

GROWTH DRIVERS

Environmental taxation: towards a "green tax shift" in France?

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Around the world, people are becoming increasingly aware of the ecological issues and the growing threats to the environment. The European Union has set a target for environmental taxation to account for 10% of compulsory levies by 2020.

As it stood at 4.47% of French compulsory levies in 2014, there will need to be a significant increase in this taxation. While environmental taxation must rise to speed up the energy transition and change behaviours, offsetting this increase by a drop in other taxes would have the benefit of boosting economic activity at the same time. This is what we refer to as the "green tax shift".

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Reading
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THE GROWTH POTENTIAL OF ENVIRONMENTAL TAXATION

Environmental taxation wavers between environmental interests, on the one hand, and budgetary interests, on the other. The principle behind any effective environmental tax is to encourage actors – via a clear "price signal" – to adopt more environmentally friendly methods of production or consumption.

In principle, therefore, it does not aim to generate sustainable revenues, due to the attrition of the tax bases, even though in practice, the base never disappears altogether.

However, due to strong budgetary constraints, the State has often used environmental taxation to top up its budget.

Environmental taxation remains low: two key indicators

Given this paradox which is difficult to address, what is the situation in France today? Environmental taxation is too diffuse (more than 70 different taxes have been identified¹) and often ineffective (due to inappropriate price signals).

It also lacks consistency, due to its many contradictions (as illustrated by the large number of environmentally unfriendly tax regimes which outweigh the environmentally friendly ones²).

Two significant indicators show that environmental taxation is afforded less importance in France than in the other European countries.

¹ CGDD, "La fiscalité environnementale en France : un état des lieux", avril 2013.

² Cour des Comptes, "L'efficacité des dépenses fiscales relatives au développement durable", 8 Nov. 2016: between 2010 and 2015, environment-friendly tax expenditures fell (€4,973 M in 2015 compared to €6,878 M in 2010), while non-friendly ones increased (€6,043 M in 2010 to €6,900 M in 2015).

At 2.05% of GDP in 2014 against 2.46% in the European Union (EU), France is ranked in joint 25th position (ex-aequo with Belgium) among the 28 EU countries (Eurostat 2016).

Furthermore, and contrary to popular belief, there has been a significant decline in the share of environmental taxation in GDP over the last 20 years: 2.49% in 1995, compared to 1.96% in 2012.

What is an environmental tax in the European meaning?

According to Eurostat, an environmental tax is "a tax whose base is a physical unit (or a proxy of it) of something that has a proven, specific negative impact on the environment and which is defined in the European system of accounts as a tax"¹.

¹ Regulation (EU) no. 691/2011 relating to the European environmental economic accounts.

on the one hand, and the gradual ramping up of the carbon tax, on the other.

In volume, however, France is near the top of the European ranking

It is also important to mention the financial masses involved. According to the Eurostat definition, France cleared a little more than €43 billion in environmental tax revenues in 2014, which puts it in third place behind Germany (€48 billion) and Italy (€47 billion). While the European definition offers the advantage of facilitating comparisons, it does have several limitations.

Is the French approach compatible with the European target?

The EU has set a target for environmental taxation to account for 10% of compulsory levies, on average throughout Europe, by 2020. Although there is still a long way to go, France has already started to follow the path marked out by the EU, as shown by the planned changes to certain taxes such as the carbon tax

The rise of the carbon tax: + 335% between 2014 and 2017

Years	2014	2015	2016	2017	2018	2019	2020	2030
Price per metric tonne (€/t CO ₂)	7	14,5	22	30,5	39	47,5	56	100
Projected revenues for the Carbon Tax	€340 M	€2,5 Bn	€4 Bn	€5,8 Bn	€7,8 Bn	na	na	na

Source : Commission des affaires économiques et de l'évaluation préalable dans le cadre de la LFR 2015

France also remains the country in which environmental taxes account for the smallest proportion of compulsory levies: 4.47% in 2014, against an average of 6.35% in the EU.

How can we explain such a ranking? The proportion of environmental taxation in compulsory levies has dropped in twenty years (even faster than their decline in the proportion of GDP), falling from 5.74% in 1995 to 4.22% in 2012. The revenues from environmental taxes have risen at a much slower rate than all compulsory levies which, on the contrary, have significantly increased, especially between 2009 and 2013.

This trend could change with the stabilization of compulsory levies since 2013,

(cf. table). Environmental taxation is therefore destined to continue to grow.

WHAT IS THE BEST WAY TO ENTER INTO THE "GREEN TAX SHIFT"?

If environmental taxation is increased with a view to encouraging changes in behavior and triggering energy transition, this rise must not be brought in unconditionally: it must be offset by a drop in other taxes³.

This is referred to as the "green tax shift". This type of policy has already been implemented in other countries such as Sweden and Denmark.

³ M. Chiroleu-Assouline, "La fiscalité environnementale en France peut-elle devenir réellement écologique ?", revue de l'OFCE, 139, 2015.

The difficulty of European comparisons

The definition endorsed in the France's budget is wider than the Eurostat version. To evaluate the environmental tax burden, "taxes that aim to discourage behaviour that is not virtuous on the behavioural level, and taxes that finance an action that could be described as environmentally friendly" are taken into consideration¹.

This means that this tax burden is consequently assessed at a higher level.

In 2014, environmental tax revenues brought in €57.78 billion, nearly 85% of which came from seven taxes, with 43% coming from the Domestic tax on the consumption of energy products (TICPE) alone. In 2015, these revenues rose to €62.08 billion, and should amount to €64 billion in 2016².

¹ <http://www.assemblee-nationale.fr/14/pdf/rapports/r3110-tl.pdf>

² http://www.assemblee-nationale.fr/14/rapports/r4125-tl.asp#P3360_97566

Back in 2012, the French Environmental Taxation Committee was considering the longer-term implementation of a green tax integrated into a more general tax reform. The question of the "greening" of taxation should be moved back to the heart of the discussions.

What approach should be adopted in order to move towards a greener tax system? Until now, this process has been carried out a little at a time and in a fragmented manner, whereas a global approach should be favored.

Two actions should be undertaken simultaneously: strengthening the incentive nature of the existing environmental taxation in order to modify behaviours and increase revenues, on the one hand, and redistributing the environmental tax revenues by reducing other taxes, on the other.

Towards a more incentive-based environmental tax system

Environmental effectiveness is assessed by how behaviours react to a price signal. If environmental taxation is to play its role, a clear and intelligible price signal with the power to change behaviours must be determined and progressively implemented over the long term.

To this end, three main factors must be combined: the tax base, the price elasticity and the rate.

► The three main factors

Firstly, the tax base must be clearly identified and targeted on a specific pollutant or behaviour (but without excluding a user of this pollutant or an instigator of this behaviour).

Some existing taxes could be thus reinforced simply by extending their base to substances which are currently excluded⁴. From this perspective, it should be possible to target taxes whose base is likely to be elastic with regard to prices and for which a substitute product exists.

New taxes could also be created on polluting bases that are not currently taxed and which could also be elastic regarding prices.

At the same time, taxes with an apparently low level of price elasticity could be abandoned due to their obvious ineffectiveness in relation to a desired environmental objective. This would help to reduce the large number of small and inefficient taxes.

To optimize the effectiveness of the taxes, their rates should be raised to levels that are sufficiently persuasive, and which may even be close to the price of the externalities on which they are based. However, determining the level of taxation is no easy matter.

In theory, an effective environmental tax should be determined at the "Pigovian"⁵ level, i.e. ensuring equality between the tax and the marginal damage arising from the pollution by deducting the marginal cost of anti-pollution measures.

In practice, it is not always easy – and in certain cases it may be impossible – to obtain data that are accurate enough to estimate the value of the damage caused and the cleanup costs.

Such a difficulty may also partly explain why some of the rates set are inconsistent with the conformity upgrading costs incurred by firms⁶.

To analyze the cost of externalities, several aspects must be considered: the product life cycle or pollutant emission sources, the characteristics of the business sector concerned and the conditions determining the acceptability of the tax in question.

In addition, the level of taxation should vary according to the target set. For the tax to have a powerful incentive effect, its rate should be high enough to trigger the fastest possible transition to other more virtuous practices, which presupposes that the tax relates to a "substitutable" activity.

► Innovative practice: when firms integrate the price of carbon

More and more companies are setting an internal carbon price to internalize the economic cost of their greenhouse gas emissions.

As shown by a study conducted by the association Entreprises pour l'Environnement⁷, this practice is an effective way to encourage economic decision-makers to invest in clean energy sources and low carbon technologies.

1. <http://www.epe-asso.org/prix-interne-du-carbone-septembre-2016>

► A change whose impacts are spread out over time

In line with the European Commission's recommendations⁷, the rates could be increased progressively, over a period of 5 to 15 years or even longer, followed by a period of stabilisation.

If firms are aware of the long-term trajectory of the rates, they will be able to plan, anticipate and invest with greater confidence.

"A stable and enduring price signal boosts innovation by encouraging

manufacturers to seek cleaner solutions in order to reduce their production costs" (Chiroleu-Assouline, 2015).

To avoid distortions within the EU, these levels of taxation should also be determined by taking account of the practices observed in other European countries.

A "green tax shift" at a constant levy rate

The revenues from environmental taxation should be redistributed so that other taxes can be reduced accordingly. In this way, the "green tax shift" should be carried out at a constant levy rate.

The aim is to obtain a "double dividend" (Chiroleu-Assouline, 2015): the first being environmental and the second socio-economic, which could assume different forms, such as boosting economic growth (Ekins, 1997). The European Commission⁸ considers that by shifting the current heavy tax burden on labor towards environmental taxes, employment and growth could receive a further boost.

► The Swedish experience

In 1991, facing a significant budget deficit, Sweden decided to implement its own "green tax shift"¹: on the one hand, VAT on energy products was increased and taxes on CO₂ and SO₂ were introduced; on the other, the corporate tax rate was cut from 53% to 30%, the marginal rate of income tax was reduced, and VAT was generalised at a uniform rate. In the early 2000s, the "green tax shift" allowed income tax to be reduced by €1.34 billion and social contributions by €220 M.

Thanks to the increase in taxes on CO₂ and carbon, the taxation of labor decreased by €7.4 billion between 2007 and 2010.

1. D. Bureau, "Fiscalité verte et compétitivité : la démonstration suédoise", CEDD, n° 26, 2013.

The "green tax shift"'s relevance to France could be even greater given that the French tax system is suffering from significant distortions that need to be corrected. There is much to be learned from the Swedish example insofar as this country

4 G. Sainteny, "Plaidoyer pour l'écofiscalité", Buchet-Chastel, Édition 2012.

5 A.-C. Pigou, "The Economics of Welfare", Macmillan, 1920, London.

6 For example, car fleets, sustainable marketing...

7 Rapport Commission européenne, Study on assessing the environmental fiscal reform potential for the EU28, janv. 2016, p. 256 et s.

8 Rapport Commission européenne, Annual Growth Survey 2015, p. 15.

was also suffering from significant tax distortions when it implemented its own "green tax shift" (cf. box).

In this way, a proportion of the environmental revenues could be redistributed to firms with a view to boosting employment. France has embarked on this process, with the creation of the Competitiveness and Employment Tax Credit in 2013, which was partly offset by the introduction of the Carbon Tax in 2014⁹.

Another proportion of the revenues could be redistributed, especially to the lowest-income households, in the form of a lump-sum payment, for example, (such as the "energy voucher" which is currently being trialed in four French "départements" as a way to offset the Carbon Tax).

Can the "green tax shift" be used as a tool for reducing compulsory levies?

The main benefits of a "green tax shift" would be:

- a positive environmental impact due to the implementation of an incentive environmental tax policy;

⁹ This, in turn, was offset in the first year by a drop in the Domestic tax on the consumption of energy products (TICPE).

- a stimulus to employment and growth by reducing the levels of other taxes;
- in the longer term – in up to 20 years' time-based on the assumption that revenues from environmental taxes would, in principle, decrease due to the attrition of their tax bases – the "green tax shift" could be a way to reduce compulsory levies progressively. If the EU manages to reduce its greenhouse gas emissions by 40% between now and 2030 (goal of the Paris COP21), the States will lose an important proportion of their revenues¹⁰.

Consequently, several questions are raised:

- with regard to the actual attrition of tax bases: to what extent does the drop in environmental tax revenues actually occur? Although the tax bases gradually diminish, they do not disappear completely. In certain business sectors, the decline may be quite fast; in others, the change will depend on technological developments. The drop in revenues should therefore occur but with variations according to the sectors (cf. box).

¹⁰ S. Tagliapietra et G. Zachmann, Bruegel, "Le paradoxe de la fiscalité écologique", Le Monde économie, 22 oct. 2016.

> The question of the attrition of tax bases differs from a situation to another

- Tax base on laundry detergents containing phosphates: the rates of the General Tax on Polluting Activities (TGAP) increased sharply in 2007, which triggered a very fast transition from 90% to 5% of laundry detergents containing phosphates.
- Tax base on fuels: the tax product from a carbon tax will not start falling until at least 2040.

- with regard to the public finance context: will a drop in public expenditures be undertaken at the same rate as the drop in revenues? At a time when these revenues are declining, will it be possible to envisage a drop in compulsory levies?

In any case, the public authorities should be able to anticipate this decline by taking account of the predefined trajectory of the rates.

CONCLUSION

To proceed on the path towards energy transition, environmental taxation should provide more of an incentive and be stepped up. However, any increase must be simultaneously offset by a reduction in other taxes though the "shift" can occur without changing the tax burden. In the longer term, the "green tax shift" could mark the start of a planned reduction in the overall level of compulsory levies due to the attrition of the tax bases. In this way, environmental taxation provides an opportunity to rebuild the entire French tax system...

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