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**OECD LABOUR/MANAGEMENT PROGRAMME**

**SOUND ENVIRONMENTAL PRACTICES AND TAX/SUBSIDY POLICY**

**Report on a Workshop with experts from International Non-Governmental Organisations held  
under the OECD Labour/Management Programme**

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held under the OECD Labour/Management Programme

(Paris, 26 September 1997)

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## **FOREWORD**

Under the OECD Labour/Management Programme for 1997, a Workshop with experts from International Non-Governmental Organisations on “Sound Environmental Practices and Tax/Subsidy Policy” was held in Paris on 26 September 1997. The meeting was prepared in collaboration with the Business and Industry Advisory Committee to the OECD (BIAC), the Trade Union Advisory Committee to the OECD (TUAC) and representatives of international environmental NGOs.

Below is an overall report of the discussions of the meeting of experts, prepared by Dr. Anne Richards, who was designated as General Rapporteur for this activity.

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## FINAL REPORT ON THE MEETING

by Dr. Anne Richards<sup>1</sup>  
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(United States)

### INTRODUCTION

Within the framework of the OECD Labour/Management Programme for 1997, the BIAC, TUAC, representatives of international environmental NGOs and the OECD Secretariat held a one-day workshop on 26 September 1997, on Sound Environmental Practices and Tax/Subsidy Policy. The objective of the meeting was to contribute to the work in progress in pursuing the mandate from the Council to perform: “a wide-ranging study of the effects of subsidies and tax disincentives to sound environmental practices in various economic sectors, and the costs and benefits of their elimination or reform, as proposed by the G-7 Environment Ministers in May 1995”. The study is to be presented to the OECD Council at Ministerial level at its meeting end-April 1998. The Chairman, Mr. Long, noted in his opening statement that the workshop would inform the process of fulfilling the Ministerial mandate, in particular, by identifying the message to convey as well as the means to convey it.

The agenda covered four substantive items: (1) Brief overview of trends and of ongoing work on data collection and previous analytical case studies; (2) Important supports and tax incentives in various economic sectors; (3) How, from the environment perspective, can we prioritise support measures and tax incentives to be reformed or eliminated; and (4) An action-oriented approach. The Chairman invited participants to share their views and best information available to them on the environmental implications of subsidies and tax measures; to discuss the added value in the approach and methodology developed in the Secretariat’s study; and to give their advice on formulating a strategy for phasing out subsidies and tax measures that have harmful effects on the environment. A summary of the discussions is presented below under each agenda item.

### **ITEM 1: Brief overview of trends and of ongoing work on data collection and previous analytical case studies**

To begin the discussions, first Mr. Long then Mr. Pieters reviewed the nearly 30-year history of the OECD’s work on support measures and the environment. Starting in the early 1970s, the OECD first became involved with PPP analyses. Subsequently, work focused more on certain sectors – agriculture, water, wetlands, transport, energy – where problems appeared to be most severe. In the mid-1980s worldwide efforts to reduce/eliminate agricultural subsidies were greatly facilitated by the OECD’s work in developing the PSE/CSE measures. In the early 1990s, analyses of environmentally harmful subsidies

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<sup>1</sup> Dr. Anne Richards was formerly a Principal Administrator in the Trade Directorate of the OECD.

focused on energy and the accumulation of greenhouse gases. OECD and World Bank estimates of these subsidies were in the hundreds of billions of U.S. dollars. Many governments began to change policies as a consequence.

In November 1995, at an OECD workshop on “Subsidies and Environment: Exploring the Linkages”, numerous sector studies were reviewed simultaneously for the first time<sup>1</sup>. As outlined by Mr. Michaelis, these studies showed that the effects of subsidies on the environment can be very diverse in size and impact. In some cases, the effects could even be positive. The complexity of the results made it difficult to draw strong conclusions from them, handicapping cross-sector and cross-country generalisations. Although the methodologies used in the studies differed in important ways, notably in their definition of subsidies, and therefore they were not strictly comparable, there were three important side outcomes:

- One was to highlight the role that institutional systems play in shaping support mechanisms and in determining their economic and environmental impact. Here, it was critical to identify the stakeholders, or the interest groups, that benefited originally as well as those benefiting subsequently from the various support measures
- Another was the finding that subsidies tend to cluster. For example, subsidies to energy attract materials-intensive industries. These industries, in turn, bias the incentives facing the upstream and downstream industries in a corresponding manner. Institutions, moreover, and the behavioural patterns they engender, can greatly influence the extent and duration of such clustering.
- The third notable outcome was that general trends indicate a decline in the level of subsidies overall, corresponding to a change in their composition, but the pace of the transformation in subsidy types is uneven across sectors.

In the case of agriculture, while price supports remain the dominant form, direct subsidies to inputs are declining as direct payments are rising. This reduces the impact of subsidies on the environment. In the energy sector, subsidies have been cut where they were previously concentrated, notably for coal. The transport sector, in contrast, continues to be subsidised in various ways: infrastructure as well as certain traditional fuels are still provided at prices below long-term social costs. Similarly in the industrial sector, many forms of support are in existence. Tax exemptions are prevalent; but measurement of the subsidy element in tax exemptions is subject to dispute since there is no agreement on the benchmark reference, or social welfare function. Many forms of industrial support, in addition, are not transparent, and these may be on the rise.

At a recent meeting of experts in the UN on subsidies, concern was renewed over the effectiveness of subsidies in achieving their stated social objectives, while having serious disruptive effects on the environment. In the last two years, international interest has heightened further due to two main factors: globalisation and the ensuing need for governments to set policies at the global level; and widespread fiscal consolidation, causing governments to seek new sources of public savings. Where alliances between Finance and Environmental Ministries have formed, this has given rise to the expectation that win-win solutions can readily be found by reducing subsidies and tax concessions that are harmful for the environment.

Mr. Pieters explained that the Secretariat’s present study follows from this historical and political context and will create a template that all governments can use. It will serve as a framework for: (1) deriving distinct characteristics of support measures and tax incentives that are reliable indicators of significant adverse effects on the environment; and (2) identifying possible implementation strategies to reduce

support, nationally and internationally. [Please also see the Discussion Paper for the Workshop, SG/RE/LMP(97)10.]

Participants raised a number of issues in response to Mr. Pieters' presentation. First of all, there was a broad consensus that the study should give greater importance to the social incidence of subsidy reform. Many participants stressed that equity considerations should be included explicitly along with the budgetary and environmental impacts. Reference to the three pillars of sustainable development was made repeatedly by way of example. Citing the experience of Greece, Professor Skourtos noted that certain subsidies had been identified as being clearly win-win from all three perspectives and others clearly no longer brought net benefits to anyone. In this last category, he placed certain energy subsidies and noted that public opinion had begun to shift towards their removal. Other participants (notably, Ms. Kruszezka, Mr. Gjelsvik and Mr. Green), however, thought that identifying subsidies for win-win outcomes at the international level would not be that easy. They stressed the importance of respecting differing national interests and aims. Still others were concerned that the Secretariat's approach would be too mechanistic. They had been disappointed in this respect with the results of the OECD's regulatory reform project.

Mr. Green made a plea for caution in carrying out subsidy reforms. He noted that subsidies are often in place to compensate for an otherwise uneven playing field. Their removal could undermine this balance and place an unintended disadvantage on certain groups of people. Another concern was voiced over the potential loss of competitiveness of the final product when subsidies are removed. Ms. Lovera pointed out that trade promotion could take the place of subsidies and recommended that more attention be paid to the interests and concerns of developing countries. These countries, she pointed out, will experience the greatest environmental impacts from climate change and need to be included in any analysis of the subsidy-environment interface. Other participants, notably Ms. Hamilton, Ms. Lovera and Mr. Jones, underlined, in addition, that subsidy reforms, to be effective, need to be planned and implemented in the context of a coherent policy plan. A pro-active report should consider not only subsidy removal but also jobs, technology and ways to change environmental behaviour.

There was considerable discussion around the question of whether subsidies to certain production inputs tend to lock in technologies that lead to environmental damage. One point of view expressed by Mr. Lepas was that the actual lock-in effects of subsidies are greatly influenced by the institutional and policy framework in place in the region or country. Another opinion expressed by Ms. Hamilton was that the development of new technologies to reduce CO<sub>2</sub> emissions needs to be accelerated as a first priority. It was no longer acceptable, she said, to support mature non-renewable energy producing and consuming industries, regardless of the speed of their technological transformation. She argued, moreover, in favour of a redirection of subsidies in favour of renewable energies that can not otherwise compete with traditional energy forms. Ms. Hamilton then stressed that if support can not be shifted to renewables, then at least it should be decoupled from production if it is truly the employment concerns that are the main purpose of the support in the first place. She suggested it would be better to directly subsidise employment creation and transitional unemployment instead of the current production-linked support. Mr. Pieters agreed with this point and emphasised that most subsidies to energy and material inputs are very inefficient ways of supporting employment and income; direct income payments, he stressed, could clearly be more efficient.

Mr. Nyberg similarly spoke in favour of tax incentives to service industries which depend much less than other industries on environmentally-harmful inputs. Mr. Martin thought that more work on the service sectors was needed in general. Other participants urged the Secretariat to try to include subsidies that directly benefit the environment in their study. Examples included the provision of subsidies for

education, public transport and new technologies. Participants noted that from their own experience, the results of support for public transport were mixed: positive in Belgium, negative in Greece.

In reply, Mr. Pieters explained that the mandate indeed called for studying the costs and benefits of support, but that any evaluation of the equity and employment effects of support measures should start with exploring how support measures actually influence production and consumption decisions. He also explained that, given the diversity of support measures, a comprehensive overview of the equity and employment effects, like the precise environmental effects, was not feasible, and that the study would therefore inevitably focus on the way support influences production and consumption decisions. From there, analysis of the environmental and social consequences can be developed. Following the mandate and drawing from the available case studies, the report will try to indicate some general insights regarding the characteristics of support measures that lead to harmful social and environmental effects (win-win situations for support removal). As to the question of the technological lock-in effects of certain subsidies, Mr. Pieters added that the lock-in effects seem to be particularly evident where the support measures have been conditional upon resource use and specific technologies. Such conditional support impedes technological change towards greater resource productivity, one of the most promising strategies for environmental improvement.

On the recommendations to broaden the study to include pro-environmental subsidies, Mr. Pieters explained that the Secretariat's mandate for this particular study was limited to subsidies of which the removal will lead to win-win outcomes. Nevertheless, he added that, given certain conditions, there could be a case for supporting renewable energy sources as infant (public good) industries. At the same time, he warned that subsidies to renewables, should they be considered, should not be made conditional upon certain technologies or input uses, but rather upon environmental criteria, and they would have to be temporary.

Mr. Pieters noted that the study would, however, take account of the institutional and broad policy mix in place in the OECD countries. Although the study would not be specific as to which subsidies needed reform in particular countries, the study would provide a common approach or template for governments to use in carrying out their reform programmes. The aim is to help governments look more efficiently at the problem of environmentally-harmful subsidies.

## **ITEM 2: Important supports and tax incentives in various economic sectors**

Mr. Pieters presented a detailed overview of the methodology to be applied in the Secretariat's forthcoming study. [Please see Annexe I for this Item -- only available in English.] There were essentially three steps involved: (1) identifying subsidies and tax supports by sector; (2) analysing the way these measures work through the economy; and (3) analysing the way they affect the environment. Examples were presented for four sectors (agriculture, energy, transport, industry) as well as an overall measure of the impact of support measures on producer and consumer prices, the Marginal Effective Tax Rate (METR). Based on the existing evidence from the sectoral case studies, Mr. Pieters stated that one could draw the conclusion that the prime suspects for priority removal are subsidies to traditional energy forms and material inputs. This is because such subsidies are likely to have large environmental effects, tend to be especially costly and, more often than not, do not serve their social objectives effectively, especially in the long run.



Participants thanked the Secretariat for their presentation and commended them for the solid analytical framework they had developed. Questions were raised nonetheless that continued to reflect the concerns expressed under the previous Item.

First in importance, participants felt that the social incidence of subsidy reforms needed to be made clearer in the Secretariat's methodology and brought into equivalence with the fiscal and environmental incidence<sup>ii</sup>. Some thought that the question of compensation, especially for workers, needed to be addressed more fully. The possibility was also raised of shifting subsidies directly to those losing their jobs due to subsidy removal.

The inclusion of non-price support measures was urged by Mr. De Vries. Measures such as subsidies to R&D, other participants felt, could have particularly important lock-in effects on harmful technologies and industrial patterns. Several participants noted the importance of handling possible conflicts in subsidies for the same industry. In this regard, Professor Skourtos noted the case of fisheries in the Aegean Sea.

Mr. Brandt cautioned that differential tax rates are not automatically equivalent to subsidies. He cited as an example the relatively low tax rate on unleaded fuel in the Netherlands that is paid for by the relatively high tax rate on leaded fuel. Mr. Pieters stressed that to evaluate tax differentials, it is important to look at the overall effects of government interference in prices, netting taxes and support, and to investigate whether this net effect could be justified according to social cost accounting (i.e. social and environmental effects). The METR, he explained, is a useful indicator in this regard for it captures the net effect of support/tax incentives on prices as well as the impact of support/tax measures on the level and rate of intake of materials and energy. He added that, notwithstanding its considerable data requirements, the METR does permit estimates of both the environmental and social impacts of subsidies. Useful results have been obtained for recycling vs. non-recycling, for example, he said.

There was very little support for trying to apply the METR, however. Ms. Hamilton felt that the lumping together of supply and demand prevented tracing links accurately between support measures and their social costs and benefits. She also stated that the tremendous data requirements precluded using the METR to prioritise harmful subsidies for removal or reform. Professor Skourtos suggested using material flow accounts instead of the METR, according to the EU's practice. Finally, concerns were again raised that the developing countries were not included in the analytical framework.

### **ITEM 3: How, from the environment perspective, can we prioritise support measures and tax incentives to be reformed or eliminated**

On the basis of the Secretariat's analytical framework, Dr. Richards proposed a simple method for identifying characteristics of support measures that are reliable indicators of significant adverse effects on the environment. Drawing upon neutral network techniques, this method can yield information for governments on how to prioritise support measures that are candidates for removal or reform. Information can be sifted in three stages:

*Step 1:*

- Classify support measures by method of financing and support conditions
- Rank sectors which receive substantive support, notably through support to energy, water, materials, and which generate significant amounts of waste and pollution

*Step 2:*

- Calculate, for the top x existing support measures, the fiscal incidence, or the net effects of these measures on groups benefiting/footing the bill in the future time periods under consideration (t+1...t+n)
- Calculate the environmental incidence from changes in potential pollution due to: (1) support measures in time t; (2) environmental policy changes in time t+1; and (3) environmental damages in time (t+1...t+n)

*Step 3:*

- Prioritise support measures for reform by ranking them according to the asymmetry between the fiscal and environment incidence, or, more specifically, the degree to which the benefits outweigh the costs associated with their removal

The Chairman then sought the views of participants on the feasibility of applying such a method. Most participants felt that such a simple method neglected aspects of reality that were essential to consider in a report to Ministers. For the most part, these pertained to the details of social cost/benefit accounting that had already been stressed as being critical to the OECD study. The missing information included: the segmented distribution effects; the identification of the stakeholders and of the consequences for them; transition aid; and the regulatory/institutional context. Other participants thought that the question of which group would be doing the prioritising was important to address at the start of the analysis. Many participants also felt that the method neglected the dynamics of subsidy reform. Ranking measures according to their net fiscal incidence would overlook the fact, for example, that fossil industries make a contribution to government programs on renewable energies. Some participants thought that more work was needed to better capture the mix of subsidies and taxes together.

#### **ITEM 4: An action-oriented approach**

In introducing this Item, Mr. Potier addressed the question of how to orient strategy to find a win-win solution once support measures have been prioritised. He proposed six ideas that might be recommended to Ministers:

- (1) Invite governments to heighten transparency: inform the public on subsidies. One could cite the numbers as to the relative size, costs and benefits, the distribution of the burden. Put into evidence the conflicts between different groups. Make clear the consequences for developing countries of such conflicts. For example, one could establish whether it is true that subsidies to certain traditional energy sources are greater than subsidies to nascent renewable energy sources.
- (2) Invite governments to reconsider/rechannel subsidies in a direction that is more favourable to the environment.
- (3) Accent the synergy between different reforms. Synergy may be enhanced if reforms can be consolidated.

- (4) Stress the timeframe of reform. Allow different transition periods for different social groups and consider transitional compensation.
- (5) Invite governments to support positive international coordination/collaboration.
- (6) Identify better different social actors touched by measures/reforms: raise awareness of the costs of support for taxpayers; broaden the coalition for reform.

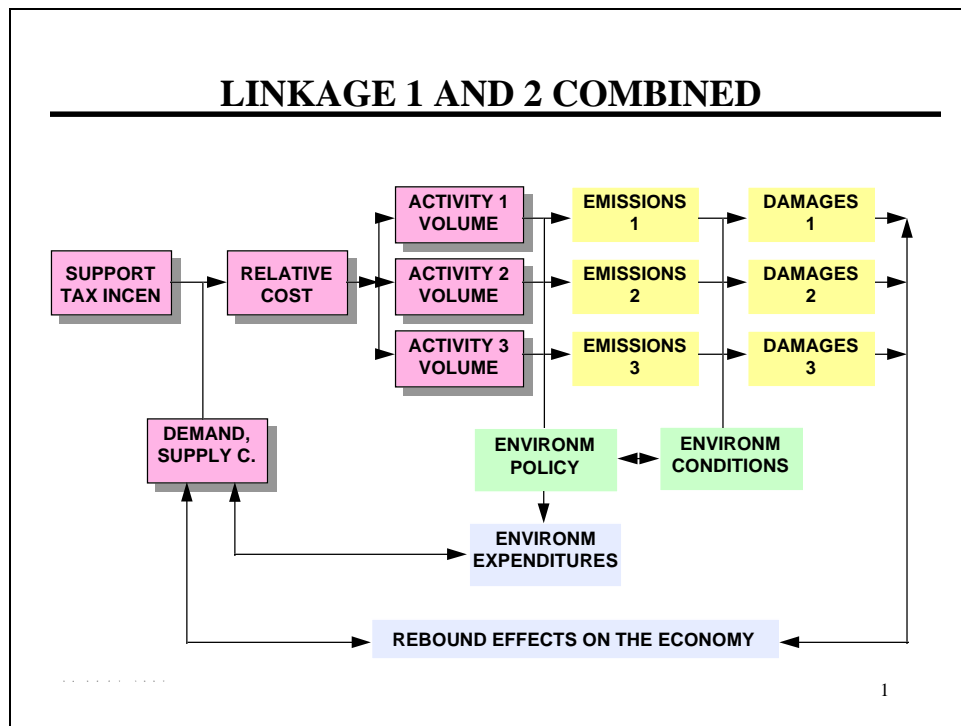
The Chairman then added one more to the list: (7) Monitoring performance.

Participants generally welcomed these recommendations. Making subsidies more transparent was considered to be especially important by all speakers. While questions were raised about who would do the monitoring and against what criteria, participants considered that better data collection and international coordination would help governments in this regard.

The Secretariat thanked participants for their helpful suggestions throughout the workshop and stressed in particular that they would devote greater attention to the details of social incidence in the forthcoming study. Participants, in turn, expressed their thanks for a good and constructive meeting around a well-organised agenda.

ANNEX I -- PRESENTATION BY MR. JAN PIETERS<sup>2</sup>

INTRODUCTION TO ITEM 2 OF THE AGENDA:  
“Important supports and tax incentives in various economic sectors”



<sup>2</sup> Mr. Jan Pieters, Administrator, Economics Division, Environment Directorate of the OECD.

## ANALYSING LINKAGE 1 AND 2 COMBINED

LINKS BETWEEN:

SUPPORT AND TAX INCENTIVES AND VOLUMES OF ECONOMIC ACTIVITIES (PRODUCTS, PROCESSES)

CHANGES IN THE COMPOSITION OF PRODUCTION AND VARIABLES OF ECONOMIC POLICY (EMPLOYMENT, GROWTH, EQUITY)

FACTORS

DEMAND-, SUPPLY- AND SUBSTITUTION ELASTICITIES

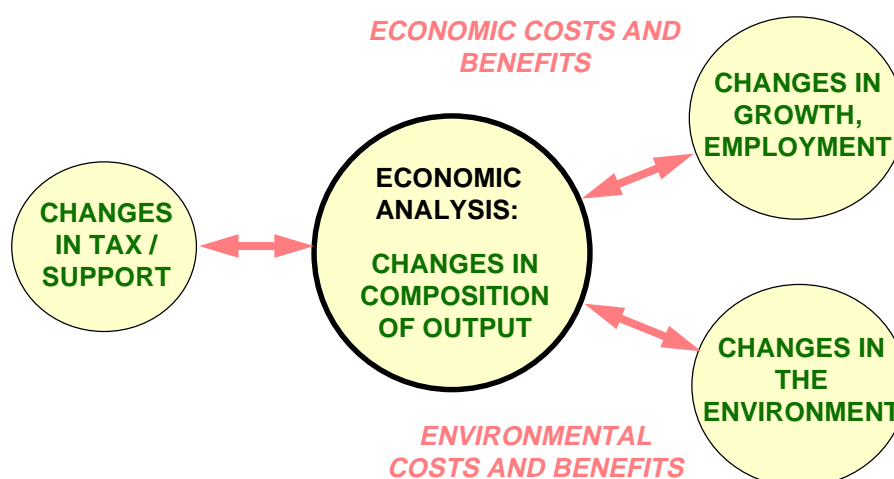
TYPE OF ANALYSIS

MARGINAL EFFECTIVE TAX RATES - ; GENERAL/PARTIAL EQUILIBRIUM ANALYSIS

26 SEPT 1997

2

## THE CRUCIAL ROLE OF ECONOMIC AND FISCAL ANALYSIS



26 SEPT 1997

3

## **KINDS OF SUPPORT AND TAX INCENTIVES**

- **COST REDUCING**
  - **MATERIALS / ENERGY:  
VARIABLE COST (MARGINAL COSTS)**
  - **VALUE ADDING FACTORS:  
LABOUR, CAPITAL, RISK, LAND**
- **REVENUE RAISING**
  - **MARKET PRICE SUPPORT (OUTPUT)**
- **DIRECT INCOME SUPPORT**
  - **NOT RELATED TO INPUT OR OUTPUT**

26 SEPT 1997

4

## **FISCAL INCIDENCE & ENVIRONMENTAL INCIDENCE**

- **FISCAL INCIDENCE**
  - **EFFECTS ON COMPOSITION OF OUTPUT**
    - **MARGINAL COST = VARIABLE INPUTS =  
MATERIALS AND ENERGY**
    - **MARGINAL REVENUES = MINIMUM PRICE  
REGULATIONS = GOVERNMENT BROKERED SALES**
- **ENVIRONMENTAL INCIDENCE**
  - **EFFECTS ON INPUT USE & EMISSIONS =  
EFFECT ON RESOURCE PRODUCTIVITY**
- **PRIME SUSPECTS: ENERGY, MATERIALS**

26 SEPT 1997

5

## SECTORAL SUPPORT AND TAXES (1)

---

- **AGRICULTURE**
  - **MARKET PRICE SUPPORT**
  - **INPUT SUPPORT**
  - **DIRECT INCOME SUPPORT**
  - **SPECIAL TAX RATES**

26 SEPT 1997

6

## HOW SUPPORT PERFORMS (1)

(TENTATIVE CALCULATIONS FOR AGRICULTURAL SUBSIDIES;  
EFFECTS ON THE AGRICULTURAL SECTOR ONLY)

---

POINTS OF INCIDENCE	EFFECTS ON:			
	EMPL.	TRADE	INCOME	ENVIR.
INPUTS	+	- - -	+	- - -
MARKET SUPPORT	++	- - -	++	- -
<b>DIRECT INCOME</b>	.....	.....	.....	.....

**THREE CHEERS FOR DIRECT INCOME SUPPORT !**

7

## **SECTORAL SUPPORT AND TAXES (2)**

---

- **ENERGY PRODUCTION**
- **ROYALTIES**
- **R&D (?)**
- **RISK**
- **NON INTERNALISED COST**
- **LOW RATES OF RETURN**
- **TAX EXPENDITURES**
- **REGULATIONS**
- **TAX CODE**
- **MARKET PRICE SUPPORT (COAL)**

26 SEPT 1997

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## **SECTORAL SUPPORT AND TAXES (3)**

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- **ENERGY CONSUMPTION**
- **MATERIALS CONSUMPTION**
- **(INDUSTRY)**
- **LOWER USER COSTS PASSED ON**
- **PREFERENTIAL TAX RATES FOR LARGE ENERGY USERS**
- **TAX CODE**
- **TAX EXPENDITURES**
- **GOVERNMENT BROKERED SALES CONTRACTS**
- **REGULATION**

26 SEPT 1997

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## **SECTORAL SUPPORT AND TAXES (4)**

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- **TRANSPORT**
- **COST OF INFRASTRUCTURE**
- **FUEL TAXES**
- **NON- INTERNALISED EXTERNAL COST**

26 SEPT 1997

10

## **A COMPREHESIVE YARDSTICK OF TAXES AND SUPPORT**

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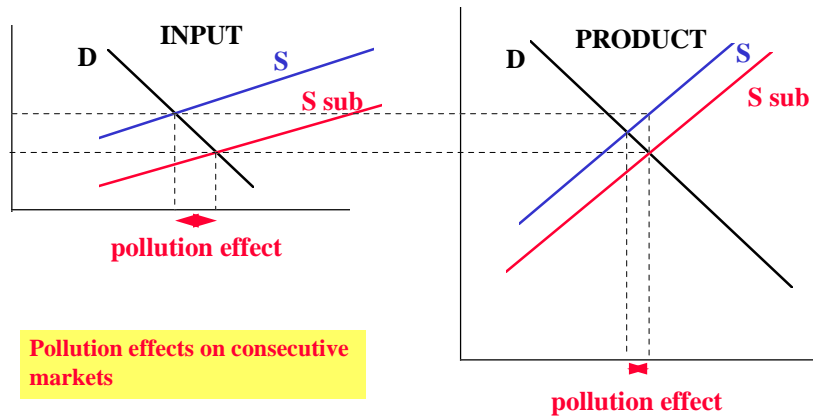
### **MARGINAL EFFECTIVE TAX RATE**

- **HOW MUCH TAXES - SUPPORT ENDS UP IN CONSUMER / USER PRICES**
- **DECISIVE FACTORS:**
  - **INPUT SHARES**
  - **TAX CODE, SUPPORT, TAX EXPENDITURES**
  - **DEMAND/SUPPLY ELASTICITIES**

26 SEPT 1997

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### SUPPORT MEASURES (3) MARGINAL EFFECTIVE TAX RATES



Pollution effects on consecutive markets

26 SEPT 1997

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**ANNEX II -- LIST OF PARTICIPANTS****MANAGEMENT EXPERTS**

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Mr. Eystein Gjelsvik	Economic Adviser Norwegian Confederation of Trade Unions (LO-N)	NORWAY
Mr. José Miguel Leunda	Président Solidarité des Travailleurs Basques (ELA-STV)	SPAIN
Mr. Sven Nyberg	Expert The Swedish Trade Union Confederation (LO-S)	SWEDEN
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Mr. Jyrki Raina	Energy Officer International Federation of Chemical, Energy, Mine and General Workers' Unions (ICEM)	

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Mr. Bill Long **Chairman of the meeting**  
Director

Mr. Jeremy Eppel Counsellor

Mr. Michel Potier Head of the Economics Division

Mr. Jan Pieters Administrator, Economics Division

Ms. Helen Mountford Assistant, Economics Division

Mr. Laurie Michaelis Administrator  
Pollution Prevention and Control Division

#### **Development Co-operation Directorate**

Ms. Marilyn Yakowitz OECD Co-ordinator for Sustainable Development

#### **General Secretariat**

Mr. François Rousseau Deputy Head of the External Relations Division

## NOTES

<sup>i.</sup> These studies are published under the title, “Reforming Energy and Transport Subsidies: Environmental and Economic Implications”, OECD, December 1997. Related information can be found on the Internet at [www.oecd.org/env/online.htm](http://www.oecd.org/env/online.htm).

<sup>ii.</sup> For definitions of fiscal and environmental “incidence”, please see the Discussion Paper for the Workshop [SG/RE/LMP(97)10] and Annexe I to this Final Report.