

ICC ENVIRONMENTAL TAXATION PRINCIPLES

Fiscal instruments and environmental
policy-making



Prepared by the ICC Commissions on Environment and Energy and Taxation

Introduction

There are many different economic instruments that can be used for environmental policy-making, including fiscal instruments and tradable permits, which aim to promote the production and use of environmentally sound products and processes within a market framework. By enabling industry and consumers to adapt to market signals, such instruments provide greater economic flexibility and efficiency over traditional command and control regulations.

This paper represents a first comprehensive ICC effort across the environment and taxation disciplines to help clarify and frame “environmental taxation” for non-experts on taxation. Whether taxes, subsidies or other policy instrument are employed, they need to be based on cost-benefit analysis, transparent and economically, environmentally, and socially effective.

Definition and terminology

Environmental externalities refers to the economic concept of uncompensated environmental effects of production and consumption that affect consumer utility and enterprise cost outside the market mechanism. Negative externalities lead to private costs of production to be lower than the “social” costs. It is the aim of the “polluter/user-pays” principle to prompt households and enterprises to internalise externalities in their plans and budgets (OECD Glossary).

While the concepts may be clear and understood, the indicators and methodologies to evaluate such externalities still need to be developed. As outlined in the ICC Green Economy Roadmap, for a “green economy” to become operational, indicators, metrics, accounting measures and better disclosure and reporting must be developed that make sense in economic terms while ultimately including the cost for externalities.

Externalities associated with long-term concerns such as climate change, resource depletion, long-term wastes, biodiversity reduction, may develop over time. It should be noted that, under the “environmental taxation” umbrella, there are different issues associated with, for example carbon emissions, use of toxic products in farming activities as well as taxes to support recycling/treatment activities. Policy approaches designed today will need to be flexible both to account for new knowledge as well as national circumstances and priorities. This should be balanced within the need for a long term stable policy framework.

Definitions:

- *Taxation:* The purpose of taxation is to raise funds to meet the expenditure plans of government. Taxation policy should seek to do this in the most economically efficient manner, consistent with the macroeconomic policies of the government.
- *Environmental taxation:* The primary purpose of “Environmental taxation” is not to raise revenue but to change behaviour by accounting for environmental externalities.
- *Scope of the policy statement:* Environmental taxation includes taxes and other imposts on environmental externalities and tax reliefs or exemptions provided to incentivise environmentally “positive” behaviours.

Environmental taxation issues and incentives

Given its purpose to incentivise behavioural change, environmental taxation should not increase the overall tax burden. It is important to note that using taxation for pursuing environmental policies is an interference with markets and must thus be used with caution. This is even more important when taxation is levied on a country basis, and not levied on a co-ordinated and worldwide (or large regional) basis, requiring to take into account cross-border trade issues and their pricing effects caused by such domestic tax rules.

The design parameters for environmental taxation should provide a framework that underpins environmental policies in the most economically efficient manner as to affect behaviours for specific environmental goals in the most economically efficient manner. Such a framework has to be designed within and be consistent with the overall context of the total fiscal framework. Otherwise, environmental taxes may increase the economic costs of taxation while providing only a limited environmental benefit.

Tax is one of a number of policy instruments (market mechanisms are another possible instrument, for example) and policy-makers should seek to utilise the most appropriate policy instrument to achieve environmental goals.

The scale of technological change and development for example needed to meet the environmental targets of governments is significant. Also, potential timescales for change could be very demanding. Together they provide a major challenge in terms of research, development and the initial deployment of commercial scale technology required to “green” economies. Policies should thus seek to deliver environmental objectives at the lowest overall cost to society. For that reason in the case of quotas mechanisms, provision should be made to allow the use of lower cost offsets with environmental integrity wherever they are located.

Differing environmental policies between nations have consequences in terms of impact leakage, which may lead to economic competitiveness distortions. For climate change, this is especially true for energy intense industries that produce globally competitive commodity goods. ICC believes that any policies aimed to redress such concerns should be consistent with existing agreements on trade and investment.

Environmental taxation principles

- a) The following overarching taxation principles should be followed in designing a framework for environmental taxation:
- **Simplicity and cost effectiveness should be primary objectives.** The environmental objective should be clearly stated and measurable, taking into account the competitive impact on affected businesses.
 - **Prices imposed for environmental externalities should be economy-wide,** covering all relevant sectors without exception in the context of a global policy framework. If various sectors have different abatement costs for changing behaviour, they may require different pricing, which should be temporary. The competitive position of trade exposed industries needs to be addressed until consistent environmental taxation applies globally.

- **Potential social implications of environmental taxation should be addressed through integrated policy approaches.** There may be social implications in establishing a price for externalities, as poorer members of society may be more affected than others. Given the principle of simplicity and clarity, it is not advisable to use tax exemptions as the means of addressing the social impact of environmental taxation.
 - **In pricing externalities, there should be no overlap of different mechanisms pricing the same externality** (avoid “double taxation”), either directly or indirectly. The secondary tax consequences of pricing need to be consistent with the primary environmental policy. For example, the provision of allowances within an emission trading system will affect actual prices differently depending on whether they are deemed taxable or not.
 - **New taxes, and changes to existing taxes, must be introduced with sufficient lead-in-times to avoid disruption to investment plans.** Rates should be set as far in advance as possible, or an end outcome should be specified, to provide the certainty needed to underpin new business investment. Tax and legal certainty are essential for market players’ decisions and this is therefore of utmost relevance.
- b) The following guidelines and design principles should be followed in developing specific environmental taxation measures:
- **Establish stable and predictable tax laws** that provide business with a foundation to design long-term economically and environmentally effective strategies; such laws typically use following design elements:
 - *Allow for use of offsets*, with environmental integrity, from foreign sources.
 - *Be economy-wide, covering all elements without exception* but taking into account other (potentially non-fiscal) drivers for behaviour/pricing externalities either explicitly or implicitly.
 - *Provide for credits of taxes imposed abroad on same object of tax domestically* (no double taxation) or other factors mitigating the externality.
 - **Ensure a predictable price for externalities¹ and revenue neutrality.**
 - **Minimize complexity to reduce administrative costs:** provide businesses with flexibility to utilise whichever mechanism is most efficient to achieve the objective and reduce compliance costs. Maximize transparency for companies and consumers.
 - **Assure that provisions for treatment of import and exports are consistent with existing trade agreements:** be as global as possible, for example being applicable to all jurisdictions at similar levels, so as to avoid creating inequalities that may affect a country’s competitiveness.

¹ Such externalities include for example carbon emissions across the economy. Global externalities should eventually be priced in a uniform way. However, in the short term different abatement costs (to change behaviour) may require different pricing. Implementation should aim to take place in all economies in the same manner in order to avoid “tax leakage” effects.

- **Ensure flexibility** to adjust to future developments in environmental science as well as evaluate the economic impacts of environmental policies over the longer term: provide a framework which allows the efficient development of investment to achieve the environmental objectives.
- **Provide for a tax rate commensurate with environmental change** at an adequate rate: ensure that environmental effects are measured and monitored and that competitiveness concerns are assessed.

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The International Chamber of Commerce

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the 20th century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rule setting, dispute resolution, and policy advocacy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice. ICC also offers specialized training and seminars and is an industry-leading publisher of practical and educational reference tools for international business, banking and arbitration.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. These include anti-corruption, banking, the digital economy, telecommunications, marketing ethics, environment and energy, competition policy and intellectual property, among others.

ICC works closely with the United Nations, the World Trade Organization and other intergovernmental forums, including the G20.

ICC was founded in 1919. Today it groups hundreds of thousands of member companies and associations from over 120 countries. National committees work with ICC members in their countries to address their concerns and convey to their governments the business views formulated by ICC.



International Chamber of Commerce

The world business organization

Policy and Business Practices

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