

ENVIRONMENTAL TAXATION IN CENTRAL AND EASTERN EUROPE: THE CASE OF ALBANIA

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Abstract

The purpose of this article is to discuss the effects of environmental taxation in the transition economies of Central and Eastern Europe, with a particular focus on Albania. The first part of the article reviews the theory on the so-called first, second, and third best environmental taxes in transition countries, illustrating the discussion with a broad range of examples. The balance of the article deals with the specifics of the Albanian environmental policy climate during the post-communist transition and the application of environmental taxation in this context.

Keywords: Environmental Taxation, National Environmental Funds, Albania, Central and Eastern Europe

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1. INTRODUCTION

Environmental taxes are “fees levied for the purposes of raising revenues and/or altering the behavior of economic agents vis-à-vis the environment” [Bluffstone, 2003]. They are the main market-based instruments of environmental policy. Examples of environmental taxes include fees on pollution emissions by factories, gasoline taxes, charges on environmentally damaging products and taxes on production inputs that damage the environment.¹

The use of environmental taxes is believed to create a double dividend effect: (1) produce incentives for polluters to reduce environmental damages at lower costs – through the creation of a dynamic effect in the presence of competition, and (2) reduce the level of other distortionary taxes, such as income, payroll, and sales taxes, which distort labor supply and saving decisions [Fullerton and Metcalf, 1997]. However, this hypothesis is subject to

strong debates in the academic world. Some scholars believe that they tend to create higher deadweight losses than standard tax sources [Goulder 1994].

The purpose of this article is to discuss the effects of environmental taxation in the transition economies of Central and Eastern Europe, with a particular focus on Albania. The first part of the article reviews the theory on the so-called first, second, and third best environmental taxes in transition countries, illustrating the discussion with a broad range of examples. The balance of the article deals with the specifics of the Albanian environmental policy climate during the post-communist transition and the application of environmental taxation in this context.

2. TYPES AND CHARACTERISTICS OF ENVIRONMENTAL TAXES IN CENTRAL AND EASTERN EUROPE

Most often, “second-best” or “direct” environmental taxes are used in Central and Eastern Europe. They are linked to a level of environmental protection (i.e. specific pollution standards) set arbitrarily by the public sector, while ideal “first-best” or “Pigovian” environmental taxes take into consideration the full marginal social cost or externalities produced by an activity. In practice, the calculation of the full marginal social cost requires large amounts of information, which is costly to collect or entirely unavailable in the region. In addition, the marginal cost changes in time, requiring effective monitoring and assessment methods.

For direct taxes, the base is the amount of emissions that an activity produces. These taxes are effective: in several developing countries, it has been found that the elasticity of industrial air pollution emissions with respect to pollution tax rates is relatively high. Many countries use a two-tiered pollution tax structure, in which the tax rate slides according to the pollution levels. However, this policy encourages polluters to stay just below the threshold level.

Central and Eastern Europe and the former Soviet Union make wide use of direct environmental taxes, which were introduced in the region since the late 1970s. However, during communism, tax rates were based on engineering formulas with little relation to pricing theory and market notions, leading to non-payment.

“Third-best” or “indirect” environmental taxes are those levied on specific products or inputs, rather than on pollution emissions. Examples of indirect environmental taxes include taxes on gasoline, diesel fuel, electricity, heating oil, natural gas, vehicles, pesticides, chlorinated solvents, nickel-cadmium batteries, tires, and even plastic bags, and fees on fuels differentiated by sulfur and CO₂. They are widely used in Central and Eastern Europe, in addition to direct taxes, due to their implementation simplicity, a characteristic that some scholars deem essential in transition countries [Goodstein, 2008; Backhaus, 2004]. Their drawback is they create incentives to reduce the use of the product or input which is taxed rather than alter the polluter’s harmful behavior.

Now, while the cost of externalities is not yet paid for in full, due to low levels of tax rates and inefficient tax collection systems, the benefits of environmental taxation are evident [Bluffstone, 2003]. Other tools of environmental policy, which are used in Central and Eastern Europe with varying degrees of success include: environmental regulation (command-control approaches), government subsidies, marketable pollution permits, and public voluntary agreements (based on self-monitoring and self-reporting). Some scholars believe

that environmental taxation has been less effective than command-and-control regulation measures [Asný et al., 2009].

A particularly sensitive issue in Central and Eastern Europe is the use of revenues generated by the system. In general, revenues from pollution taxes are at least partly earmarked for environmental funds, which have a wide variety of structures and disbursement mechanisms [Bluffstone, 2003; OECD, 1995; Cowan, 1998]. Some interest groups, such as environmentalists, strongly support the use environmental funds. However, if these funds are not put into use as efficiently as they would have been by the private sector, then the support for environmental taxation is undermined and the tax system becomes regressive. In addition, the environmental funds of Central and Eastern Europe have very high administration and transaction costs, often even higher than the collected revenues [Asný et al., 2009].

3. ENVIRONMENTAL TAXATION AND OTHER REGULATION IN ALBANIA

Many of the current environmental problems, such as soil and river pollution, are inherited from the communist era, during which outdated industrial technologies were used. Prior to 1990 in Albania, environmental issues were generally ignored by the government and the population. Although the first basic law on environmental protection was adopted in 1967, the concept of environmental policy is a relatively recent introduction. The first National Environmental Action Plan was developed in 1993 and the first Ministry of Environment, now called Ministry of Environment, Forestry and Water Administration, was established in 2001. The process of developing environmental laws and policies is still under way and environment protection is not yet considered a political priority.

However, after 2000, the environmental cause received stronger impetus owing to Albania's aspiration to join the European Union. EU requirements for candidate states require the adoption of 1,200 environmental directives, in addition to the fulfillment economic and political criteria [Avignon, 2011]. The formulation and implementation of environmental policies and programs in line with the EU agenda represents a major challenge for the Albanian government.

Environmental policy is composed of a national strategy and several sectoral strategies, national and local action plans, and environmental programs, which make use of market-based instruments. Environmental taxes are conceived mainly as user charges to raise public revenues and are designed based on the principle "the polluter pays". Royalties, concessions, and penalties for law violations are also commonly included in environmental legislation.

Nevertheless, command and control measures, in the form of environmental quality standards, dominate environmental policy. New economic or social activities, which have an impact on the environment, must obtain a special permit.ⁱⁱ The law defines the general requirements that such activities should meet, many of which are based on self-control and self-reporting.

However, there are not yet technical means to evaluate the pollution that different activities impose. In general, monitoring activities lack standardized methodologies and adequate monitoring equipment, although some methodologies have been revised, based on international agreements that Albania has signed. There is no national environmental monitoring program with different monitoring subcomponents and the monitoring responsibility is spread across several institutions [CEP, 2002].

In general, law enforcement is very weak. Laws are regularly ignored or breached. This is due to: low wages of law enforcers, who are prone to corruption; lack of efficient regulation; difficulties in integrating the environment into other sectors; unclear division of responsibilities between ministries and national/local authorities; ineffective monitoring and reporting systems; insufficient environmental financing; and low awareness among policy makers and the public related to environment and climate change issues [SBEL, 2008]. Moreover, there is a lack of experts in environmental policy and legislation and the number of civil employees in the environmental sector is very low. This leads to dependence on international technical assistance, which weakens further the coordination between laws and projects [UNDP 2007].

3.1. Mechanisms of environmental policy in Albania

The mechanisms of environmental policy in Albania are scattered among myriad laws and regulations. Few comprehensive documents exist that discuss these mechanisms, and considerable research was required to collect the information for this section. Moreover, environmental taxes, fees, and charges are collected by several uncoordinated institutions.

The environmental economic mechanisms in Albania are classified as follows:

- Taxes on environmental pollution, i.e. user charges for sewage treatment and industrial waste collection and disposal. The Law on Environmental Protection (no. 8934, 2002) states that individuals and entities that have high pollution potential and/or discharge into the air, water and soil, are subject to environmental taxes.
- Taxes on the extraction and use of natural resources, i.e. taxes on water, land, minerals, flora, fauna.
- User charges for municipal services, i.e. charges for water supply, sewage collection, and municipal waste collection and disposal.
- Product charges, i.e. charges on transport vehicles.
- Penalties and fines for non-compliance.
- Financial incentives such as grants and soft loans.
- Instruments for air pollution management [CEP 2002].

Unlike other Central and Eastern European countries, Albania has no air pollution taxes based on emissions, no taxes on fossil fuels, and no tax differentiation for more polluting fuels. Environmental inspectors can impose fines for the following violations: unpermitted transportation of hazardous substances within the Albanian territory, import of waste and hazardous substances, violation of conditions for storage of hazardous materials during their transportation, and unpermitted release of pollution or release of pollution without informing the population about the hazard.ⁱⁱⁱ Also, inspectors can impose fines and penalties for non-compliance with air quality standards, on a case-by-case basis.

Instruments for water resources management include extraction charges, user charges for water consumption, sewage charges, and non-compliance fees. There are no charges on effluent discharges. The Council of Ministers sets the payments for water use depending on the city, the user group, the type of water to be used, the purpose of use, the season of the year, the amount of water, and the type of equipments available for water management after its use.^{iv} All payments are collected by water authorities. The Council of Ministers may decide to exclude from payment particular subjects at its discretion [CEP, 2002]. In many cases, households and businesses entirely evade payments for water use, including drinking water, although a number of sanctions for noncompliance are set, with fines varying from

100,000 to 2,000,000 ALL (\$1,000-\$20,000). Also, a large quantity of supplied water is lost, due to infrastructure defects.

In the case of municipal waste services, the sole economic instrument is a user charge for waste collection and disposal (the so-called “cleaning tax”), which is paid annually by residents and businesses to the local government and varies by user category. There is no charge on the amount of solid waste produced. Local revenues from waste services are relatively small and far from sufficient to provide proper incentives for waste reduction and internal recycling.

Taxes and charges on products and inputs (indirect taxes) are the most widely used instruments of environmental policy in Albania. However, their environmental impact has not been estimated. Some of these taxes are currently under revision, in order to align with EU requirements [Council of Ministers, 2010]. According to Law on National Taxes (no. 9975), these taxes are divided in four groups.

1. Import tax for used vehicles. For vehicles older than 10 years, the tax varies from 40,000 ALL to 128,000 ALL (\$400-\$1280), depending on the type of vehicle and the number of seats. For vehicles less than 10 years old, the tax varies from 48000 ALL to 80000 ALL (\$480-\$800). As Table 1 shows, this tax brings more revenues than all the other environmental mechanisms.

2. Import tax for all transport vehicles,^v which is calculated based on the engine power and the vehicle age.^{vi} Despite the formula results, the tax rate must be at least 60,000 ALL (\$600) for vehicles older than 10 years, and 40,000 ALL (\$400) for vehicles newer than 10 years. This tax overlaps with the prior one.

3. Carbon tax. This tax is set at the level 0.5 ALL (0.5 cents) per liter of gasoline and benzene and 1 ALL (1 cent) per liter of diesel. This tax is levied on both imported and domestic fuels. This tax was introduced in 2002 and its level has not changed since.

4. Tax on plastic containers of liquids. This tax is set at 2 ALL (2 cents) per liter for packages of more than 1.5 liters, and 1 ALL (1 cent) per liter for packages of less than 1.5 liters. Currently this tax is under revision (Council of Ministers, 2010).

A few other vehicle taxes are in use as well, including an excise duty and a value added tax on transport fuels, a vehicle registration tax, and a tax on the circulation of foreign vehicles. The excise duty on gasoline is different for leaded gasoline, unleaded gasoline, diesel, and other fuels. The excise on fuels is levied as a unit tax, which depends on the amount rather than value of imported fuel.^{vii} The value added tax on transport fuel is 20%. The responsible institutions for the collection of vehicle and fuel related environmental taxes, as well as the tax on the plastic containers of liquids, are the General Directorate of Customs, the General Directorate of Taxes and the Road Inspectorate.

Environmental fees include: fees for wetlands, services, forestry, pastures, fishery, aquaculture, and cleaning, environmental experts certificates, environmental licenses, and professional permits in forestry [Council of Ministers, 2010].

In case of violation of environmental legislation, fines and penalties can be imposed, too. Both the Civil Code and the Penal Code cover liability issues resulting from tempering with the environment. According to the Civil Code, individuals and businesses that damage natural resources or cause environmental pollution must pay compensation for the resulting damage. The Penal Code defines seven criminal acts against the environment, with sentences varying from fines to imprisonment up to 15 years.

Table no. 1 Revenues from environmental taxes and fees.

Environmental Tax and Fees	2007 (Euro)	2008 (Euro)	2009 (Euro)
Cleaning tax	8,329,186	9,945,569	11,934,683
Fuel Tax	4,175,573	4,396,947	3,480,916
Tax on plastic package	1,282,443	1,213,740	1,206,107
Used vehicles tax	21,167,939	20,801,527	20,000,000
Wetlands fee	626,896	45,690	317,980
Environmental licenses	221,439	272,513	230,574
Environmental experts certificates	26,089	30,081	0
Professional Permits	0	0	626
Seals fee	15,159	25,726	18,450
Environmental fines	9,935	24,146	487
Policy fines	2,614,959	2,300,740	483,480
Forestry fees	1,876,191	1,776,029	1,505,805
Fishery fees	12,414	25,446	33,038
Total value of environmental tax and fees	40,358,223	40,858,154	39,212,146
GDP	7,413,909,421	8,287,585,332	9,577,235,772
Share of environmental taxes to GDP	0.54%	0.49%	0.41%

Source: [Council of Ministers, 2010]

3.2. Use of revenues from environmental mechanisms. The National Environmental Fund

The use of environmental revenues is a disputed issue in Albania, due to the low trust of the population in the tax system. Currently, the revenues from environmental taxes and fines, which are collected by a number of scattered institutions, are turned over to the Ministry of Finances. The Ministry redistributes them to other institutions as part of their projected budget. The income generated from service fees is reallocated based on a joint guideline of the Ministry of Finance and the Ministry of the Environment, Forestry and Water Administration. By law,^{viii} the income from permit fees and fines for environmental law non-compliance should be used to finance the following activities:

- Elimination of pollution sources.
- Projects and rehabilitation measures for ecologically damaged zones.
- Scientific research and studies and professional training.
- Compensating environmental experts and institutions that prepare and review environment impact assessments.
- Administrative expenses related to the supervision of environment impact assessment monitoring programs or other similar programs.

Albania has not created yet an Environmental Fund. A draft law in 1995 on the environment proposed the creation of such a fund, based on OECD's Saint Petersburg

Guidelines and the polluter-pays principle. However, this project failed due to opposition from both the Ministry of Finance and the International Monetary Fund (IMF). They took the position that the establishment of extra budgetary funds would undermine the policy of fiscal integrity, which the IMF strongly advocates [CEP, 2002].

Today the creation of an environmental fund is seen as a necessity, if for no other reason than to comply with EU requirements. The National Environmental Fund will be created within 2011, as an extra budgetary program of the Ministry of Environment, Forestry and water Administration. A special inter-ministerial committee, with representation from all the Ministries, will be created for its administration. The fund will receive its financing from environmental taxes and fines, including the vehicle registration tax, the carbon tax, and the package tax, as well as other payments that will be introduced in the future. Moreover, each ministry (based on its field of activity) and international donors (based on specific projects) will contribute an amount to the fund [MoEFWA, 2010].

The functioning of the fund is not supposed to impede the competitiveness of the private sector (including imports). All sources of revenue will be earmarked exclusively for the purposes of improvement of environmental quality and reduction of health risks, including investments for environmental infrastructure (i.e. the management of solid waste and sewage), investments to increase energy efficiency and the use of renewable energy sources, research and plans for biodiversity and the environment in general, and training and education in order to promote environmental awareness. The fund will also address cross-cutting issues, such as the reduction of poverty and the increase of employment. Local governments will be important beneficiaries of the fund. Priority will be given to technological improvement, projects for which co-financing can be ensured, and projects that enable the enforcement of EU legislation. The Ministry of Environment, Forestry and Water Administration hopes that the creation of an environmental fund will make the reporting of national investments to the EU easier, more tangible, and assessable.

4. CONCLUSIONS

Environmental policy in Albania still underdeveloped and mainly consists of command and control regulatory measures, with few market-based instruments in the form of third-best taxes or indirect taxes. While the legal framework is well defined, and has been drafted in accordance with EU legislation, its implementation is very weak. Taxes on vehicles play the most important role. No taxes on other pollution emission sources are in use due to deficiencies in monitoring infrastructure. Fees and fines are also used but they often remain unpaid. The use of revenues is often put into question, since the population has little trust in the tax system. A national environmental fund will be created within 2011, as an extra budgetary program of the Ministry of Environment, Forestry and Water Administration. Its effectiveness remains to be seen.

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Notes

1. Environmental taxes are distinct from environmental charges and royalties. All payments of economic agents to the government for publicly-owned environmental goods or related services are defined as charges or royalties. Examples of charges and royalties are forest stumpage fees, land rent, mineral royalties, garbage collection fees, and water charges.
2. Law on "Environmental Protection". (2002, no. 8934)
3. Law on "Environmental Protection" (2002, no. 8934) and Law on "Protection of air from pollution" (2002, no. 8897).
4. Law on "Water resources" (1996, no. 8093).
5. Defined in Chapter 8703 of the Combined Goods Nomenclature.
6. The exact formula is: fixed tax × engine cylinders (m3) × coefficient of years of use. The level of the fixed tax is either 20,000 ALL or 25,000 ALL, according to the vehicle type. The coefficient of years of use is set arbitrary. The years of use are defined as the difference between the year when the vehicle entered the Albanian territory and the production year.
7. Law on Excises (2002, no. 8976).
8. Law on Environmental Protection (2002, no. 8934).