The government's pledge to raise the share of revenue from green taxes has always been problematic

One little discussed aspect of the Autumn Statement has been the ambiguous state in which it has left the commitment to environmental taxes made in the coalition agreement. ***Andrew Leicester and George Stoye*** *explore the current status of this pledge, going on to argue that it is indicative of an ineffective and problematic approach to taxation.*

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Amidst all the discussion of the Chancellor's fiscal rules following the Autumn Statement, rather less attention has been paid to another tax-related target. The Coalition Agreement set out a commitment to "increase the proportion of tax revenue accounted for by environmental taxes." The Environmental Audit Committee reported last month that whether or not this pledge is met depends on how 'environmental taxes' are defined. This article looks at the status of this pledge after the Autumn Statement, and asks whether such a target is sensible in the first place.

The Treasury finally clarified its interpretation of the pledge in July:

- environmental taxes should make up at least as big a part of total revenue in 2015/16 as in 2010/11;
- only taxes whose primary objective is to encourage pro-environmental behaviour change (rather than, say, revenue-raising) count as 'environmental'.

International bodies such as the OECD and Eurostat, however, define environmental taxes not according to their *intent*, but on whether the tax encourages pro-environmental *outcomes*. On this basis, the ONS classifies taxes such as fuel duty and air passenger duty as environmental, which the Treasury does not.

The table summarises Treasury and ONS definition of environmental taxes. We also suggest a third definition, which perhaps best reflects all those taxes which are environmental either in terms of intent or outcome, and for which we have revenue forecasts to 2015/16. This includes company car taxes which, like vehicle excise duty, depend on the fuel efficiency of the car. However, in line with international practice, it excludes VAT on fuel duty since VAT is a general consumption tax rather than a particular environmental tax. As shown at the foot of the table, we find that the definition of green taxes does indeed affect whether or not the target is met.

Three definitions of 'environmental taxes', and compliance with target

On the Treasury

On the Treasury definition, the government would easily meet its pledge: the green tax share is set to more than double, from 0.4% to 0.9% of revenues. Green taxes in 2015/16 could fall by £3.2 billion (56% of forecast environmental receipts that year) before the target is missed.

	HM Treasury	ONS	IFS
Aggregates levy	•	•	•
Air passenger duty		•	•
Carbon reduction commitment	•		•
Climate change levy (i/c carbon price floor)	•	•	•
Company car taxes			•
EU emissions trading scheme auctions	•		•
Fuel duties		•	•
Landfill tax	•	•	•
Renewables obligation		•	•
VAT on fuel duties		•	
Vehicle excise duty		•	•
2010/11 revenue, £ bn (% of total)	2.1 (0.4%)	42.8 (7.8%)	40.2 (7.3%)
2015/16 forecast revenue, £ bn (% of total)	5.8 (0.9%)	47.4 (7.1%)	46.9 (7.0%)
Target met?	✓	×	×

Note: Figures for 2010/11 are out-turns and 2015/16 are forecasts. Revenues are taken from the OBR Economic and Fiscal Outlook, consistent with the December 2012 Autumn Statement. The exception is company car taxes, where forecasts are taken from a written ministerial statement to the House of Commons on 16 July by Economic Secretary to the Treasury, Chloe Smith.

On the ONS definition, however, the green tax share will fall from 7.8% to 7.0% of revenues, breaching the target. Revenues from this set of taxes would have to rise by £5.3 billion (11%) in 2015/16 to meet the target.

On our definition, the pledge is also missed, with the green tax share falling from 7.3% to 7.0%. Green taxes would need to rise by £2.3 billion (5%) to hit the target.

Why do the results differ? Total green taxes are substantially lower on the Treasury definition, mainly because it excludes fuel duties which are estimated to raise £27.8 billion in 2015/16. Including fuel duties makes the pledge much harder to meet: their share of total revenues is set to fall by 0.8 percentage points by 2015/16.

Excluding fuel duties also allows the Chancellor to make further concessions on duties in future years without jeopardising the target. Indeed, if fuel duty is not considered an environmental tax, it actually makes the target *easier* to meet by reducing total 'non-environmental' revenues. The Autumn Statement announced that the planned duty rise for January 2012 was to be cancelled, and future planned inflation adjustments in duties were pushed back by five months from April to September each year. Together these reforms cost around £1.7 billion in 2015/16, the year in which compliance with the green tax target is to be judged. This is almost the entire amount by which, on our definition, the pledge would be breached.

It may well be reasonable to take different views on the precise definition of what constitutes a green tax. More fundamentally, we should ask whether the pledge to raise their importance in total revenues has any particular merit, setting aside the definitional issues. Ideally, taxes (including green taxes) should be raised in the most effective way, rather than to hit some essentially arbitrary target for receipts from one part of the system. Whether environmental taxes make up a bit more or a bit less of total revenues in 2015/16 than they did in 2010/11 is not of much real consequence. Moreover, the green tax share of revenues is not really a good indicator of a government's environmental credentials. The tax system can be 'greened' without raising more money: reforms to vehicle excise duty to base payments on fuel efficiency are one example. Other environmental policies such as regulation and subsidies operate outside the tax system but could still have important environmental benefits. Some green tax revenues may erode away as people change their behaviour in response to the tax. The green tax share also depends on total revenues which can be very sensitive to overall macroeconomic conditions.

It took the government more than two years to lay out the rules against which it wished its green tax target to be judged. In the end, its chosen definition makes the pledge easy to accomplish but implies a very limited role for green taxes. If they really do make up less than 1% of total receipts, then any ambition to move towards a significant role for such taxes in the future (such as that adopted by the Liberal Democrats at their 2010 conference) appears to be a very long way away.

More fundamentally, pledging to meet certain targets which are then defined in such a way as to make them trivial both to meet and in their apparent importance does not look like an effective way of gaining credibility. A green tax definition more in line with international convention would be much more constraining and require the government to take policy action. As a result, there will almost certainly be an argument at the next election as to whether or not the pledge was met. A better argument would be that it wasn't really worth making in the first place.

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Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

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