

Chapter 5

Economic incentives to encourage greening of EaP SMEs

This chapter examines some of the economic tools that governments can use to support the greening of SMEs. This includes tax privileges such as incentives and exemptions. The chapter also examines the role of direct subsidies for consulting services, which can help increase SMEs' awareness and secure their initial engagement in green practices. At the same time, to both ensure the sustainability of practice, as well as the perceived value of the assistance, the chapter also points to the need to gradually shift to a fee-based system for technical assistance. Greening public procurement is also a powerful tool that governments can deploy. The chapter explores how it can impact entire value chains and provide an important lever to support greening. The chapter also notes that while public financial institutions are an important piece of the puzzle, it is also important to enhance the role of private banks and insurance companies in providing incentives for good environmental performance of SMEs, through better loan or insurance policy conditions to businesses with green credentials.

Introduction

Governments have a range of economic tools at their disposal that can be deployed to encourage green practices in SMEs, and support their uptake. These include providing incentives through the tax code to make investing in green technology and more energy efficient equipment financially attractive, creating grants for environmental consulting services and simplified EMS certification, and greening government procurement to encourage supply chain transformation and create a market for green products. This chapter explores those tools and looks at how they have been deployed so far in OECD countries, and what that means for their use in EaP countries.

Tax privileges

Tax privileges are a powerful tool to encourage SMEs to enhance their environmental practices, as well as to support the development of new green enterprises. In many OECD countries, entrepreneurs are allowed to take *tax exemptions* and deduct certain categories of environment-related investments from their taxable corporate income. These exemptions are intended to encourage going beyond environmental compliance, and expire after a clearly defined period of time. Often, they are developed in the context of economic policy aimed at promoting innovation, research and development. Similarly, the government may offer *tax incentives – accelerated depreciation, reduced property or corporate taxes* – for the purchase of new environmental technologies and other environmental investments. Tax reductions or exemptions can also be differentiated based on the actual environmental impact of the investment.

Box 5.1. Financial incentives for environmental investments in the Netherlands

MIA and VAMIL are two separate measures to promote the use of environmental technologies by Dutch companies. Although MIA and VAMIL have been introduced separately in the Netherlands, these measures have many similarities.

VAMIL is a measure enabling a company to freely determine the depreciation period of up to 75% of the cost of the invested environmental technology that is on an official environment ministry listing. Consequently, VAMIL can offer entrepreneurs a financial advantage, as technologies can be depreciated more quickly. Although it is difficult to determine the precise advantage that is gained by using a VAMIL technology – the benefits depend largely on the specific conditions under which the entrepreneurs apply for VAMIL – generally the advantage is estimated between 3 to 8% of the investments made.

MIA enables companies to deduct environmental investments up to 36% of the investment cost. The benefits that can be gained via the MIA scheme depend on the investment and the applied tax scheme (corporate tax or income tax). The percentages of the investment that can be deducted from taxes are explicitly determined and mentioned in the “Environment list”. Depending on the investment and applied technology, entrepreneurs can deduct 15, 30 or 40%.

Both schemes are accessible for all business. Yet, 93% of applicants are SMEs, and most of them work in the agricultural sector, as trade associations in this sector are particularly active in encouraging businesses to use this fiscal instrument.

Sources : Lindblom and Delgado (2007), *Promoting Environmental Technologies in SMEs: Barriers and Measures*, <http://publications.jrc.ec.europa.eu/repository/bitstream/JRC37214/eur22769en.pdf>; ECAP (2011), *Environmental Compliance Assistance Programme for SMEs, Case studies*, http://ec.europa.eu/environment/archives/sme/cases/case_study_en.htm.

For example, the Netherlands has been operating two tax reduction schemes to promote the purchase of new environmental technologies (Box 5.1): the Arbitrary Depreciation of Environmental Investments (VAMIL) allows accelerated depreciation of newly purchased environmental technologies listed by the government, and the Environmental Investment Allowance (MIA) allows a partial write-off of an investment in environmental technology against tax.

The French government uses accelerated depreciation and reduced property and professional taxes to stimulate purchases of renewable energy and energy efficient equipment. The Japanese government provides industry with tax preferences (e.g. reductions in the local corporate tax) for cleaner and climate-friendly technologies (OECD, 2009). However, environmental tax incentive schemes tend to benefit larger companies, which are better informed about the existence of such instruments.

These tax reduction instruments should be complemented by the taxation of negative environmental impacts. Taxes on environmentally harmful products clearly dominate environmentally related taxation in OECD countries (OECD 2014a) and should provide an additional stimulus for SME greening. At the same time, pollution taxes only have an incentive impact if the real pollution is monitored at the source (while under simplified regulation SMEs usually do not have self-monitoring requirements); and the administrative cost of collecting environmental taxes from the multitude of small companies is excessive.

Grants and free consultancy services

Grants may be offered by public agencies for the purchase of environmental technologies (Box 5.2), but more often they *subsidise a share of consultancy costs for the identification and implementation of resource efficiency and other environmentally oriented measures*. Sometimes the government reimburses SMEs the full cost of an initial environmental audit.

Box 5.2. Subsidies for environmental technology investments in Belgium

The Ecology Premium programme in Flanders, Belgium is a subsidy provided to enterprises that invest in environmental technologies. Investments that are considered environmentally friendly are eligible for support as long as they concern purchases from third parties under market conditions.

The size of the subsidy depends on the environmental performance of the technology, measured by an environmental performance factor. This performance factor is a qualitative indication that ranges between 0.6 and 1. The Flemish Department of Economic Support Policy has composed a list of environmental technologies and their performance factors. When a company applies for a subsidy to finance a technology that is not on the list, its potential environmental impact must be assessed.

SMEs can receive a subsidy with a maximum of 35% of the investments made (it can be higher if the company is certified according to ISO 14001 or EMAS) but cannot exceed EUR 3.6 million.

Source : Lindblom and Delgado (2007), *Promoting Environmental Technologies in SMEs: Barriers and Measures*, <http://publications.jrc.ec.europa.eu/repository/bitstream/JRC37214/eur22769en.pdf>.

For example, Enterprise Ireland, a public industrial development agency, provides grants to SMEs as a percentage (up to 50%) of consultancy costs for the identification and implementation of resource efficiency and other environmentally oriented measures (as long as they go beyond compliance with legal requirements). One enterprise can get up to EUR 200 000 over three years. Grants are associated with compliance audits, which also serve as a compliance assistance tool. France’s Environment and Energy Management Agency (ADEME) subsidises up to 50% of the costs of environmental audits, which cover both compliance and resource efficiency. The German public bank *Kreditanstalt für Wiederaufbau* (KfW) has a “Special Fund for Energy Efficiency in SMEs” which covers up to 80% of costs for SMEs to receive professional advice on energy efficiency improvements (Miller, 2011).

In the late 1990s and the early 2000s, many OECD governments provided direct financial support and extensive technical assistance to businesses, especially SMEs, for the establishment and certification of an EMS. For example, the Bavarian Environmental Agreement, launched in 1995 between the *länder* (state) government and industry, allowed SMEs to receive subsidies for an audit by an environmental consultant and the establishment of an EMS (SNIFFER, 2008). Some of these support programmes have now been phased out (e.g. in the Netherlands) as their primary mission to jump-start the market demand for corporate environmental management has been accomplished. Others, like the Green Offer by Enterprise Ireland (Box 4.3), have made the increased competitiveness of national industry an explicit focus of their EMS promotion activities.

Direct subsidies and free technical assistance to SMEs helps to increase their awareness and secure their initial engagement in green practices. However, given the limited availability of public funding for promoting compliance and green business practices, *a gradual transition toward a fee-based system for technical assistance would improve its long-term sustainability*. This transition would also mean transferring the delivery of technical assistance to trade associations which often charge businesses cost recovery fees for compliance audits, assistance with EMS implementation, training of environmental managers and similar services (see also Section 4.1.4). The dilemma with having small businesses pay for technical assistance is that they may not be able to afford the fees (and often feel that the provision of environmental help and support should be free). At the same time, charging for a fee for services helps alleviate the distrust of free services that businesses have, particularly when they are provided by government agencies.

Role of supply chain management and public procurement

Supply chain pressure offers a valuable means of influencing the environmental behaviour of SMEs. Environmental awareness in global supply chains also affects which suppliers a firm is willing to use, so suppliers receive pressure from buyers to reduce impact. Meeting green quality standards can be challenging for SMEs which face growing pressures to reduce costs, but they also offer SMEs access to environmentally conscious large firms, knowledge flows and global markets.

There are several motivations for large companies to engage in greening the supply chain. Firms with global supply chains and outsourcing strategies are forced to monitor environmental impact to reduce risk: a supplier closed down for poor environmental performance could both disrupt the supply chain and cause serious reputational damage. In addition, better “upstream” environmental performance generates cost savings for larger firms from more efficient production practices.

Increasingly complex supply chains make it difficult to implement and sustain green practices because production is increasingly dispersed across multiple sites and autonomous partnerships. So the whole supply chain needs to engage in green initiatives to gain competitive advantage. ***Supply chain pressure is particularly important and effective in sectors dominated by business-to-business transactions.***

Larger firms often not only require good environmental performance from their suppliers but also work with them to facilitate the improvements. They invest in the environmental capacity of smaller suppliers because without it their own environmental goals cannot be met. The examples include Wal-Mart in the US and Marks & Spencer in the UK. Big Korean companies sign “voluntary green purchasing pacts” with smaller suppliers. Larger companies may also audit their suppliers for resource and energy efficiency, this being primarily a cost-driven measure.

Less formally, sustainable supply chain management may serve to influence suppliers in a more indirect way, if these suppliers improve their production processes in anticipation of gaining new business from a different or broader set of customers demanding sustainable products. Buyers’ pressure and support are especially important for small suppliers who lack internal capabilities to proactively define their own greening strategy (OECD, 2012).

The government should encourage larger firms to form partnerships with smaller suppliers and provide public recognition to those who do so. For example, a Business-to-Business Green Mentor Programme was launched in 2003 by the Limerick/Clare/Kerry Regional Waste Management Office in Ireland. It urges larger good practice companies to provide guidance on waste prevention to SMEs. Programme activities include an informational visit by SMEs to a volunteer “mentor” company, with follow-up guidance for individual SMEs on how to identify and implement ways of reducing waste generation or energy or water consumption. In another example, Zero Waste Scotland concludes voluntary agreements with retail companies that then pass on the resource efficiency requirements down the supply chain.

Governments can exert its own supply chain pressure through its procurement policies. Green public procurement (GPP) can play a significant role in creating demand for green products and services and boosting the market where private consumer demand for them is insufficient. By using their purchasing power to choose goods and services with lower environmental impact, public authorities can help to drive down the costs of such purchases and make them more affordable generally. Green public procurement also increases market acceptance of green products (e.g. by demonstrating their commercial feasibility). Countries increasingly recognise that GPP can also be a major driver for innovation, providing industry with incentives for developing green products and services, particularly in sectors where public purchasers represent a large share of the market (e.g. construction, health services and public transport).

GPP makes it a condition of tendering for government contracts that the applicant commit to maintaining specified environmental standards up and down the supply chain. Green procurement may also take the form of exclusion criteria, where only firms certified to a recognised environmental standard are allowed to be considered, or assessment criteria, where a firm’s environmental performance is scored on a scale, and the result if part of the procurement decision.

GPP guidelines often require that particular products contain a minimum amount of recycled content or achieve specified levels of energy efficiency. Purchasing guidelines may also favour – through price preferences, explicit set-asides, or other mechanisms – suppliers who comply with environmental requirements, obtain green certification, qualify

for environmental labels, or otherwise demonstrate their environmental credentials. GPP most often covers areas such as the purchase of energy-efficient computers and appliances, environmentally-designed buildings, recycled paper, electric cars, and electricity from renewable energy sources. Irish EPA’s Green Procurement Guidance for the Public Sector went even further and targeted several additional areas: food and catering services, cleaning products and services, and uniforms and other textiles (EPA, 2014).

OECD governments at the national, regional and local levels increasingly include environmental criteria in their purchasing decisions. The 2002 OECD Council recommendation to improve the environmental performance of public procurement (Box 5.3) reflected their commitment to such practices. The European Commission has proposed that 50% of all public tenders in the member states be “green”, i.e. compliant with common core Green Public Procurement criteria.¹ The 2010 OECD Survey on Public Procurement found that 26 out of 34 OECD member countries have introduced practical guides on green public procurement, and 19 countries have developed training materials for public officials on green procurement (OECD, 2014b).

Box 5.3. OECD recommendation on the environmental performance in public procurement

As part of the Recommendation on the Environmental Performance in Public Procurement, OECD countries committed taking steps to:

- provide the appropriate policy framework to incorporate environmental criteria into public procurement of products and services, along with price and performance criteria
- introduce financial, budgeting, and accounting measures to ensure that public procurement policies and practices consider the environmental costs of products and services
- provide information, training and technical assistance to officials involved in the public procurement and use chain, including those who set the performance criteria of products and services, those who are responsible for procurement, and those who use the products and services
- make information and tools that facilitate greener public purchasing available to all levels of government
- disseminate the information needed to facilitate and encourage greener public purchasing decisions, as well as the results and benefits derived from their adoption
- Establish procedures for the identification of products and services which meet the objectives of greener public purchasing policies
- encourage the development of indicators to measure and monitor progress made in greener public purchasing
- assess and evaluate greener public purchasing policies in order to ensure that they are economically efficient and environmentally effective.

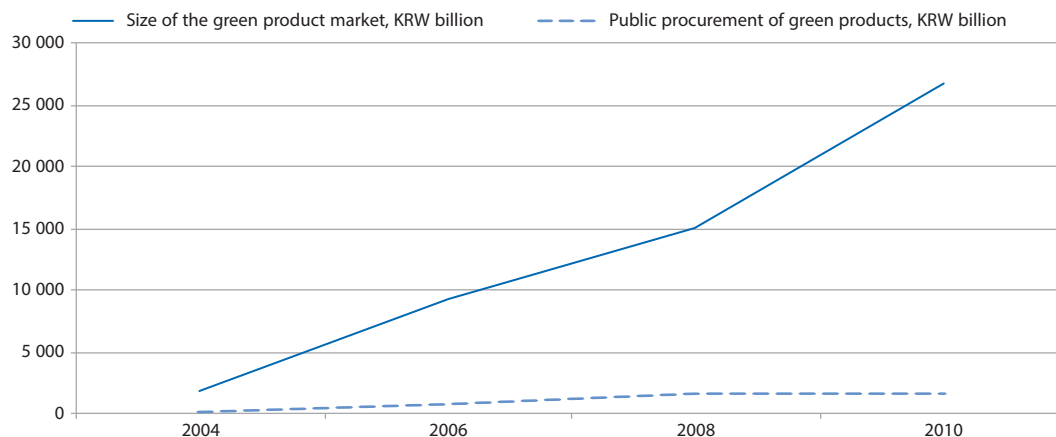
Source : OECD (2002), *Council Recommendation on Improving the Environmental Performance of Public Procurement*, <https://legalinstruments.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=46&Lang=en&Book=False>.

For example, the Scottish Government’s “Public Procurement and Sustainable Development: Guidelines for Public Purchasers”² states that “those who fail to comply with environmental legislation may be excluded from selling to the Scottish Government” and that “development of environmentally preferable goods and services and use of recycled/renewable materials is likely to offer a competitive advantage”. The Scottish Government also seeks evidence that suppliers have in place appropriate environmental management policies and systems. In addition, suppliers are encouraged to take advantage of eco-labelling schemes to be able to provide evidence of their good environmental practices. UK Defra has gone even further, encouraging suppliers to provide product-level lifecycle greenhouse gas data using emission factors from relevant inventory databases.

The US Federal Government requires that 95% of all government contracts meet sustainability requirements. Its ambition is that environmental considerations become part of normal procurement practice along with such traditional factors as product safety, price, performance and availability (OECD, 2013).

Procurement policies co-ordinated across all levels of government may directly affect, on average, up to 20% of purchases in a targeted market (OECD, 2003). As shown in Figure 5.1, public purchasing of environmentally-friendly goods and services in Korea helped jump-start the private sector market for them, whose growth rate has quickly outstripped the expansion of green public procurement.

Figure 5.1. Size of the green product market and public procurement in Korea



Note: EUR 1 equalled approximately KRW 1 480 in February 2012.

Source: Ministry of Environment of Korea, responses to the OECD questionnaire, February 2012.

Although the vast majority of public sector contracts go to large firms, public procurement is a big issue for SMEs because for many of them public contracts represent a significant share of business. Several OECD countries (e.g. Australia, France, Korea and the US) give preference to SMEs in public procurement (OECD, 2011). Still, only one out of ten EU SMEs bid for public procurement contracts that include environmental requirements versus 16% of large companies (EC, 2012). In a recent Eurobarometer SME survey, just 12% of SMEs in the EU report to have bid for a public procurement tender that included environmental requirements. More than half of SMEs have never been confronted with such a tender (EC, 2013).

To reach SMEs, governments should communicate their green purchasing policy to a wide range of stakeholders, including present and future suppliers, service providers or contractors, so that they can take account of the new requirements. They should also educate procurement officials on how to implement these policies. The target group for educational activities can be contracting authorities of central administration bodies and their subordinated organisations, at the level of regional governments and local authorities. These activities should include dissemination of technical information on GPP and related issues, such as eco-labelling, environmental management systems and energy labelling.

Conclusion

The government has a range of tools at its disposal to create economic incentives for SMEs to go beyond the minimum environmental compliance requirements. At their base, they all come down to the same thing: ensuring that it makes economic sense for SMEs to undertake changes to improve their environmental performance. Tax exemptions and incentives lessen the short-term costs of investing in greener practices. Grants and subsidisation of consultancy costs helps SMEs identify and implement more resource efficient and environmentally practices. Putting green requirements into government procurement helps create market incentives for greener practices, both for SMEs who are directly participating in government procurement, and those who are participating in the supply chain of larger companies. This supply chain pressure is particularly important in industries that are business-to-business, rather than customer facing.

Notes

1. www.ec.europa.eu/environment/gpp/gpp_criteria_en.htm.
2. www.gov.scot/Publications/2009/10/sspap.

References

- EC (2013), *SMEs, Resource Efficiency and Green Markets*, Flash Eurobarometer 381, conducted by TNS Political & Social at the request of Directorate-General Enterprise and Industry, European Commission, Brussels, https://data.europa.eu/euodp/data/dataset/S1086_381.
- EC (2012), *SMEs, Resource Efficiency and Green Markets*, Flash Eurobarometer 342, conducted by TNS Political & Social at the request of Directorate-General Enterprise and Industry, European Commission, Brussels, ec.europa.eu/commfrontoffice/publicopinion/flash/fl_342_en.pdf.
- EC (2004a), *Buying Green! A handbook on environmental public procurement*, European Commission, <http://ec.europa.eu/environment/gpp/pdf/Buying-Green-Handbook-3rd-Edition.pdf>.

- ECAP (2011), *Environmental Compliance Assistance Programme for SMEs, Case studies*, http://ec.europa.eu/environment/archives/sme/cases/case_study_en.htm, accessed 12 August 2011.
- EPA (2014), *Green Procurement Guide for the Public Sector*, Environmental Protection Agency, Ireland, www.epa.ie/pubs/advice/green%20business/GreenPublicProcurementfinalwebv2.pdf.
- Lindblom, J. and L. Delgado, eds. (2007), *Promoting Environmental Technologies in SMEs: Barriers and Measures*, Institute for Prospective Technological Studies, DG Joint Research Centre, European Commission, Seville, Spain, <http://publications.jrc.ec.europa.eu/repository/bitstream/JRC37214/eur22769en.pdf>.
- Miller, K. et al. (2011), *First Assessment of the Environmental Assistance Programme for SMEs (ECAP)*, Final report, prepared by AEA Technology Plc. for the European Commission, DG Environmental and Climate Action, London, <http://ec.europa.eu/environment/archives/sme/pdf/First%20assessemnt%20of%20the%20ECAP%20for%20SMEs.pdf>.
- OECD (2014a), *Creating Market Incentives for Greener Products: Policy Manual for Eastern Partnership Countries*, Organisation for Economic Co-operation and Development, Paris, www.oecd.org/environment/outreach/economic-instruments.htm.
- OECD (2014b), *Going Green: Best Practices for Green Procurement*, Public Governance Committee, GOV/PGC/ETH(2014)1/REV1, August 2014, Organisation for Economic Co-operation and Development, Paris, [www2.oecd.org/oe.cd/info/info.aspx?app=OLIScoteEN&Ref=GOV/PGC/ETH\(2014\)1/REV1](http://www2.oecd.org/oe.cd/info/info.aspx?app=OLIScoteEN&Ref=GOV/PGC/ETH(2014)1/REV1).
- OECD (2013), *Mapping out good practices for promoting green public procurement*, Public Governance Committee, GOV/PGC/ETH(2013)3, January 2013, Organisation for Economic Co-operation and Development, Paris, [www2.oecd.org/oe.cd/info/info.aspx?app=OLIScoteEN&Ref=GOV/PGC/ETH\(2013\)3](http://www2.oecd.org/oe.cd/info/info.aspx?app=OLIScoteEN&Ref=GOV/PGC/ETH(2013)3).
- OECD (2012), *Green Entrepreneurship, Eco-innovation and SMEs*, Working Party on SMEs and Entrepreneurship, CFE/SME(2011)9/REV1, April 2012, Organisation for Economic Co-operation and Development, Paris, [www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=CFE/SME\(2011\)9/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=CFE/SME(2011)9/FINAL&docLanguage=En).
- OECD (2011), *Government at a Glance*, Organisation for Economic Co-operation and Development, Paris, www.oecd.org/gov/governmentataglance2011.htm.
- OECD (2009), *Ensuring Environmental Compliance: Trends and Good Practices*, Organisation for Economic Co-operation and Development, Paris, www.oecd.org/env/tools-evaluation/ensuringenvironmentalcomplianceandgoodpractices.htm.
- OECD (2003), *The Environmental Performance of Public Procurement: Issues of Policy Coherence*, Organisation for Economic Co-operation and Development, Paris, www.oecd-ilibrary.org/environment/the-environmental-performance-of-public-procurement_9789264101562-en.
- OECD (2002), *Council Recommendation on Improving the Environmental Performance of Public Procurement*, C(2002)3, Organisation for Economic Co-operation and Development, Paris, <https://legalinstruments.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=46&Lang=en&Book=False>.
- SNIFFER (2008), *Better Regulation – Rethinking the Approach for SMEs*, Final Report, Project UKCC19, Scotland and Northern Ireland Forum for Environmental Research, Edinburgh, UK, www.fwr.org/waterq/ukcc19.htm.



From:

Environmental Policy Toolkit for SME Greening in EU Eastern Partnership Countries

Access the complete publication at:

<https://doi.org/10.1787/9789264293199-en>

Please cite this chapter as:

OECD (2018), “Economic incentives to encourage greening of EaP SMEs”, in *Environmental Policy Toolkit for SME Greening in EU Eastern Partnership Countries*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264293199-8-en>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d'exploitation du droit de copie (CFC) at contact@cfcopies.com.