

# **ENVIRONMENTAL PROTECTION AS A FACTOR FOR TOURISM DEVELOPMENT - NONFISCAL GOALS OF TAXES**

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## **1. INTRODUCTION**

What is Macedonia? What is the reason why to visit this country? Are there any natural beauties? Any rarities of nature that are worth seeing? Is it unique in something? Is there anything in it that is worth preserving?

- The largest areas in the world covered with *Pinus Peuce* which is in fact endemic and relict five-leaf pine are on the mountain of Pelister!
- The *New York Times* newspaper describes the Cave Peshna in the city of Makedonski Brod as an identical to the ones imagined and described in “The Lord of the Rings”!
- A hundred and twenty dolls in Kuklica (near Kratovo) are 10 million years old!
- The Lake of Ohrid is the oldest lake in Europe. It is over 4 million years old and is one of the three oldest lakes in the world! It is also the deepest lake on the Balkans! It holds 200 endemic types that have a world meaning! The Ohrid trout represents a living fossil!
- In a length of 80 kilometers, the hill of the Mountain

Shar Planina is at a constant height of 2000 meters! This is not the case even with the Alps!

All these beauties and rarities (and much more) should be preserved and made available to all the tourists who want to enjoy them during their visit of Macedonia. In order to protect the valuable Macedonian natural heritage, great contribution has the positive national legislation. The Constitution of the Republic of Macedonia states that basic value of the constitutional order, among other is also the protection and preservation of the environment and nature, whereas each citizen is entitled to healthy environment. However, for having a unique and rich Macedonian nature besides willingness, it is also necessary to have financial means allocated from the state budget.

Environmental protection should reflect itself everywhere where there is policy creation: decision making, legislation, strategic guidelines, undertaking certain activities etc. It is certain that one of the most useful mechanisms is adopting a legislation that will comprise provisions which define opportunities for using fiscal instruments for environmental protection. Considering the fact that the new trends in certain areas always change the conditions in the development process, the motive for this research is to which extent the fiscal instruments regulated with the national legislation give basis for environmental protection.

## **2. THEORETICAL APPROACH TOWARDS THE USE OF TAXES FOR THE PURPOSE OF ENVIRONMENTAL PROTECTION**

Because of the fact that the exploitation of natural resources becomes greater, and the degradation of environment led to enormous increase in social costs, a need was imposed for

using different fiscal instruments (taxes, customs, excises, subsidies) for the purpose of being directly implemented to protect the environment. It is expected that the economics should give suitable proposal solutions and thus will cut the relations between the economic growth and the increased pressure on the environment. This suggests that fiscal instruments are used in order to directly contribute to the environment preservation and promotion.

It is generally known that taxes must not be an instrument that will be used only for fiscal purposes i.e. they have to serve for the purpose of meeting other non-fiscal objectives. They should be made functional for the overall development (social, political, cultural, demographic etc). Therefore, the fiscal policy in a contemporary circumstances should contribute to the realization of the right to develop, in such manner as stated in the UN Declaration of the 4<sup>th</sup> December 1986 which reads: “The right to develop is a human right to which each individual is entitled, the benefits of which are enjoyed by all the individuals who contribute towards development of economic, social, cultural and political development, where all the human rights and basic freedoms will be fulfilled.”

According to the contemporary economic theory, taxes/charges are a low-cost solution to standard setting. This is a feature of the tax/charge solution to externality which is of great importance. Namely, compared to standards set without taxes, charges will tend to be a lower-cost method of achieving a given standard. This statement is due to the least-cost theorem for pollution charges of Baumol and Oates.<sup>1</sup> Actually, standard-setting process incurs greater total abatement costs than taxing to achieve the same standard. Hence the use of taxes is a low-

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<sup>1</sup> William Baumol and William Oates formulated their least-cost theorem for pollution charges in their paper “The use of standards and prices for protection of the environment”, published in *Swedish Journal of Economics*, in 1971.

cost solution for achieving a given standard. Whether it is the least-cost solution to standard-setting depends on what other mechanisms we have at that moment for achieving a standard (for instance tradeable permits or some other instrument). Typically, we can only find out by 'simulating' pollution control - i.e. by devising computer simulations which 'mimic' the actual situation and then assessing the response to each method of securing a standard.

One can notice that in the previous paragraph it has been said nothing about the standard being optimal. To find an optimal standard it is needed information on the damage function. However, even where 'accessible' standards have been imposed, a tax has an important role to play.

It is obvious that pollution taxes have many virtues. They make use of market mechanisms by charging a price for hitherto unpriced but valuable services provided by the natural environment. "To some extent, they 'mimic' the market since the tax could be varied to reflect increasing scarcity of these services. They have optimality properties if both damage costs and abatement costs are known, and, even if they are not known, they have least-cost (i.e. 'cost effectiveness') properties. Yet in the real world, pollution taxes are the exception, not the rule. Not only are the charges limited in extent, their formulation tends to owe little to the economic theory." (Pearce and Turner 1990, 96-97)

There are various reasons for the limited role of taxes. First of all, here is uncertainty about the justice of Pigovian taxes. Namely, the industries will always understandably resist new taxes. But this is not adequate to explain opposition if the situation is that some form of regulation will be introduced. One fear, however, is that the tax will go 'beyond' taxing Pareto-relevant pollution, to taxing for optimal pollution, and even

for physical pollution. In this context, industry might tolerate the 'standard' polluter pays principle, but not the 'extended' polluter pays principle.

Secondly, there is an obvious lack of knowledge of the damage function. A strict Pigovian tax requires that we know at least part of the marginal external cost curve ('damage function'), which is the marginal interpretation of the overall total external cost function. The point of view of the economists and pollution control agents is that damage functions are very difficult to estimate in practice. Moreover, they argue, even if we secure some estimates, it is not difficult to find other experts who will argue for different damages, opening the way for disputes about the legal basis for a tax or charge. This objection has some validity, and the charge that the damage figures can be 'massaged' could be serious in countries where it is possible to dispute the basis of taxation in the courts. But the idea that an 'optimal' Pigovian tax can be calculated is unrealistic. The point of damage estimates is to obtain some overall 'feel' for the levels of damage, not to find accurate numbers (even if they could be found). The kind of information needed would tell us whether we are very wide of the mark in taking a particular pollutant or whether we go in the right direction. Moreover, the use of taxes to regulate consumption and production is not unusual in modern economies. For example, few would dispute that tobacco and alcohol taxes have a social cost 'component'. In the same way, taxes on pollution should bear some relationship to social cost estimates.

Thirdly, the argument of status quo. Pollution regulation has, by and large, grown from earlier public health laws. These were formulated mainly in the last century when the only real mechanism for controlling pollution was direct regulation based on standards and backed up by inspection and penalties for transgression. Therefore, taxes are not a 'new' idea in the context of pollution control. Newness is not generally welcome in

regulatory circles, not least because the regulator wants to know why the existing system is inadequate. It is not just a matter of pointing to the desirable characteristics of taxes: it is necessary also to show that alternative systems, and especially the one already in place, are worse than the proposed one. There are indeed benefits in 'sticking with what we've got'. Particular concerns will be whether regulatory taxes are compatible with the existing legal system, and what the transitional costs are.

### **3. FINANCING ISSUES REGARDING ENVIRONMENTAL PROTECTION**

The issue regarding the amount of funds necessary for financing the environment protection was a constant subject of discussion in the contemporary countries especially in countries in transition. The economic problems that these countries were facing with on a daily basis cause a significant gap between the amount of required financial means and the potential capacity of the available resources. It is estimated that in such conditions, the countries in transition during this turbulent period spent an average amount between 0.5 to 1% of the GDP for the purpose of solving the problems in this area. These amounts were certainly lagging behind the amount spent in highly-developed countries which is from 2.5 to 3% of the GDP. However, if the high budget deficits are taken into consideration, and the fall in production activity is also considered, then an image could be created about the intensity and the efforts made on behalf of the countries in transition (which under no condition means that this is the amount that should be stopped at). On the other hand, the information showed that in the countries that the foreign donors were more inclined to (e.g. Poland and Hungary) the foreign aid given for this purpose hardly reached an amount of 5% of the total

costs.<sup>2</sup> Due to this, a conclusion can be drawn that the source of funds required for alimending the needs for environment protection policy, as well as in many other occasions, should be searched for within internal frameworks. Namely, "...if we do not turn towards ourselves and without us creating and using our own domestic sources of accumulation, which will be the only real and stable ground for overcoming 'the two gaps' and providing development of the countries and economies in transition, it would be impossible for us to get out of the vicious circle of non-development, deficits, inflation and low standard of living." (Cepujnoski and Zografski 1994, 186). This was followed by the financial burden that results from the adjustment of the domestic legislation in accordance with the one of EU. Namely, "the EU legislation regarding environmental protection can be transferred in the corresponding national legislation and thus implemented in an appropriate manner... The financial means required for transferring and applying the key EU legislation in the field of quality of air, water, as well as the solid waste is estimated to be pretty high... The lion's share of financing should come from domestic sources. Therefore, the overall transparent and efficient funds for environmental protection can play an important role in the process of transition." (Klarer et al 1999, 31). The basic reference when it comes to determining the optimum level should be looked for in the comparison of the respective levels of parts of GDP for this purpose, in the highly developed countries with the internal (their own) economic conditions i.e. the performances in their own economy.

It is almost impossible to make an accurate estimate of the adequate conditions in our country. The provisions regarding

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<sup>2</sup> In this sense it was used the debt-for-nature swap. An illustrative example of this was the agreement of 1990 between Poland and Finland. For the purpose of realization of 23 mutual investment projects with ecological repercussions in Poland in the period from 1991/93, Finland wrote off part of its liabilities towards Poland in the counter value of today's 6.6 million Euros.

environmental protection in the past were not explicitly shown as a part of the central budget. It is even harder to realize all this especially when talking about the whole economy especially for the private sector. The projected budget spending that had side-environmental effects can be marked as positive ones (for example, during the year 1994 and 1995 0.6% and 0.3% of the central budget, respectively, was intended to be spent for building up the gas system), but this was far away from the amount that would meet the needs in these domain. Lately, it has been possible to separate these provisions, but this does not change the impression gained so far. Namely, the concrete budget spending intended for solving issues in this area can be estimated as being minimal. For example, in 1994 their amount was 0.068%, in 1995 0.072% whereas in 1996 0.13% of the total budget spending.

Taking into consideration the conditions existing in Macedonian economy, it can be said that pointing out certain amount of funds as percentage of GDP, which should further be used for financing the environmental protection needs, is something that should not imply that there is a strict obligation for the macroeconomic policy makers in the sense of previous division of this amount of funds. It is certain that previous projection for using some percentage of GDP cannot be made even for some other purposes (such as science, health-care etc). The aim here is to point out the concrete conditions, to compare them with their counterparts in the other parties, to plan and undertake measures for improving them, without determining and imposing strict and obligatory frameworks.<sup>3</sup>

The programme for public investments in the Republic of Macedonia in years 2003-2005, projected 20.17 million Euros i.e. 2.1% of the total amount of its funds planned to be used

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<sup>3</sup> The budget of the Ministry of Environment and Spatial Planning in 2000 amounted only 2.56 million Euros, but this amount was made ten times bigger in the previous year (1999), when this Ministry was put aside as a separate Ministry.



for public investments in the period that follows. The Government has showed an ambition to engage more foreign direct investments in a form of concessions, donations, direct and joint investment, instead of the actual forms of foreign credits that participated the most over the previous period of time. To be more concrete, in the sector of environmental protection "...what is being given priority to, is the protection of waters from pollution, provision of quality drinking water and renewing and preserving the forests. Within these frameworks, what will keep on being implemented is the carrying out of the projects: 'Protection of the Lake of Ohrid' and 'Protection of the lake of Prespa' – phases which are financed with the non-refundable assistance from the Government of the Republic of Germany." (Shakiri 2003, 104-106)

In order to provide permanent solution to the issue related with financing environmental protection there is a need to clearly allocate the responsibilities between the private sector and the Government. Referring to the world practices most often shows that there is equal quantitative allocation of responsibilities in this sense (for example, in the USA, 55% of the costs for environmental protection are covered by the Government, whereas the rest of it is covered by the private sector), but quite often the Government bears largest part of the burden (pretty indicative is the example with Austria, because almost 70% of these costs are allocated to be settled by the Government).

The residuals of the transition ambience present in our country impose additional care to be taken about the relations of the Government with the private sector. One of the issues that have been managed very badly tackled (the appearance of 'environmental indebtedness' during the process of privatization) is an example of the Government's behavior in this direction. Namely, by avoiding to put too much of a

burden on the private sector, for the purpose of achieving 'more competitive' goals, the Government takes the largest part of the burden regarding financing. However, all this would not be that tragic if the so many times quoted economic turbulences appear to be absent, which most often do not leave enough free space for respecting these needs, and due to this the undertaken obligation is turned into a virtual one. Under such conditions, the solution can be seen in having an appropriate implementation of the economic measures that would further stimulate an improvement of the manner the economic entities operate in, without the necessity for making larger investments. In fact, the intention would be to have equal allocation of responsibilities regarding the financing of environmental protection activities, by stimulating 'good economy' i.e. implementation of the win-win measures. (OECD and World Bank 1994, 35-36)

#### **4. ENVIRONMENTAL ASPECTS OF CERTAIN FISCAL INSTRUMENTS IN MACEDONIAN PRACTICE**

In the Republic of Macedonia, there are number of Laws which regulate the possibility for financing the environmental protection. The economic instruments intended for environmental protection are determined with the Law that regulates the field of environmental protection i.e. with the Law on Environment ("Official Gazette of the Republic of Macedonia" No. 53/05, 81/05; 24/07.), which determines the fees, the Law on Nature Protection ("Official Gazette of the Republic of Macedonia" No.67/04; 14/06; 84/07.), the Law on Energy ("Official Gazette of the Republic of Macedonia" No.47/97; 40/99; 98/00; 94/02; 38/03.) and other Laws.

It is interesting to point out that the customs duties almost always have been worked for the benefit of environmental

protection. For example, by paying customs duties there are relieved items that are directly intended for environment and nature protection, unless they are manufactured in the Republic of Macedonia (in accordance with Article 183, line 7 of the Law on Customs, “Official Gazette of the Republic of Macedonia” No. 21/98; 26/98; 63/98; 86/99; 25/00; 109/00; 31/01; 4/02; 55/02; 42/03.). Also, the Law on Customs Tariffs (“Official Gazette of the Republic of Macedonia” No.23/03, 69/04.) defines higher customs rates for goods that when being used burden the environment such as: used tires, used travel-vehicles, buses and trucks.

Regarding the excises, there is determined higher excise for petrol that has a lead content of over 0.013 g/l (24.396 denars/liter) compared to the determined excise for unleaded petrol that contains lead of under 0.013 g/l (21.692 denars/liter) and the diesel petrol (12.121 denars/liter).

When it comes to taxes, maybe the best thing to do is to quote Frederick the Great, Prussian king from the 18<sup>th</sup> Century who says: “No Government can exist without taxation. This money must necessarily be levied on the people; and the grand art consists of levying so as not to oppress”.

Bearing in mind the previous, the Law on Personal Income Tax (“Official Gazette of the Republic of Macedonia” No. 80/93; 3/94; 70/94; 71/96; 28/97; 8/01; 50/01; 52/01; 2/02; 44/02; 96/04.) states that the income from sales of used solid waste generated by physical entity is not subjected to taxation. Besides this one, there are also other examples in support of the environmental protection policy. However, especially relevant is the corporate tax (taxation of the companies’ profit). The question is whether this tax as well as the personal income tax, besides their traditional fiscal goal also have non-fiscal objective i.e. protection of environment?

Throughout its “evolution” the Law on Corporate Tax of the Republic of Macedonia has undergone numerous

amendments probably due to the reason that it appears not to be very simple to create a solid law on profit taxation. In fact, the great Albert Einstein in one occasion stated: “The hardest thing in the world to understand is the tax on profit. This is too difficult for a mathematician... it takes a philosopher.”

In the first version of the Law on Income Tax (5/93 – at that time, essentially this tax was not a corporate tax) it states that the basis of the profit taxation is the profit presented as a difference between the total income and total expenditures of the tax liability person. However, in one of its lines it states that the total expenditures are the depreciation costs up to the amount determined with the defined rates, except for the depreciation costs for the means that are used for environment and nature protection. In other words, the depreciation of funds intended for the environmental protection, does not represent a cost i.e. it does not fall under the category of expenditures.

The same Law also defines the part of the profit that is not paid tax for. Namely, this tax was not paid for that part of the profit that is within the amount of the invested funds for environment and nature protection (line 3).

Changes and amendments of this Law, besides other, also refer to the provisions that affect the environmental protection. Namely, No. 80/93 of this Law, in Chapter 6 which defines the tax reliefs and exemptions, defines that “the tax liability person is entitled to faster depreciation of funds that serve for environment and nature protection”. According to this “the tax liability person has a reduced obligation to pay taxes in the amount of the funds invested for environment and nature protection...”

Two years after this basic Law, the Law on changing the Law on Income Tax (since September 1995) defines that the tax liability person should have a decreased obligation to pay tax in the amount of the funds invested in environment and

nature protection.

It is obvious that regarding the decrease in the obligation to pay tax on the funds invested in environment and nature protection, the version of the Laws in 1993 and 1995 do not differ much. The changes made in 1995 just add other actions that this profit could be invested in, and also state the actions that does not require paying a tax on profit.

With the Law on changing and amending the Law on Income Tax, in December, 1996, Article 35 was changed and it states: “ The tax liability person has the tax basis for profit taxation decreased in the amount of funds invested in environment and nature protection”.

The Law from year 2006 (“Official Gazette of the Republic of Macedonia” No. 27 from 8.03.2006, and No. 139 from 30.12.2006.) defines that “the tax liability person is entitled to having a faster depreciation of the basic funds in cases when he/she makes technological modernization or supplies funds for environment and nature protection, up to not more than the amount which is 25% above the depreciation calculates in a manner defined in Article 15 of this Law.” As funds that serve for environment and nature protection are defined funds that are intended to be used for equipment and instruments that serve for the purpose of decreasing the pollution and measuring the condition of air, water and land pollution, introduction of clean technologies as well as construction of filter stations for communal and industrial water, setting up filters against air pollution, manufacturing products from waste materials, collecting and disposing communal and dangerous matters etc. (in accordance with the Guidelines for the manner of calculating and paying the corporate tax and prevention of double exemption or double taxation).

Also, the paragraph that states “ As an exemption from paragraph 1 of this Article, the tax liability person is entitled to having a faster depreciation of funds intended for

environment and nature protection” does not exist any more in the Law on Corporate Tax.

In the following changes and ammendments in 2007, 2008 and 2010 there is no change of the Articles that refer to environment and nature protection.

## **CONCLUSION**

The human trust in permanent progress is a key feature in the development of the civilization, representing a development of all human material and spiritual values. This imposes a symbiosis of economic, social and environmental protection goals.

One of the fundamental preconditions for overall development is the existance od legislation according to which the financial funds are in the function of development, on one hand, and on the other, it is the existence of economic instruments in support of the environmental protection policy. In other words, this means spreading a range of goals that should be accomplished with the taxation policy. Or, as stated by Oliver Wendel Holmes, Jr. Supreme Court, USA: “Taxes are what we pay for civilized society”.

The Constitution defines the fundamental values of the constitutional system of the Republic od Macedonia which have economic, social, legally-political and ”environmental” dimension.

The national legislation treats from different perspectives the issue with the environmental protection financing, through the Laws that consist of Articles on customs tarrifs, excises, taxes, fees etc. One of the Laws that deserves to be paid attention to is the Law on Corporate Tax that determnes the mechanisms for decreasing the tax basis in the amount of the funds invested in environment and nature protection. The tax liability person is recognized the right to have a faster

depreciation of the basic funds in cases when he/she achieves technological modernization or provides funds for environment and nature protection, not more than up to the amount of 25% above the depreciation calculated in accordance with one of the methods for depreciation calculation.

Taking this into consideration, in the direction of fulfilling the non-fiscal goal defined as environmental protection, the Law on Corporate Tax is one of the Laws that deserves to be qualified as modern and progressive one.

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