



## Environment Tax

This article is based on [“The many benefits of an eco tax”](#) which was published in The Hindu on 24/05/2021. It talks about the benefits & challenges associated with the environmental tax.

Environmental challenges are increasing the pressure on governments to find ways to reduce environmental damage while minimising harm to economic growth. The Covid-19 pandemic has also forced countries all over the world to rethink climate change and the need for preservation of the environment.

In this context, an **Environmental tax** is a novel idea to enforce or introduce taxes on substances, which pollute the environment, the ultimate aim being the substantial reduction of pollution.

India currently focuses majorly on the command-and-control approach in tackling pollution. The success of an environmental tax in India would depend on its architecture, that is, how well it is planned and designed.

### Environment Tax & Benefits

- **Aim:** The aim and purpose of environmental taxes is to curb or reduce the extent and amount of the use or consumption of harmful substances or activities, or depletion of a resource.
- **Constituents:** Environmental tax reforms generally involve three complementary activities:
  - Eliminating existing subsidies and taxes that have a harmful impact on the environment.
  - Restructuring existing taxes in an environmentally supportive manner.
  - Initiating new environmental taxes.
- **Rationale:** To the extent that promotion of ‘environment’ is a public good, like all public goods, financing of this public good should also be from the general pool of taxes including the environmental taxes.
- **Intended Benefits:** The implementation of an environmental tax in India will have broad benefits:
  - **Environmental:** It can induce appropriate environmental decisions by raising the relative costs of polluting inputs and outputs and thereby correcting the negative externalities of a polluting activity.
  - **Fiscal:** Environmental tax reforms can mobilise revenues to finance basic public services when raising revenue through other sources proves to be difficult or burdensome.

### Status of Environmental Tax in India

- Under the Forest Conservation Act, 1980, any entity that diverts forest land for non-forest purposes is required to provide financial compensation for the purpose of afforestation in non-forest or degraded land.
  - In 2002, the Supreme Court had directed that a Compensatory Afforestation Fund (CAF) should be created to manage the funds generated.

- Similarly, India's Clean Environment Cess or coal cess acts as a carbon tax.
  - The coal cess is levied on coal, lignite and peat at the rate of ₹ 400 per tonne, and the funds raised are managed by the National Clean Environment Fund.

## Associated Challenges

- **Inflationary Effect:** Environmental regulations may have significant costs on the private sector in the form of slow productivity growth and high cost of compliance, resulting in the possible increase in the prices of goods and services.
- **Diversion of Funds:** A large part of taxes raised for environmental purposes are being diverted or lying unutilized.
  - Most countries' experiences suggest negligible impact on the GDP, though such revenues have not necessarily been used for environmental considerations.
- **Affecting Competitiveness:** The adding of costs to a producer within one country or region, that is not imposed on producers outside that country or region, may of course impact on the competitiveness of the local producer.

## Way Forward

- **Assessment of Externalities:** The environmental tax rate ought to be equal to the marginal social cost arising from the negative externalities associated with the production, consumption or disposal of goods and services.
  - This requires an evaluation of the damage to the environment based on scientific assessments.
- **Provisioning:** In developing countries like India, the revenue can be used to a greater extent for the provision of environmental public goods and addressing environmental health issues.
- **Better Targeting:** In India, environmental taxes can target three main areas:
  - Differential taxation on vehicles in the transport sector purely oriented towards fuel efficiency and GPS-based congestion charges;
  - In the energy sector by taxing fuels which feed into energy generation;
  - Waste generation and use of natural resources.
- **Environmental-Fiscal Reforms:** There is also a need to integrate environmental taxes in the Goods and Service Tax framework as highlighted by the Madras School of Economics in its studies.

## Conclusion

Green taxes shall have a deterrent effect, sensitizing the citizens about pollution control and management. Hence, this is the right time for India to adopt environmental fiscal reforms.

### ***Drishti Mains Question***

Green taxes shall have a deterrent effect, sensitizing the citizens about pollution control and management. Discuss.