Briefing

Friends of the Earth

Friends of the Earth's recommendations for the pre-Budget statement 2001

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Introduction

The Government's green tax and re-spend programme is at a cross-roads. Despite welcome progress in introducing a range of polluter-pays taxes on energy pollution and materials waste during the last administration, serious question marks hang over the Government's commitment to use fiscal policy to significantly achieve sustainability policy goals (where environmental, economic and social gains are realised through carefully designed fiscal packages).

Concerted industry opposition to sensible and mild polluter-pays taxes and re-spending measures to encourage behaviour shifts to meet environmental, economic and social goals - such as the climate levy, aggregates tax and road-fuel duty - has led to a situation where the Treasury's commitment to put sustainability objectives at the heart of fiscal policy is in serious doubt. For example, while Budget 2000 completed these long-awaited introductory green fiscal measures, it also saw a massive Government retreat from two of its most positive polluter-pays measures, the established road fuel duty and the long-awaited pesticides tax. No 10 insisted that the Treasury-approved pesticides tax, and re-spend on organic conversion, was dropped, and the response to the hyper-hyped fuel protests was a £1.5 billion tax cut bribe to motorists.

The Election manifesto statement to simply 'continue to tax pollution' was a significant down-grading of the previous manifesto commitments to put 'environmental concerns at the heart of all government decision-making' and to use taxes and public expenditure to 'send clear signals about the economic activities they (the Government, sic) believe should be encouraged or discouraged, and the values they wish to entrench in society. Just as, for example, work should be encouraged through the tax system, environmental pollution should be discouraged'. The 1997 Statement of Intent on Environmental Taxation provides little help, as it is merely a useful set of principles. We need a new Statement of Intent, which is a clear and committed strategy to realise the increased employment, cost efficiency and competitiveness benefits of cutting pollution, increasing resource use efficiencies and encouraging innovation by developing a domestic market for environmental technologies, infrastructure and services, while stimulating UK firms to meet this demand at home and abroad.

In an important speech delivered in March before the Election, the Prime Minister pledged to create a low-carbon, low-waste economy, and to green the agriculture sector and the Common Agriculture Policy. These are welcome initiatives, but they will not be realised unless a comprehensive green fiscal strategy is put in place quickly. The first Pre-Budget Statement of the new administration is the perfect time to unveil such a strategy. Apart from the measures listed below, that strategy should be based on three over-riding objectives:

- be clear and honest about the environmental and social objectives of green taxes
- introduce them as part of a well-designed package, which emphasises rewards for environmentally virtuous companies and households, as well as penalties on polluters. Use a proportion of revenues to pay for appropriate tax incentives and spending programmes to reinforce the aims of green taxes, and address any significant adverse impacts
- and, use remaining revenues to shift, rather than increase, the overall tax burden on companies, for example by cutting taxes (NIC) on jobs.

Charles Secrett and Tim Jenkins, November 2001

Key recommendations

1. Publish an improved Statement of Intent on Environmental Taxation as a strategy - not merely a restated set of principles - that commits the Government to a significant shift in taxation away from jobs and work and onto polluting and inefficient natural resource use activities, and to revenue re-spends that achieve sustainability goals.

2. Target this environmental fiscal reform agenda at developing a low carbon economy, significantly improving resource use productivity, and stimulating a thriving green farm sector.

3. Developing a low carbon economy.

- **Commit to a steady rise in carbon-nuclear energy taxation over the next 10 years.**
- **Rule out further cuts in road fuel duty (with incentives for cleaner fuels delivered by increasing the rate for dirty fuels), and seek to introduce taxes on aviation fuels.**
- **Announce a Task Force to examine the options for a tax and spending package to reduce CO2 emissions from the domestic sector.**
- **Consult on the proposals for a tax break for the next generation of renewable energy technologies, and in particular wave, offshore wind and solar.**

4. Improving resource use productivity.

- **Announce the Government's intention to turn the Landfill Tax into a Waste Tax by including waste incineration.**
- **Commit to a continuing and significant rise in waste taxation over the next 10 years.**
- **Announce the Government's intention to scrap the Landfill Tax Credit Scheme and to use a proportion of Waste Tax revenues to fund a nationwide household recycling and compost programme.**

5. Developing a thriving green farming sector.

- **Make clear that a Pesticide Tax remains on the agenda while efforts trying to establish a credible voluntary alternative continue.**
- **Announce a consultation into proposals for a Fertiliser Tax.**
- **Propose to increase the target for modulation from 4.5% to 20%, based on social and environmental criteria.**

6. Announce the formation of a high level and high profile Task Force to examine how the Government's measurement of economic growth can be modernised to reflect environmental and social 'quality' factors as well as 'quantity' considerations.

Details of key recommendations

1. Publish an improved Statement of Intent on Environmental Taxation as a strategy - not merely a restated set of principles - that commits the Government to a significant shift in taxation away from jobs and work and onto polluting and inefficient natural resource use activities, and to revenue re-spends that achieve sustainability goals.

The 2001 Budget, which included £1.5 billion of tax cuts for motorists in this financial year alone, has put the Government's commitment to green tax reform in doubt. At this Pre-Budget Statement the Chancellor must reaffirm this commitment in strong and strategic terms. In particular, the strategy should focus on green fiscal reforms that meet sustainability goals - the simultaneous realisation of environmental, economic and social policy objectives. For example, by taxing dirty or wasteful energy and resource use, and by providing tax incentives and/or re-spending measures for environmentally efficient investments, and company and household behaviours.

If the Chancellor fails to take this opportunity, it is highly likely that the effectiveness of existing, as well as future, green taxes to deliver on key manifesto priorities, as well as the capacity of British companies to take a leading role in the rapidly expanding overseas markets for environmental technologies, will be seriously undermined.

Following the concerted attacks on the climate levy by industry, and the many concessions granted, the Treasury's commitment to using polluter-pays taxation, and re-spend incentives, is not being taken seriously. In the present defensive climate, polluting and wasteful companies, who should be encouraged to curb their activities and invest in environmental technologies, are likely to conclude that green taxes are a paper tiger, and may even consider a cut in the rates possible. This will likely also lead to a slowing down in investment and development of innovative environmental technologies. Such investment and innovation is vital for Britain to develop a thriving low-carbon, low-waste economy using British made and installed environmental technologies - as opposed to importing them from other countries.

The weak manifesto statement to "continue to tax pollution", which is a significantly milder statement than in the 1997 manifesto, failed to dispel these concerns. In fact it compounds the problem by not signalling a firm strategic shift in the burden of taxation away from jobs and work and onto pollution and environmental damage, and by leaving the door open to cuts in green taxes.

The previous Government's Statement of Intent on Environmental Taxation from July 1997 provided a platform for the progress made in greening the tax system over the last four years. But it is a statement of principle, rather than strategy. This Government needs to show political leadership by clearly marking out a strategic shift, through broadening and deepening its green tax reforms. This is the time to do so, in the administration's first Pre-Budget Statement.

This statement must demonstrate that the Government has learnt the three key lessons of the first decade of green tax reform. These are to:

- be clear and honest about the environmental and social objectives of green taxes
- introduce them as part of a well-designed package, which emphasises rewards for environmentally virtuous companies and households, as well as penalties on polluters. Use a proportion of revenues to pay for appropriate tax incentives and spending programmes to reinforce the aims of green taxes, and address any significant adverse impacts
- and, use remaining revenues to shift, rather than increase, the overall tax burden on companies, for example by cutting taxes (NIC) on jobs.

Road fuel duty is a central element of the Government's climate change strategy. But successive

Governments have been more attracted by the duty's capacity to raise revenue, with little negative political impact on voters for several years, than its environmental or economic efficiency benefits. In the market place, pump prices rose by less than duty increases because crude oil prices were steadily falling. No efforts were made to promote the duty's necessary environmental objectives, or to design a package of tax-spend and credit measures to deliver these most effectively. Crucially, no proportion of the revenue was earmarked to re-enforce the aims of the tax; say, through investment in public transport or tax breaks for 'greener' vehicle/engine purchases or design.

This was a huge mistake. The ability of people to respond to higher fuel prices by changing behaviour is dependent on appropriate alternatives being readily available. Years of chronic under-funding for public transport, and under-investment in walking and cycling, required a significant proportion of revenue to increase the ability of the tax to achieve its environmental goals. When rising oil prices triggered the fuel protests last year, Ministers refused to spell out the environmental and economic efficiency benefits of the tax. Not surprisingly, the motoring public simply saw the duty as a penalty, rather than the basis for curbing pollution and investing in cleaner motoring. Ironically, the Chancellor compounded the problem by claiming his rate cuts in March were environmentally beneficial, although, despite incentives to cut sulphur emissions, the move was a serious retreat on cutting CO_2 emissions.

The Chancellor must now tackle these strategic deficiencies, use this first Pre-Budget Statement to draw a line under this disingenuous approach, and commit to straight-talking on the environmental aims of green taxes.

There have been some significant and welcome moves to lay the foundations of such a strategic shift. One of the most important advances in green tax reform has been Treasury's acceptance of the benefits of hypothecation; whereby a proportion of revenues is earmarked to pay for associated tax incentives and spending programmes. The climate change levy package, in particular, was an important milestone as both Labour's first green tax, and because revenues were used to lower NIC's and create a spending fund to promote investment in energy efficiency technologies. This combination of tax shifting, tax incentives and integrated spending is a model that the Chancellor should explicitly signal that he intends to replicate in other areas over the next five years.

2. Target this environmental fiscal reform agenda at developing a low carbon economy, significantly improving resource use productivity, and stimulating a thriving green farm sector.

As well as making a clear commitment to an expanding and improved programme of green tax reforms, it is critical that the Chancellor indicates which sectors will be targeted first. The Election manifesto and the UK's Sustainable Development Strategy clearly identify three policy areas that should form the backbone of this Government's green tax reform programme. These are:

- tackling global climate change through the development of a low-carbon economy;
- developing a thriving green farming sector, which supports a diversity of farmers and farm types, promotes organic, least chemical and other environmentally sound farm practices, and encourages best practice animal welfare;
- and, cutting industrial waste and inefficiencies by significantly improving the use of natural resources through Factor 10 efficiency gains.

Tax reforms take time to design and install. The previous administration moved quickly to set in motion the process that led to the Climate Change Levy. Lord Marshall's Task Force on Economic Instruments and Industrial Energy was established in June 1997 and the Climate Change Levy came into force in April 2001. It is vital that this Government makes a similar early and confident start, but one that is more ambitious for what can be achieved for Britain and by Britain.

3. Developing a low carbon economy

The Government recognises in its manifesto the "need to press ahead with a radical agenda for the development of low carbon economic growth". Fiscal policy is essential to achieve this aim, for two reasons. First, because it provides incentives that help change behaviour and redirect investment. Second, it can clearly signal the Government's intentions and strategic resolve, which underpin other policy measures. Carbon and energy taxes have a central role to play in managing demand, directing investment, stimulating innovation and transforming the energy supply to a low-carbon footing, through rapid and continuing growth in renewable energy generation and energy efficiency gains.

The Chancellor should take four steps to establish the role of fiscal policy in delivering a low carbon economy in the UK.

- **Commit to a steady rise in carbon-nuclear energy taxation over the next 10 years.**

Governments often set long-term targets for fiscal policy such as rates of income tax or corporation tax. Any radical agenda for the development of a low carbon economy needs to be underpinned by a gradual increase in carbon and energy taxation over the next decade. It is important that firms and households are convinced that this will be the case. A clear understanding of the direction of energy taxation over this period will allow firms and households to make strategic, effective and efficient responses.

The scrapping of the road fuel duty escalator and the recent effective cuts in road fuel duty rate have seriously undermined confidence in the Government's commitment to reduce greenhouse gas emissions from transport. As a matter of urgency the Government needs to back a steady rise in energy taxation over the next decade, focussing on high tax rates for polluting fuels and energy supply/sources, and low taxes on clean fuels and energy supply/sources. Concerns over the social and competitiveness impacts of these higher energy tax rates should be dealt with through appropriate tax breaks for clean energy/fuel investments and public spending on alternatives.

- **Rule out further cuts in road fuel duty (with incentives for cleaner fuels delivered by increasing the rate for dirty fuels), and seek to introduce taxes on aviation fuels.**

Road transport produces 24.6% of the UK's emissions of carbon dioxide, the main gas causing climate change. Its share has risen from 20.9% in 1990[1], making it the second fastest growing UK source after aviation, which accounts for a much smaller percentage of emissions. In order to re-establish the Government's clear position on road fuel duty, a statement should be made ruling out any further cuts in the standard rate of road fuel duty. This should make clear that any differential rates for new lower pollution fuels will be installed by either no increase or a reduced increase for these fuels the next time the standard rate is raised. The Chancellor should confirm last year's decision to reinvest revenues from future increases in transport, but direct that spend to options which deliver low-carbon growth.

Despite the difficulties currently experienced by the aviation industry, the Chancellor should signal his intention to tax aircraft fuel once flights and passenger miles start rising.

- **Announce a Task Force to examine the options for a tax and spending package to reduce CO2 emissions from the domestic sector.**

Carbon dioxide emissions from the domestic sector remain a major cause for concern, but are more or less exempt from taxation. Friends of the Earth has campaigned vigorously for policies aimed at eliminating fuel poverty and have seen these as a pre-requisite for taxing domestic energy. The Warm Homes and Energy Conservation Act 2000 (drafted by FOE and the Association for the

Conservation of Energy) has begun the process of eliminating the scandal of fuel poverty. At the same time falling domestic energy prices (down 35-40% since 1990) have discouraged energy efficiency measures such as insulation. A mechanism is urgently needed that will encourage better-off households to install such measures while protecting those on low incomes. Such a mechanism will require an integrated package of taxation and spending, with the latter potentially financed by borrowing against revenues from the former. The marginally applied cut in VAT (from 17.5 to 5%) on certain public sector housing energy conservation materials and goods, which also resulted from a joint FOE and ACE campaign, is a small step in the right direction.

Given the importance of making progress on this issue and its complexity, we urge the Government to appoint a Task Force as soon as possible following the Pre-Budget Statement to report on the options available.

- **Consult on the proposals for a tax break for the next generation of renewable energy technologies, and in particular wave, offshore wind and solar.**

The Green Technology Challenge announced in Budget 2001 is an important tax measure which Friends of the Earth and the Environmental Industries Commission lobbied hard for over several years. The first generation of renewable energy technologies (onshore wind and biomass) are likely to benefit from the scheme. The second generation of renewable energy technologies, such as offshore wind, wave power and photo-voltaics, are unlikely to benefit because they require further development in a commercial setting. A tax credit for investment in these technologies is a more compelling incentive, and will accelerate their development and application in the UK.

The Chancellor should announce his intention to consult on the options for installing a tax break for these technologies, which promise both the delivery of low-carbon growth and the creation of significant number of jobs in the UK. The consultation should be completed in time for measures to be installed at Budget 2002.

4. Improving resource use productivity.

- **Announce the Government's intention to turn the Landfill Tax into a Waste Tax by including waste incineration.**

The Government has recognised that our economy is grossly inefficient in its use of material resources. Both Treasury and the Department of Trade and Industry have statements of intent that aim to increase resource-use productivity. The Treasury should help the Prime Minister reach his goal, announced in a significant pre-election sustainability speech in March, of achieving a Factor 10 improvement in resource use efficiencies. Currently, for every tonne of goods consumed by the British economy, some ten tonnes of raw materials and natural resources are used. The profligate use of resources leads to high levels of waste, most of which is buried or burnt rather than re-used or recycled. This in turn leads to higher than necessary costs for industry, the retail sector and households, and severely undermines the competitiveness of the UK economy.

Over the next five years, the Treasury should be looking at taxing the use of virgin natural resources and raw materials, such as timber/pulp, minerals and metals, and providing tax credits for the use of secondary materials. This is necessary to do to lower the UK's unfairly high consumption of such resources, cut down on waste and encourage new markets and companies in waste minimisation, recycling and reuse. German taxes and other policy measures to greatly stimulate recycling and re-use industries over the past decade have led to the emergence of over 1,000 such companies employing some 150 people on average.

Despite the Prime Minister's aim of every local authority offering doorstep recycling (although the manifesto only talked of 35% of households being covered), and some new money being made available for that purpose, taxation still offers little incentive to invest in waste minimisation, recycling and composting - although there are substantial tax breaks for waste incineration.

Overhauling the taxation of waste disposal is an urgent task that the Chancellor should address in Budget 2001. At present the signals coming from the Treasury are confused - they should be clear and coherent. The following reforms would go some way to providing proper incentives for recycling and composting, and removing the current bias in favour of incineration.

When the Landfill Tax was introduced, it was hailed as a move to "taxing waste not jobs". Yet waste incineration remains totally exempt from the tax. This means that the tax provides an incentive to divert waste disposal from one unacceptably polluting route, landfill, to another, incineration. Any incentive for waste producers to minimise waste or recycle is undermined by this exemption. The subsidy for incinerators must stop.

The Treasury is concerned that the administrative costs of removing this exemption would be high given the small number of incinerators in operation. Yet the Government's waste strategy has already increased the number of local authorities planning to use incineration. The Chancellor should move now to remove the exemption before investments are made that undermine efforts to improve waste minimisation, and increase recycling and composting.

- **Commit to a continuing and significant rise in water taxation over the next 10 years.**

The current escalator is a useful mechanism for increasing the incentive to reduce waste and recycle in a way that allows businesses to adjust in a planned way. But it is too slow. Waste taxes in many other European countries are set far higher than the current escalator will reach by 2004. The waste industry indicates that a much higher rate is required to significantly impact upon a wide range of waste producers.

- **Announce the Government’s intention to scrap the Landfill Tax Credit Scheme and to use a proportion of Waste Tax revenues to fund a nationwide household recycling and compost programme.**

Government attempts at reforming the credit scheme to increase support for recycling and composting have lamentably failed. A key reason for this is the corporate control of the scheme. Shifting the reinvestment of this portion of the tax revenues to public expenditure would allow for necessary and vital investments in setting up a nationwide household collection, and recycling and composting, programme.

5. Developing a thriving green farming sector.

Foot and mouth is the latest in a long line of entrenched farm crises that spring from the over-intensive production and export oriented development model, which has underpinned UK agriculture for forty years. It is imperative that the Government take the lead in transforming UK agriculture away from practices and methods which are environmentally damaging, increasingly fail local economies and consumers, and make it very difficult for small and medium-sized farms and family farm businesses to survive. Both revised public spending policies and tax reforms must underpin this strategically achievable transformation. The Chancellor should take three steps at this Pre-Budget Statement to fulfill this obligation.

- **Make clear that a Pesticide Tax remains on the agenda while efforts trying to establish a credible voluntary alternative continue.**

It is crucial that the Chancellor makes absolutely clear that the Pesticide Tax, which should be graded according to use and toxicity criteria, remains on the agenda for two reasons. First, it increases the incentive for the pesticide industry to establish a credible alternative scheme - something they are struggling to do at present (just as the Quarry Products Association, and quarry companies, struggled in vain to develop a viable voluntary alternative to the aggregates tax). Second, if the industry's efforts fail to provide a better option than a pesticide tax package, which appears highly likely, the rationale for introducing the tax quickly will be more apparent and better understood.

One of the key arguments against implementing a pesticide tax package has been that, in the current climate, farmers would find it difficult to respond to the incentive of tax and that the adverse impact on farmers would be too high in the short-term. However, as the proposals for the Voluntary Package are progressed, it is becoming clear that they will place additional costs and financial burdens on farmers anyway; but crucially without the advantage of using new tax revenues to support farmers in adopting more sustainable methods of pest and disease control. The Voluntary Package is dependent on farmers being willing to take up the measures proposed, and is therefore highly unlikely to deliver its aims if the costs and burdens are perceived by farmers to be too high.

The Crop Protection Association (CPA) has estimated that the direct cost to farmers of implementing the voluntary package will be £11million pa for five years. In addition to these direct costs, there will be many additional burdens on farmers if they choose to participate in the measures proposed by the CPA. For example, one of the key elements of the package is the introduction of Crop Protection Management Plans. Yet these are flawed proposals. They are of limited value in reducing pesticide impacts, because they will not prohibit the use of the highest risk pesticides or encourage non-chemical methods. They will require farmers to spend valuable time in extra record keeping and inspection. And, it is very unclear what additional benefit such plans will deliver to existing Assurance Schemes; or, indeed, whether farmers already involved in Assurance Schemes will be expected to also draw up a separate Crop Protection Management Plan. Farmers already have to pay to join Assurance Schemes, with no contribution from industry or from retailers who insist on Assured Produce.

For farmers to meet the Government's objectives for minimising pesticide use, they will need advice and training in using non-chemical methods of control as well as in more targeted use of pesticides. The introduction of a Pesticide Tax would raise revenue, which would enable Government to provide the necessary training and advice to enable farmers to adopt more sustainable farming methods. Under the Voluntary Package the commitments from the CPA to provide additional advice to farmers are predominantly concerned with meeting existing legal requirements. Farmers will have to meet the cost of undertaking additional training themselves.

Although the Voluntary Package proposals were drawn up in September 2000, and revised in February 2000, there is still no clear indication of how progress towards meeting the Government's objectives for pesticide minimisation and environmental protection will be measured. A set of indicators has been produced by the Pesticides Forum, but the Voluntary Package group has made no commitment either way and many of the indicators have little or no baseline data by which to measure progress.

- **Announce a consultation into proposals for a Fertiliser Tax.**

The Government has previously twice raised the issue of a fertilizer tax; first as an option for reducing water pollution and, second, as a component of climate change policy. There are clear benefits in introducing a fertilizer tax package in terms of reducing risks to human health and the environment, cutting greenhouse gas emissions and increasing sustainable farming practices, such as organic systems.

The previous Government put forward options for a fertilizer and pesticide tax or charge, but concentrated on pesticide policy. The option of a fertilizer tax has never been properly assessed or discounted since being put forward four years ago. With the pesticide tax proposals on hold while attempts to run a voluntary scheme continue, the Government should devote time to developing this proposal through a consultation paper announced at this Pre-Budget Statement.

- **Propose to increase the target for modulation from 4.5% to 20%, based on social and environmental criteria.**

Currently, the Government has committed to a meagre 4.5% modulation of existing public sector spend on agriculture. Most of this spend goes for production-based subsidies, which are overwhelmingly garnered by intensive, large-scale farmers; some 11% of farmers take over 70% of these public monies. These are also the farmers who wish to compete on the world market. Meanwhile, the majority of farmers struggle to make a living, and there is never enough money to help farmers who need and deserve government assistance, whether they wish to convert to organic or least chemical methods or to supply local markets and small-scale farm processors and retailers.

Under CAP rules, it is possible for Member States to modulate up to 20% of annual farm support for environmental and social reasons like these; including based on farm size. The Government should signal its strategic intention to increase the modulation target to 20%, and gear these monies for such social and environmental criteria. Large-scale farmers would have to fund these disbursements, by having less support payments - but then these free marketeers, who employ very few people, shouldn't be subsidised if they want to compete on world markets.

6. Announce the formation of a high level and high profile Task Force to examine how the Government's measurement of economic growth can be modernised to reflect environmental and social 'quality' factors as well as 'quantity' considerations.

The Prime Minister has recognised that unalloyed economic growth can be detrimental to the quality of life. The Chancellor has repeatedly stressed the need for improving the quality of investment. Yet economic policy remains a slave to an overtly simplistic quantitative measure - GDP. This approach persistently undervalues the needs of future generations and environmental systems, and provides no measure of social quality. Other composite alternatives have been proposed. Reform is vital, but will not be straight-forward. A high-level and high profile Task Force can kick-start the process of reform.

References

1. Draft UK Climate Change programme - Annex VI