's relative poverty. Indeed, there is a stronger case for Ireland to increase petrol duties than there is for Germany, which has already decided to annually increase its fuel duty levels.

The particular significance of Portugal in this respect is that, at the time of writing, it holds the Presidency of the Council of Ministers. In this capacity the Portuguese government has both to initiate negotiations in the Intergovernmental Conference (discussed above) and to steer forward measures on energy taxation. Signs on the latter are not promising, in that this measure was conspicuously absent from the Presidency's programme of priorities, but some change in thinking may be possible in the course of the IGC.

It is also noteworthy that the two presidencies in the year 2000 (Portugal and France) are the two direct neighbours of Spain, which not only shows some of the strongest opposition to ecotaxation measures, but also held elections for a new government in the spring of 2000 (Schlegelmilch, 2000). These elections strengthened the position of the leading party in the former coalition government, and early pronouncements from the new Government suggested similar priorities in terms of keeping down taxation levels. However, it has been suggested by some sources in Spain that the Government's renewed mandate and secure parliamentary majority will not necessarily entrench its position on

energy taxes. Instead, they may give it greater room for flexibility on these issues, and renewed efforts at persuasion are therefore urgently needed.

### *Inflation-indexing of Minimum Rates*

A further weakness of the Mineral Oils Directives is that they established a minimum rate of excise duty in absolute terms. As such, it bears no relation to the value of the fuel, nor to the real value of the duty when account is taken of inflation. Thus the minimum standard is eroded over time, and cannot be revised without recourse to new action in the Council. Owing to the fraught nature of such negotiations, and the cumbersome procedures involved, the minimum rates have never been changed in the case of mineral oils, in spite of the requirement in Directive 92/81 that they should be reviewed every two years.

The energy tax proposal has improved on this to an extent by calling for modest increases over time. It would seem more sensible, however, that the minimum rates should, at the very least, be indexed to the Community's inflation rate by default. A provision could be included for the Council to suspend the automatic increase in the event of a sudden increase in the underlying price of oil or other exceptional circumstances, according to an agreed voting procedure.

### *7.3 Border Area and Sectoral Relief Schemes*

In principle at least, it might be possible to mitigate many of the border-related effects of fuel duty rates through relief schemes for those worst affected. For diesel fuel duty, the most obvious target would be long distance hauliers; for petrol, it would be retailers close to borders where major differentials exist.

#### *Border schemes*

In 1997, in order to address one aspect of the problem created by fuel tourism, the Dutch government introduced a scheme to subsidise 633 petrol stations within 20 kilometres of its border with Germany for loss of business as a result of the fuel price differential with its neighbour. The subsidy amounted to 100 Dutch guilders (EUR 45) per 1000 litres supplied for those petrol stations within 10 kilometres of the border and 50 guilders (EUR 23) per 1000 litres supplied for those petrol stations between 10 and 20 kilometres from the border. The amounts were subsequently doubled, but provisions were included to reduce the subsidy if German petrol duties increased. In order to ensure that the aid did not breach European state aid rules, a limit of EUR 100000 per petrol station, the *de minimis* amount that would not constitute state aid, was set on the amount each station could receive over the three-year period for which the scheme was to operate. However in a Decision last year (CEC, 1999b) the Commission ruled that elements of the Dutch scheme breached state aid rules as petrol stations could not be counted as individual enterprises if they were owned by the same company. Consequently, the Netherlands will have to recover the aid from the 450 petrol stations which were affected by this ruling. The Commission ruled that the aid paid to the other 183 petrol stations was covered by

the *de minimis* rule and therefore should be allowed. Consequently, such a scheme would be possible in other countries as long as the *de minimis* rule was not breached. However the UK Government has rejected the introduction of a similar scheme in Northern Ireland as it could prove to be expensive (Northern Ireland Affairs Committee, 1999b).

The problems of the Dutch amply illustrate the legal pitfalls of such an approach. The Commission's Decision has effectively allowed aid to a number of small and essentially independent operators, but has required that the aid be repaid for all stations which are formally or *de facto* under the ownership or control of the major oil companies. It added (in paragraph 94 of the Decision) that

‘The Commission would point out that the state aid rules are not an appropriate instrument for harmonising excise duty differentials between Member States.’

This appears to suggest that the Commission is not minded to look favourably on this sort of approach in future, even if the rules may allow it to be operated to a limited extent.

An alternative approach would be to have differential duty rates for border areas, but this too may be problematic under the terms of the Mineral Oils Directives. The latter generally require a single rate of duty for each fuel type across each Member State. However, Council Decision 92/510/EEC (CEC, 1992d) provided for a range of derogations from the original Directive 92/81/EEC. Amongst these, regionally-based derogations were mainly for exceptional cases where Member States were allowed to retain differentials already in operation on remote islands, for example. It is however worth noting that France was granted a derogation on fuel duties ‘within the framework of certain policies aimed at assisting regions suffering from depopulation’. Additional regional derogations cover Val d’Aosta and Gorizia in Italy.

Article 8(4) of Directive 92/81/EEC (CEC, 1992a) sets up a procedure for further exemptions or partial exemptions ‘for specific policy considerations’, but none appear to have been granted since 1992. The UK government has considered this approach as a possible solution for the problem of the Republic of Ireland - Northern Ireland border, but considers that a regional derogation would not be forthcoming even in an exceptional case such as this, owing to increasing concern that such moves run contrary to the Community's state aid provisions. The UK government is also opposed in principle to this approach, however, fearing that it would set a precedent for demands for reductions elsewhere (eg in rural areas). It may therefore be desirable to explore further the possibilities of using such arrangements as a means of limiting the border effects of large fuel price differentials.

### *Sectoral Schemes*

The Mineral Oils regime already allow for a number of exemptions or partial exemptions from duty on a sectoral basis – most notably for fuel used in passenger transport, and for freight carried by rail or inland waterways. Council Decision 92/510/EEC (CEC, 1992d)

and its successors also provide for a range of specific derogations relating to public passenger transport. Such provisions do in principle reduce the effectiveness of the Mineral Oils regime and introduce distortions. They are largely accepted, however, because many Member States feel that it is necessary to minimise the cost burden on public transport and other favoured transport operations. At the least, these exemptions have allowed some progress to be made on the larger problem of private road transport taxation.

France has requested a derogation from the Mineral Oils Directive for commercial vehicles over 12 tonnes in weight, up to a specified annual limit per vehicle. This is intended to protect hauliers from the impact of a rise in diesel duty (which is primarily directed towards curbing France's unusually high level of diesel car use). This application has been incorporated into a recent Commission proposal, and it is reported that Italy is considering a similar move.

Arrangements such as this are likely to be acceptable, provided that they respect the minimum rates of duty established, as they are national in coverage and are open in principle to foreign as well as domestic hauliers. They do of course reduce the effectiveness of the original duty rise in terms of fuel consumed, however, and do not therefore contribute directly to reduced emissions.

#### 7.4 *'Eco-Schengen'*

One possible alternative to either Member State action or full Community action is for a group of 'progressive' countries to pursue common aims on internalisation of external costs and duty harmonisation without waiting for others to fall into line. This approach, which has gained attention in particular in response to limited progress on setting minimum tax levels, has been referred to as 'Eco-Schengen', by analogy to the Schengen Group's action on border controls. Several meetings of representatives of a group of like-minded and progressive countries have now taken place.

Article 11 of the Amsterdam Treaty made provision for greater flexibility for Member States to go beyond Community standards where they consider it necessary – the so-called 'environmental guarantee'. However, the precise meaning of this article is rather obscure, and in practice it has been interpreted thus far in a very narrow sense, rendering it virtually unworkable. Indeed, this is reflected in the fact that the new provisions have yet to be put into operation for any purpose. Weizsäcker, Dehaene and Simon (1999) suggest that the provisions should be revisited in the current IGC, but at present they do not appear to provide an ideal vehicle for tax harmonisation.

Furthermore, at the time of writing, the possibility of extending the flexibility provisions of the Treaty do not appear to be a high priority for the IGC. The UK government, for example, considers that the 'safeguards' built in to this provision are important, and glosses over the inoperability of the current flexibility clauses. These and similar arguments will no doubt be used by other countries which, for various reasons, do not

really wish to see a more flexible geometry in the EU. On the other hand, there appears to be a majority of states which would like to see this clause clarified at least.

Since no detailed scheme has yet been developed to our knowledge, it is not possible to provide any detailed comments at this stage. There are however a number of attractions and possible disadvantages to such an approach. The first benefit is that a looser arrangement does in principle allow more rapid progress to be made. It also allows more easily for non-EU states (notably Norway and Switzerland) to be incorporated into an 'advanced' group such as Eco-Schengen.

On the other hand, if the main focus of the group were to harmonise fuel duties, its effectiveness could be limited by its membership. That is, it has been demonstrated above that some of the most acute cross-border differentials do not arise from the poorest and most peripheral Member States. Ireland is peripheral but no longer poor: Luxembourg is neither. Almost by definition, it is difficult to see how these countries could be persuaded to join such a group; and if they do not, then many current problems will persist. More generally, it is also not apparent what inducements could be offered to persuade additional states with an ambivalent attitude to raising duty levels to join the group.

It would in fact be easier for such a group to concentrate on harmonising other types of taxation (ie vehicle taxes, road tolls and local congestion and parking charges) rather than fuel tax itself. This however could also be of indirect benefit in terms of fuel charges, for reasons outlined in the next section.

## 7.5 *Alternative Approaches*

### *Shifting the Balance between Charges*

It has been noted above that a wide range of transport charges are being used (or have the potential to be used) for environmental purposes. All of these have different strengths and weaknesses in internalising various aspects of external costs effectively. For practical and historical reasons, fuel duties are currently the most heavily used mechanism for collecting revenues from the road transport sector, even though they are not a particularly good proxy for environmental damage except in relation to CO<sub>2</sub>.

At the same time, it has been illustrated at various points in the foregoing discussion that divergences in fuel duties present some of the most significant problems at present, while greater harmonisation towards higher levels presents some of the most intractable problems. It can therefore be argued that if a greater element of external costs could be internalised through other means (notably freight weight-distance taxes, road pricing or congestion charging), a lesser proportion of tax would need to be levied through fuel duties. In this case price differentials between Member States, and hence the difficulty of harmonisation, might be significantly reduced. It is noteworthy in this context that German hauliers in particular have recently stated a preference for road charging as an alternative to higher fuel duties, which they believe are damaging the German haulage industry.

In its recently published work programme for the year 2000 (CEC, 2000a), the Commission has indicated that it will publish in December a new Communication on EU vehicle taxation and options for future action at Community level. It is too early to be sure what this document will contain, but it may well include proposals which are helpful in terms of tax harmonisation.

The Community's passenger car CO<sub>2</sub> strategy will also be helpful in this respect, as additional measures are likely to be needed to meet the Council's agreed target of 120g/km average new car emissions, over and above the recent voluntary agreements with the motor industry. Accordingly an expert group has now been convened to address fiscal reform in relation to passenger car CO<sub>2</sub> – the final pillar of the Community strategy. The group held its first meeting on 10 April, attended by representatives of both environment and finance ministries from most EU Member States, along with representatives of ACEA and the environmental NGO T&E (the European Federation for Transport and the Environment).

Most Member States welcomed the Commission's plans for the group, provided that they did not give rise to new Community legislative proposals on taxation. A subgroup of the expert group will now gather data on the structure of passenger car taxation across the EU – with the emphasis mainly on new car registration taxes and annual taxes, at least in the initial phase. The objective of this exercise is to assess the extent to which motor taxes as a whole reflect CO<sub>2</sub> emission rates, and so it seems probable that fuel taxation levels and other related taxes and duties must be taken into account. Fiscal incentives for environmentally enhanced vehicles will also be considered. This subgroup is scheduled to report back towards the end of the year, and its final conclusions in 2001 could provide a stimulus to further coordinated action.

### *Sectoral Integration Strategies*

In spite of significant successes in controlling conventional pollution from vehicles, it has come to be realised that 'end-of-pipe' solutions are not sufficient to tackle all environmental problems in the transport sector, and that beyond a certain point, they may not represent the most rational or economical approach. It is therefore increasingly recognised that it is necessary instead to take a more holistic approach which addresses the economic drivers which cause the problems in the first place. Traditional environmental policy instruments cannot do this, so the integration of environmental considerations into sectoral policy-making is receiving growing attention at both the Community and Member State levels.

Reflecting this, Article 6 of the consolidated EC Treaty requires that environmental protection be integrated into the definition and implementation of all Community policies and activities. To put this requirement into effect, on an initiative of the Swedish government, the Cardiff Summit of June 1998 called on an initial three sectoral Councils to draw up and present integration strategies. Reflecting its high priority, transport was

one of these first three, and gave its first full progress report to the December 1999 Helsinki Summit.

Although this report has been criticised for lacking specific commitments and targets, it is generally recognised to be the most advanced of those produced so far. In particular it recognises that urgent action in terms of common and coordinated policies and measures will be needed in addressing road transport CO<sub>2</sub> emissions. The obstacles outlined above continue to slow down progress in this area, but pressure will continue to grow. Thus for example, environment ministers expressed their concerns at the lack of progress on energy taxation at the March Environment Council.

Furthermore, the integration strategy is unique in its close association with a specific and well-developed indicator-based reporting mechanism in the Transport and Environment Reporting Mechanism (TERM). The latter is a joint initiative between the Commission of the European Communities (the Commission), the Statistical Office of the European Communities (Eurostat) and the EEA.

The EEA is now far advanced in developing indicators for the EU and the Member States. The baseline TERM report (TERM-0) was presented to the Helsinki Summit, and went some way to add substance to the integration strategy of the transport Council by reporting on progress towards sustainable development. The first follow-up report (TERM-1) is expected to consolidate this effort by creating the basis for effective reporting on progress towards sectoral integration. This is to be achieved, first, by improving the quality of data and analysis, and second, by extending the geographical scope of TERM reporting to cover the EU Accession States.

TERM is predicated on the need for a strategic and integrated approach to transport and environment policy, which can encompass traffic and demand management alongside supply side measures and other instruments. It is viewed as an important tool in furthering the integration process by moving beyond primarily descriptive indices, and addressing the performance and efficiency of transport systems. It also incorporates measures of important 'leverage points' such as transport pricing, land use planning and economic performance in order to assess the state of policy action.

The primary audience for these indicators are the EU institutions and policy makers in the constituent Member States. TERM is intended to inform policymakers as to the degree of progress through existing policies and measures, and to provide support for future policy decisions. Since fuel price and degree of internalisation of external costs feature amongst the proposed indicator sets, these will provide a useful source of agreed data on future progress, and will act as a driver for more consistent policies within the context of integration. By the time of the next progress report (under the Swedish Presidency in June 2001) these could be sufficiently well developed to highlight major disparities in taxation and internalisation of external costs between Member States, and to stimulate further action in the Council.

As noted above, the Commission's planned report, including options for further action on vehicle taxation, should also be available by this time. Equally, other work arising from the Helsinki assessment of the integration process may also be available at this time, notably including further consideration of the possibilities for decoupling economic growth from transport demand growth, or at least taking steps to limit the latter.

In June 1999, the Köln Summit added ECOFIN to the list of council formations which are required to produce an integration strategy. An initial report is expected during 2000, with a full strategy again expected under the Swedish Presidency in 2001. Clearly the question of how progress on ecological taxation can be speeded up should be the central question for this strategy to address, particularly if no progress is made at the IGC.

#### *'Macro Cross-Compliance'*

In July 1999, the Commission warned several Member States that it might be unable to agree Structural Fund programmes for the period 2000-2006 if they failed to supply adequate lists of proposed sites under the birds and habitats Directives. Warning letters to this effect were sent to Ireland, Germany, France, the Netherlands and Portugal. The Commission justified its move on the grounds that it would not approve EU funding for construction projects contravening EU laws which protect these sites.

By analogy to certain funding arrangements in the agricultural sector, this approach has been given the unofficial title of 'Macro Cross-Compliance'. At the level of principle, this approach seems eminently reasonable, in that it is difficult to see why funds should continue to be given to states which are in violation of other relevant EU laws or policies. By extension, one can argue that it is counterproductive to continue to use EU funding to build roads in countries which have not internalised the external costs of transport, as this can be shown to be counterproductive in economic as well as environmental terms (SACTRA, 1999).

Reasonable as this line of argument may seem, it is not an approach which is likely to recommend itself to many of the Member States. Obviously those most likely to lose out financially would be the most resistant, but others might well object to what they would see as a dangerous extension of the Commission's powers relative to national governments.

In January 2000, the Commission has reiterated its threat that Member States will not receive funds for infrastructure projects and programmes under the Structural Funds, unless applications show that they do not threaten sites designated under the birds or habitats Directives. This requirement can, they argue, only be fulfilled if Member States have submitted adequate SAC lists.

The Commission's robust stance on this highly controversial initiative appears to reflect its confidence in the firm legal basis for such action. This however arises from a specific clause in the Structural Fund Regulation, from which a clear legal argument can be constructed. In the absence of specific legislation on tax harmonisation, it would probably

be far more difficult to justify such an approach to encourage harmonisation of environmental taxes. Given the changes brought in by the Amsterdam Treaty, and the development of Community policy on internalising external costs, it might however be worth giving further consideration to this possibility in the future.

Looked at from an alternative perspective, structural funds provide an obvious route to help mitigate the supposed regional development impacts of higher transport costs, and could therefore be used as a positive incentive to those poorer countries which agree to harmonised fuel and vehicle tax rates.

## **8 Conclusions and Recommendations**

The accession of Sweden to the Presidency of the Council (and its more imminent involvement in the so-called ‘Troika’ of Presidents) comes at an important time to influence the development of environmental taxation policy towards motor vehicles and fuels. This section therefore highlights the main conclusions of this report, and approaches and policy processes which may be of relevance in taking matters forward.

The points included are intentionally brief, and are cross-referenced to the discussion in the main text where relevant.

### *8.1 Conclusions*

There are currently some significant disparities in the structures and rates of taxation on fuels and vehicles across the EU. Equally, the application of road user charging either on long-distance routes or in urban areas is very patchy and essentially in its infancy. In many cases, duty rates are graduated only loosely if at all to reflect environmental factors, and their effectiveness in promoting environmental goals is likely to be limited (Section 3).

These disparities arise from a very broad range of historical factors and different political priorities on the part of Member States. They may have an adverse effect on the operation of the single market, and certainly cause a number of specific problems for Member States with high duty rates – notably with fuel tourism, fuel tankering, competitiveness of national road hauliers, and in some areas, smuggling. It can also be argued that these problems will be exacerbated in a number of ways as the EU enlarges eastwards, and the inertia which leads to slow progress on internalising external costs will be greatly increased. More rapid progress on harmonisation of minimum duty rates is therefore highly desirable (Section 4).

The polluter pays principle and the requirement to internalise external costs are now enshrined at the level of principle in EU policy, and a number of initiatives have been instigated in order to put them into practice. These have included moves towards fair and efficient pricing through road charging; harmonisation of minimum rates of VAT and fuel duty; further efforts to harmonise energy taxes; and the Eurovignette Directive.

However, progress to date has been very limited and painfully slow. Fiscal harmonisation has been to the lowest common denominator, with some basic minimum rates, but inflation and policies towards higher fuel duty rates have rendered these essentially irrelevant in most Member States. Further progress is still possible, but appears far from certain. At the root of this lack of progress is the unwillingness of a number of Member States to cede any competence in fiscal policy matters to the Community, and the benefits which some derive from lower tax rates (Section 5).

## 8.2 *Recommendations*

- It may be that monetary union will in the longer term exert pressure for harmonisation of fuel and other taxes. This may however lead to a ‘race to the bottom’ in terms of competitive taxation, and cannot be relied upon to produce an outcome which ensures a reasonable level of environmental protection unless other measures are taken as well (Section 6.1).
- While some Accession States have already brought fuel duty rates up to levels comparable with those of their EU neighbours, others have not. Accession will force states to raise duties at least to the minimum levels required by the EU, but will also increase the inertia which blocks further harmonisation and internalisation of external costs. Early progress is therefore essential (Section 6.4).
- The current IGC presents a critical opportunity to progress changes towards a more workable voting basis for environmental taxation, and the arguments for harmonisation here are far stronger than elsewhere. A blanket switch of all fiscal decisions to QMV is unimaginable; but without some changes, further moves on environmental tax harmonisation will go from difficult to virtually impossible (Section 7.1).
- A number of possibilities exist for increasing the acceptability of shifting such measures from unanimity to QMV voting. These include a close and limited definition of the measures to be covered; pursuing a change primarily to Article 175 rather than Article 93; and considering the application of ‘super-QMV’ to ecotaxation measures (Section 7.1).
- Further improvements to existing legislation on minimum duty rates should also be considered, including the index-linking of minimum rates, and linking progress on minima to each Member State’s GDP per capita. More work is still needed to address the concerns of blocking states, notably Spain and Luxembourg (Section 7.2).
- Border and sectoral relief schemes offer relatively little scope for mitigating the effects of cross-border duty differentials (Section 7.3). However, shifting the balance of motor taxes away from fuel tax might help to solve or mitigate some of the current problems (Section 7.5).
- An ‘Eco-Schengen’ initiative by like-minded states offers only limited advantages in pressing ahead with higher fuel taxes. It does not overcome the fundamental problems of border price competition, and would be better directed towards harmonisation of other types of motor taxation, such as circulation taxes (Section 7.4).
- Sectoral integration strategies (notably in the ECOFIN Council) and the need for a more coherent climate strategy in the transport sector might also present additional opportunities for further harmonisation of environmental taxation (Section 7.5).

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REPORT 5084

# *EU - Fuel and vehicle tax policy*

pricing is widely regarded as one of the most important regulator of environmentally harmful activities and transport demand. The report addresses taxes on fuels, vehicles and infrastructure use, and their possible contribution to an environmentally sustainable transport policy for the EU. It analyses the various interests and processes underlying the development of tax policies at the European level, explaining the existing state of play, the problems which are caused by current arrangements, and the various obstacles to further greening of the fuel and vehicle taxation system.

The report was written by Mr Malcolm Fergusson at the Institute for European Environmental Policy on behalf of the Swedish Euro-EST project. The Swedish Euro-EST project is a joint project involving national transport and environment authorities and has the objective of promoting a sustainable transport system in Europe.

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