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The Relationship between Energy Taxation and Business Environmental Protection Expenditures in the European Union

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Abstract

Businesses are often subject to energy taxes that impose a charge on greenhouse gas emissions. Theoretically, energy taxes should motivate business spending on emissions abatement up to the point that, at the margin, the cost of reducing emissions equals the amount of the tax that is avoided. We use European Union (EU) data from 2001 to 2008 to test the hypothesized positive relationship between energy taxes and business spending on abatement initiatives for the protection of ambient air and climate. We find that while overall business spending and business investment expenditures are positively related to energy tax rates, current period expenditures are not related to energy tax rates.

Supplemental analyses indicate that the imposition of the EU Emissions Trading Scheme (ETS) in 2005 affected these relationships. In the pre-ETS period, energy taxes were not related to overall business spending or to current period expenditures, but there was a significant positive relationship between energy taxes and investment expenditures. After the ETS was introduced, there was a significant positive relationship between energy tax rates and both overall business spending and business current period abatement expenditures, but the relationship between business investment spending and energy tax rates was not significant.

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Our results indicate that energy taxes are effective in motivating business spending on emissions abatement. However, the nature of the effect varies across investment spending and current period expenditures. As both long-term and current initiatives are necessary to meet abatement goals, policymakers should be aware of these differences.
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1. Introduction

Corporate taxation and corporate social responsibility are important research topics in accounting, but scant research focuses on the linkage between these areas (Hoi, Wu, & Zhang, 2013); both academicians and commentators have called for more research on this relationship (Hanlon & Heitzman, 2010; Hoi, Wu, & Zhang, 2013; Sikka, 2010). Our research examines the relationship between energy taxation and business environmental protection expenditures. Specifically, we examine the relationship between energy taxes and business spending on pollution abatement activities for the protection of ambient air and climate.[2] We further decompose business spending into investment initiatives and current period expense activities; the differential nature of these spending activities implies a differential ability to impact pollution abatement.

Taxes, a powerful economic incentive and one of the strongest tools available to governments (Dickson, 2007), are used to provide incentives and disincentives for various actions. Firms respond to cash flows, taxes affect cash flows, and therefore firms respond to tax incentives (Maydew, 2001). Thus, the extent to which taxes impact corporate decisions is a measure of whether the tax is effective, and the effect of taxes on investments and expenditures incurred by the firm is an important consideration in the design of tax policy (Hanlon & Heitzman, 2010).

Further, because tax rules and regulations are determined at the national level, while firms have the ability to do business internationally, the impact of tax policies that differ across borders is a concern. Taxes may affect business decisions about where to locate operations and where to conduct business operations.[3]

Our research considers the effect of energy taxation on business spending across countries in Europe, focusing on the European Union (EU) countries. All of the EU member countries have enacted some form of energy tax across our entire sample period (Harper, 2007), and examining the relationship across countries allows a more robust examination of the impact of environmental taxes.

[2] Abatement activities include expenditures the company has designated as for the protection of ambient air and climate. These initiatives, some of which are current expenditures and some of which are investment activities, include things like spending on machinery, equipment, land, training or environmental consultancy fees. Please see Table 1 for a more detailed description.

[3] For example, Bryant-Kutcher, Eiler, and Guenther (2008) present results indicating that tax rules impact foreign investments and managers chose to permanently reinvest earnings of foreign subsidiaries to avoid the US repatriation tax.

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