The Impact of Differential VAT Rates on Consumption and Innovation

This study deals with the impact of reduced VAT for environmentally friendly products on sales and product characteristics. Ecologic analysed the fields of white goods and insulation materials to find out whether a price differential between environmental and conventional products would lead to changes in the behavior of consumers, producers and retailers.

Background

The European Union is aiming for a more intensive use of market-based instruments in the field of environmental policy. An example of such instruments includes the use of differential tax rates in order to stimulate supply and demand of environmentally friendly alternatives within a specific product group. The introduction of reduced VAT for environmentally friendly products (while keeping the standard rate for other products) would lead to a relative price reduction for “green” products, assuming that the supplier passes the financial gain on to the consumer.

Methodology

In this study, the question of how VAT can be used to achieve environmental objectives was addressed in various ways:

- through a literature review;
- by reviewing experiences with previous and existing (environmentally motivated) VAT reduction and other subsidy schemes;
- and by interviewing stakeholders.

Five case studies were carried out as illustrations and in-depth explorations of the possible impacts. These case studies looked at the following products: central heating boilers, household appliances (‘white goods’ such as refrigerators, washing machines, dishwashers and freezers), thermal insulation, domestic energy, and...
meat and dairy products. Interim results of ongoing parallel studies on related subjects were taken into account.

**Results**

If passed through fully to the consumer, VAT differentiation will reduce the price of ‘greener’ products by some 10 to 15 percent, compared to other products, which would retain the standard, higher VAT. This may not always be enough to bridge the price gap with the ‘less green’ alternative. However, in the case of energy efficient products, the payback period will become shorter.

There is also evidence for the existence of a “signalling effect”: subsidies and fiscal incentives, if properly communicated, tend to have an impact on consumer demand beyond the purely financial advantage they confer, thus a VAT reduction is likely to be used as a communication and marketing tool by firms.

VAT reduction can, furthermore, stimulate the innovation dynamics in ‘green’ product markets, including learning curve effects and Porter-type competitive advantages.

A majority of the stakeholders consulted tend to support reduced VAT rates for ‘green’ products, if properly designed and accompanied by supporting measures.

The [final report](#) [1] can be downloaded from the Europa website.

**Further Links**

- European Council: Renewed EU Sustainable Development Strategy

**Funding**

- European Commission, Directorate-General Environment (DG Environment)

**Partner**

- VU University Amsterdam, Institute for Environmental Studies (IVM), Netherlands

**Team**

- Dr. Ingo Bräuer

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