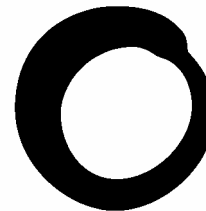


April 2002



**Friends of  
the Earth**

# Briefing

# Time for Chancellor to stand and deliver

**Friends of the Earth's eighth blueprint  
for a green Budget**

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### **Introduction**

The Government's environmental tax and respond programme is at a crossroads. After a promising first term start to greening the tax system, Labour seems to have lost its nerve and be backing away from both pollution taxes and fiscal incentives for companies and householders who conserve resources and cut pollution. This is a huge mistake for economic and social, as well as environmental, reasons.

UK PLC and British companies would benefit from a fiscally driven move away from using dirty and inefficient fuels, power and machinery toward their modern and renewable, resource-efficient and clean alternatives. A polluting, wasteful factory or household is an inefficient, poorly managed and expensively run business or home. The UK economy uses 10 tonnes of raw materials and natural resources to produce just 1 tonne of finished goods (the rest ends up as pollution and waste). That is a 10% conversion-efficiency rate, and is simply unsustainable.

Poor communities are worst affected by a range of environmental threats, including traffic pollution, toxic chemical emissions from heavy industry and climate change. These neighbourhoods are frequently deprived of decent services - public transport, energy conservation, waste minimisation - which also help resolve these threats. Polluter pays taxes are a socially progressive way of cutting pollution and waste, particularly in the energy, transport, agriculture and materials use sectors. They target the polluter responsible, and generate essential revenues to respond as tax credits or direct investment to support the development and use of clean, resource-efficient technologies, products and infrastructure. Poor families and neighbourhoods would benefit most dramatically from this type of environment-led economic modernisation, as their quality of life soars, public services improve, and jobs are created.

Substantive green tax reform is the most effective way of reshaping markets to improve performance. Building up market demand at home for goods like renewable energy, clean fuels and production processes, efficient engines and reusable/recyclable materials will help British companies develop the business strategies and investment programmes to complete this sector restructuring. Judging from the experience of competitor countries like the Netherlands and Germany, properly designed green tax reforms will stimulate technical innovation, resource-cost efficiencies and new product development - leaving British companies better able to compete in the \$300 billion global export market for environmental goods and services.

But Government policy is going in the opposite direction, with market and business consequences. For example, BP, a British multi-national, is building new solar pv plants in Spain and Germany because the public aid and tax breaks for doing so are much higher than in Britain; while domestic renewable energy companies like Solar Century in Britain struggle to penetrate markets at home.

Aggressive CBI attacks against sensible polluter-pays measures (the climate levy, aggregates tax and road-fuel duty), and the lack of Opposition concern for the eco-tax agenda, seem to have panicked No 10 and the Cabinet into making irresponsible concessions. Under the climate levy, 80% exemptions were quickly handed out to heavy energy user companies; and key measures like the Treasury-approved pesticides tax were blocked. Throw in a few straggling truckers on protest convoy, with sensationalist headlines

about Britain running out of fuel, and suddenly more motoring became the order of the day, and go hang the government's much vaunted climate response policies. Last year's pre-election Budget duly delivered a £1.5 billion tax cut (sic, voter bribe) for truckers and motorists, and traffic and pollution levels rose as a direct result.

At a stroke, these politically expedient but stupid decisions broadcast three loud messages. First, that if polluters complain enough, the Government goes soft. Second, that Ministers have not grasped the damaging economic and social consequences of supporting polluting dirty companies and outdated industrial processes, and failing to boost emergent environmental technology sectors. Third, that the 1997 manifesto promise to put environmental concerns at the heart of all government decision-making was history.

The Chancellor must use Budget 2002 to put the green tax reform agenda back on track. In this *Friends of the Earth's eighth blueprint for a green Budget*, we set out a range of practical green tax and spending priorities to accomplish these four critical sector transformations:

1. developing the low carbon economy
2. developing the low waste economy
3. greening agriculture and encouraging urban regeneration
4. a fiscal strategy for sustainable development.

We have also, for the first time, pulled together a package of measures designed to help householders go green, and build domestic market demand for British-made environmental goods, infrastructure and services.

The Treasury has put in place the foundations for developing such a coherent approach, in:

5. the 1997 Statement of Intent on Environmental Taxation, with its guiding principles for green tax reform
6. breaking long-held Treasury opposition to hypothecation (i.e. earmarking specific tax revenues for complementary spending) in 1999 for environmental policy reasons
7. introducing a range of pollution taxes, covering chemicals, fuels and materials
8. creating tax incentives and credits to support market-leader green technologies
9. creating tax/respond packages to achieve cross-cutting policy goals (e.g. carbon reduction).

These starting points must now be built up into a comprehensive green fiscal strategy. Geared to sustainable development goals (where environmental, economic and social policy objectives are realised together, and not traded off against each other automatically), the new strategy should:

10. spell out the environmental, social and economic objectives for green fiscal reform
11. introduce measures as coordinated packages, which emphasise rewards for environmentally-virtuous companies and households as well as penalties for polluting and/or resource wasteful behaviour, in every key sector
12. use a majority of pollution revenues to pay for appropriate tax incentives and credits to reinforce the aims of pollution taxes; and use the remainder to shift the tax burden on

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companies (eg cutting NIC on jobs). At this stage, the former expenditure is the priority. Gordon Brown, the Chancellor, has built a reputation for planning over the long-term to bring about gradual but radical policy changes and economic restructuring. Yet, on the central economic issue of green fiscal reform, he has begun behaving like the proverbial short-term, boom and bust merchant. His ear has been captured by the siren voices of companies afraid of change. Achieving sustainable development requires a fundamental overhaul of the way markets behave and the type of products and processes used to drive progress. The Prime Minister has begun to recognise the competitive importance of greening UK PLC, and has called for a “green industrial revolution” to power Britain in the next century. This cannot happen without an appropriate and comprehensive green tax and respend strategy, as outlined here.

Charles Secrett and Tim Jenkins, April 2002.

**Box 1: Summary of Friends of the Earth analysis and proposals**

Policy Area	Green Taxes	Re-Spending	Tax breaks
<p><b>Transport</b> Road transport accounts for 24.6% of UK CO<sub>2</sub> emissions, and rising. More than 50% of households in the two lowest income bands do not have a car. Road traffic levels continue to rise, but the real price of motoring continues to fall.</p>	<p><b>Road Fuel Duty:</b> 1p per litre petrol and diesel Commit to steady rise to 2010 Review CO<sub>2</sub> impact of Red Diesel <b>Vehicle Excise:</b> New £500 gas guzzler band and £50 band for lowest CO<sub>2</sub> emissions <b>Aviation:</b> Commit to getting EU air fuel tax by 2005</p>	<p><b>Rail and bus:</b> £16.7 - £30.2 billion<sup>1</sup> over nine years to fund increase rail investment up to 75% £2 billion for Safe Routes to School £3 billion on traffic calming £1.4 billion for 6,500 Home Zones £590 million on rural buses.</p>	<p><b>Public transport season tickets:</b> Relief against income tax. If capped at £500 cost £200m/year. <b>Employers subsidising local public transport.</b> Extend ‘works bus’ relief to public services. <b>School/work buses &amp; coach services.</b> Extend 80% fuel duty rebate</p>
<p><b>Waste</b> UK produces 400m+ tonnes of waste a year, and rising. Household recycling rates are 4 times higher in Germany.</p>	<p><b>Landfill Tax:</b> Increase escalator to £3/yr now and £5/yr from 2004. <b>Product and material taxes:</b> Review options.</p>	<p><b>Recycling and composting:</b> £200m/yr of Landfill Tax revenues to make up the total £375m/yr needed for nationwide doorstep recycling.</p>	<p><b>End perverse tax breaks for incineration:</b> End exemption from Landfill Tax and declassify as renewable energy under the CCL.</p>
<p><b>Farming</b> Farmland birds have halved since 1977 and decreased 2% in 2000. Sweden’s pesticide tax and respend package cut use by 65% in 9yrs 20% of farmers get 80% of production</p>	<p><b>Pesticide Tax package:</b> introduce in 2004 unless voluntary package proves credible by 2003. Consult on Nitrate Fertilizer Tax package</p>	<p><b>Pesticide Tax revenues:</b> All reinvested helping farmers reduce pesticide use and convert to organic. <b>Modulation of CAP subsidies:</b> 10% by 2004 and 20% by 2006 - targeting green farm systems</p>	<p><b>Tax break for investing in renewable energy:</b> commit to a measure for 2003 and consult now. Roll-over relief on development land: End un-justified tax break .</p>

subsidies		and local food economies.	
<b>Housing</b> Households forecast to rise by 3 million over 20 years. 43% of new houses built on greenfield sites	<b>VAT on new housing:</b> 17.5% VAT on new houses on greenfields bringing in £1.8 billion per year, plus 5% rate for brownfield sites.		<b>New-build on brownfield sites:</b> reduced rate of 5%. <b>Social housing:</b> commit to EU rate of 0%
<b>Energy</b> UK has more than a third of Europe's potential offshore wind and wave resources.	<b>Household energy:</b> Task Force to examine options for a tax and spend package to reduce CO <sub>2</sub> emissions while eradicating fuel poverty. <b>Climate Change Levy agreements:</b> Commit to tighten if new emissions trading shows they are too slack.	<b>Renewable energy:</b> Increase R&D spending which at £18.5 m/yr lags behind leading European countries and is dwarfed by the £230m yearly average for UK nuclear R&D spending over the past 25 years.	<b>Off-shore wind, photovoltaics and wave/tidal power:</b> Commit to tax incentive for this next generation of renewable energy. <b>Farmers and households:</b> Commit to tax break for investment. <b>Green technology challenge:</b> Include renewable energy technologies.

1: from a steady rise in fuel duty to keep the real price of motoring even.

<p><b>Box 2: Encouraging householders to go green with tax incentives/ respending</b></p> <p><b>Tax rewards for households to go green</b></p> <p><b>1) Incentives for Public Transport.</b> Paid for by increases in road fuel duty, starting with a 1p per litre increase this budget.</p> <p>a) To increase public investment for a safer, more efficient and convenient service by 75% - £11 billion over the 10 year Transport plan plus shifting £16 billion from new road-building (£</p> <p>b) To provide all children with a Safe Route to School - £2 billion over ten years (£200 million pa)</p> <p>c) To provide efficient rural bus services nationwide - £590 million over ten years (£59 million pa)</p> <p>d) Tax relief for buying public transport season tickets - £2 billion over ten years (£200 million pa).</p> <p>e) Green School Bus scheme nationwide - £500 million over 10 years (£50 million pa).</p> <p><b>2) Incentives for Recycling.</b> Paid for by increased rates of landfill tax.</p> <p>a) £200 million a year additional investment to establish a nationwide doorstep recycling.</p> <p><b>3) Incentives for Green Energy.</b> Paid for by VAT receipts from domestic energy use</p> <p>a) Consult on tax break for households investing in their own renewable energy such as solar pv, energy conservation and biomass mini-CHP boiler.</p> <p>b) 5% only VAT rate (ie cut from current 17.5%) on energy saving goods and equipment purchases</p> <p><b>4) Incentives for Greener Driving.</b> Paid for by higher rates on polluting fuels and vehicles, respectively</p> <p>a) Using low carbon fuels (eg LPG) - freezing duty (currently 40% below other fuels) as rates increase for high carbon fossil fuels</p> <p>b) Using CO<sub>2</sub> efficient engines - cut the minimum car VED rate from £90 to £50 for cars with the lowest CO<sub>2</sub> emissions</p>
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## **Friends of the Earth's recommendations for Budget 2002**

### **1. Developing the low carbon economy**

**Transport: A balanced package of polluter pays taxes, re-spending plans for public transport and tax credits for individuals and companies 'doing the green thing'.**

The Government has tried three approaches to cut CO<sub>2</sub> emissions from road transport:

- increasing the price of fuel to provide incentives to use other forms of travel and access, and to invest in vehicles that emit less CO<sub>2</sub>;
- providing direct tax incentives to encourage the use of more fuel efficient vehicles and the use of low-carbon fuels;
- increasing the funding for alternatives methods of travel such as bus and rail.

But it has not invested sufficiently or quickly enough in providing convenient, affordable and efficient alternatives to the car and lorry. The ability of people to respond to higher fuel prices by changing behaviour depends on these alternatives being readily available. Years of chronic under-funding for public transport, and under-investment in walking and cycling, can be compensated by earmarking a proportion of road fuel duty revenue to fully deliver sustainability goals.

Successive governments have been more attracted by the duty's capacity to raise revenue (with little negative political impact on voters for several years as oil prices fell steadily during the 1990s) than its environmental or economic efficiency benefits. No proportion of the revenue was earmarked for investment in public transport. Overall, the last administration's changes to fuel duty, including the cut in Budget 2001, brought in an extra £5 billion to the Exchequer. This compares to investments costs such as £590 million over 10 years to provide every rural county the equivalent of Lincolnshire's pioneering Interconnect bus scheme<sup>i</sup>.

The government has made motoring cheaper by cutting fuel duty at the same time as providing tax incentives to speed the uptake of more fuel efficient vehicles. Shifting car technology from the gas-guzzlers that dominate the market today to fuel efficient vehicles is a vital part of creating a low-carbon transport sector. But when fuel prices remain static or fall, driving becomes cheaper. Carbon cuts are soon wiped out by increased traffic levels. Higher polluting (i.e. fossil) fuel prices are a big incentive to drive less, and/or drive more fuel efficient and clean fuelled vehicles.

- Plan road fuel duty increases to keep the price of motoring level over the 10 year Transport Plan

Gordon Brown's decision to cut road fuel duty will increase CO<sub>2</sub> emissions by 1.1 - 4.0 mtC by 2010. Scrapping of the road fuel duty escalator in Budget 2000 is predicted to increase traffic growth by an extra 7% between 1996 and 2010<sup>ii</sup>. In that time, the real price of motoring will fall further and faster than the price of public transport as new cars become more fuel efficient. Road fuel duty must be increased steadily to keep the real price of motoring even over the next 10 years (see Annex 1). Otherwise, neither the Government's goal to significantly shift travel from cars to bus and rail, nor its carbon reduction targets will

be met. Raising fuel duty like this would cut road CO<sub>2</sub> emissions, reduce congestion and air pollution, and bring in £16.7 - £30.2 billion over nine years of much needed revenue to reinvest in modernising the rail system and expanding bus use.

- Begin by increasing fuel duty for petrol and diesel by 1p per litre

The Chancellor's pre-election bribe to motorists of cutting fuel duties has seriously undermined confidence in the Government's commitment to cut CO<sub>2</sub> emissions from road transport. The tax message from Budget 2001 was that buying a more fuel efficient, low sulphur fuel car when you can afford it is the only action motorists need to take to be environmentally responsible. Providing tax incentives to speed the uptake of more fuel efficient vehicles is a vital part of the creating a low-carbon transport sector - but when fuel prices remain static or fall this makes driving cars cheaper. Polluters should pay the full environmental and social cost of their emissions; and the Chancellor must reestablish road fuel duty as such a tax.

- Increase Vehicle Excise Duty (VED) to a new £500 'Gas-Guzzler' rate on high emission cars, and cut VED to £50 for least polluting cars

Gordon Brown has made welcome cuts in VED for smaller, less polluting cars, but left the rate for the worst gas-guzzlers unchanged. The top rate (on emissions over 185g/km) taxes 30 mpg vehicles at the same level as those which achieve less than 20 mpg. A significant differential is needed to influence the purchasing decisions for these expensive polluting vehicles. Britain has the second highest average new car CO<sub>2</sub> emission level in the EU. The highest rate should be for cars emitting over 230 g CO<sub>2</sub> per km. *Annex 2* is a table of selected vehicles with CO<sub>2</sub> emissions of greater than 185 g/km that pay the top rate of VED. Some of the most polluting vehicles in this band have only half the fuel efficiency but pollute twice as much as the cleaner vehicles in the band. This anomaly must be rectified. The revenues from this gas-guzzler rate should fund a new low £50 rate. Many popular smaller cars are in the £90-100 tax band (vehicles emitting less than 150g/CO<sub>2</sub> per km); but few meet the standards of the most fuel efficient in this band. A new minimum rate of £50 for cars emitting less than 130g/CO<sub>2</sub> is incentive for motorists to buy, and manufacturers to build.

- Review the 'Red Diesel' subsidy

Vehicles operating on industrial sites, airports, farms and quarries can claim a huge tax break of more than 90% off fuel duty paid on 'red diesel'. Many of these sites are ideal for the introduction of low-carbon or non-carbon fuels as the vehicles do not have refuel using retail outlets where availability of supply can be a problem. This subsidy is a barrier to cutting CO<sub>2</sub> emissions, increasing fuel efficiency and encouraging the uptake of low-carbon or non-carbon fuels on these sites. The tax break for Red Diesel is considerably more than for fuels such as LPG. The Treasury does not have a clear picture of these impacts<sup>iii</sup>. The Chancellor should review the impact of red diesel subsidy on CO<sub>2</sub> emissions and the uptake of greener fuels and vehicles.

- Plan for an EU aviation fuel tax by the next UK Presidency in 2005

Aviation is the fastest growing source of CO<sub>2</sub> emissions in the UK. Yet unlike other forms of transport, the polluter pays nothing because aviation is exempt from fuel taxes. Action can and must be taken in Europe, by either introducing a tax on aviation fuel or an emissions based levy. The Chancellor should make a firm commitment to taking a leading role in

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delivering this important tax reform by the next UK Presidency in 2005.

- Reinvest road fuel duty revenue increases on rail and bus

The Chancellor is committed to ring-fencing the revenues from any future increases in road fuel duty for transport spending. He should specifically set out to reverse decades of chronic under-investment in rail and bus services. More public money is urgently required if the rail modernisation programme is to be a success<sup>iv</sup>. Small scale transport schemes, such as Safe Route to Schools, traffic calming and Home Zones, are crucial to integrated and sustainable transport solutions. The cost of providing a Safe route to School for every child in the country has been estimated at £2 billion. Traffic calming on all appropriate residential roads would cost £3 billion. Providing 6,400 Home Zones (as many as in the Netherlands) would cost £1.4 billion. For example, giving every rural county the equivalent of Lincolnshire's pioneering Interconnect bus scheme would cost £590 million over 10 years<sup>v</sup>. Reinvesting pollution revenues reinforces the impact of fuel duty by providing convenient, affordable, reliable and comfortable alternatives to the car.

- Budget for a US-style school bus service nationwide

The Government is dragging its feet on this critical measure to get rid of 'school run' congestion, and cut air pollution peaks. It took nearly year to start the first pilot which is forecast to cut out 50,000 car journeys a year<sup>vi</sup>. In Britain, just 7% of 5-10 year olds go to school by bus, whilst in the US 54% of under-12's travel on the yellow buses. Gordon Brown should commit at this Budget to providing financial support for a nationwide service benefiting all children. But paint them British 'racing green' - not American 'mustard yellow'! What a Chancellor's legacy that would be.

- Grant tax relief for public transport season tickets

Car commutes are a major cause of traffic congestion, urban air pollution and greenhouse gas emissions; and account for 70% of journeys to work. Commuting by public transport relieves congestion and reduces air pollution and greenhouse gas emissions, but only accounts for 14% of journeys to work. Granting tax relief at this rate for commuting on public transport would cut car commuting by 5% pa, and boost public transport services. If relief was targeted at less-advantaged people by a maximum ticket value of £500, restricted to basic rate of income tax and available whether the ticket was paid for by employer or employee, the cost would be £200 million per year.

- Extend fuel duty rebate for buses to cover school buses, works buses and scheduled coach services

All these services reduce traffic. School and works buses do so at times when congestion is most severe. All pay full duty at present. Extending the 80% rebate available to local public buses to these services would cost some £60 million<sup>vii</sup>. This change can be made without waiting for the current studies on rebate payment details to be completed.

**Energy: A package of measures to stimulate a surge of investment in renewable energy, protect the tax incentive for companies to reduce pollution, and begin to reduce energy consumption in households while eradicating fuel poverty.**

Providing additional tax breaks for emergent renewable energy technologies - like solar, off-shore wind, wave and tidal - can be persuasively justified on several grounds.

They reduce costs. This is a tax expenditure made to avoid the external costs of climate change. Expanding renewable energy generation is recognised by the Government as central to tackling climate change. But restricting that expansion to technologies which have lower costs at present is short-sighted and inefficient. We need to exploit the full range of available renewable technologies, each of which have particular characteristics, in order to deliver the levels of output required. For example, off-shore wind can exploit the substantial resource provided by constant high winds and shallow seas in many areas around the UK; and, photovoltaic technologies can by-pass conventional electricity infrastructure and be installed directly at the customers point of use, their buildings.

They reduce the price of renewable energy technologies. Early investment in these technologies is undertaken the faster the costs will fall for future investments. In other words, investments now have a positive external effect on investment costs in the future.

They increase the cost-efficiency of the overall package of policies aimed at increasing renewable energy output by reducing investment costs. Investing in these renewable energy technologies becomes less risky. A declining cost base does not mean that investing in renewable energy is free of commercial risk, as the rate of decline, for example, cannot be predicted with certainty. Tax breaks can help reduce those risks and stimulate further output of renewable energy. Investment decisions are very sensitive to future expectations, and the costs of initial capital investment (rather than operating costs). Investment tax breaks reduce initial costs and increase confidence.

They increase the pace of innovation. Markets are too slow at delivering lower investment costs, when we need urgent renewable development. There is a clear target-driven timetable for addressing climate change: 60% minimum CO<sub>2</sub> cuts by 2050. Tax incentives of this type speed up investment rates, increase technological innovation and reduce the costs of future investments.

They benefit job creation and competitiveness in the UK. Britain has an established marine engineering industry, which can combine with UK firms that have begun to compete successfully in the market for wind turbine components, to exploit increased demand for off-shore wind generation. Two major UK companies are significant players in the photovoltaics market and would be well placed to exploit increased demand. The UK has a technological lead in the development of wave-power that should be built upon immediately and not allowed to be lost.

The Chancellor should consult now on which form the tax incentive takes, in time to implement at Budget 2003. Leading edge renewable energy countries use a variety of tax incentives and subsidies to build domestic demand and capacity. Initially in Denmark, individuals, co-operatives and companies investing in wind energy could claim exemptions from income tax and company taxes. Now, individuals and companies no longer enjoy an exemption as the market has become established but they can still claim deductions on annual depreciation, and on operation and maintenance expenditure. In the United States, the Energy Policy Act of 1992 included a 10% investment tax credit available to any company investing in or purchasing solar energy property. The effectiveness of these incentives is dependent upon them being part of package of measures including subsidies for capital investment and funding for R&D. The Chancellor should clarify that developing this tax incentive would complement spending commitments in Spending Round 2002.

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- Introduce new tax incentives to encourage investment in off-shore wind energy, photovoltaics, wave and tidal power

These technologies are essential to reduce UK climate emissions over the medium-term and developing renewable supply base-load capacity. New tax credits for developing and installing these four renewable sources will reduce their cost and investment risk. Britain has major wind and wave potential - the best in Europe. Increasing domestic demand will create major opportunities for UK businesses; which in turn will help UK PLC remain competitive with other nations (e.g. USA, Germany, Denmark and Japan) who are quickly building up expertise, patent holdings, manufacturing capacity and market share in this rapid growth sector. (*See above*).

- Bring in a renewable energy investment tax break for farmers/households

UK's renewable energy obligation is an important policy for increasing large scale renewable energy projects. But the old energy supply structure of a small number of large power stations feeding a grid needs to change rapidly. Embedded generation which supplies energy more locally, and net-metering which allows farms, businesses and households to be both consumer and small-scale producers, will weaken the dominance of the large-scale power plants. At present those who can play a role in this reform, such as farmers, small businesses and home-owners, are concerned about the investment risks, despite being squeezed by energy costs. The evidence from countries that have expanded renewable energy capacity faster than the UK is that tax incentives help overcome this market failure.

Farmers and renewable energy are typically good partners. In Denmark, farmers, often working cooperatively, have been central to the wind-power revolution and supply diversity. As well as receiving subsidies for capital investment by private cooperatives, farmers have enjoyed a tax exemption on 40% of the income from electricity sold <sup>viii</sup>. This is highly attractive given the 50% tax rate. Existing Government support for renewable energy is heavily focused on larger units. Smaller units installed in farms and households have the potential to make a significant contribution to meeting both the renewable energy and CO<sub>2</sub> emissions target set by the Government. Wind, solar and biomass all offer opportunities. Investments in renewable energy will also cut farmers' climate levy bill. Other countries have followed, reaping a double dividend of expanding renewable energy and protecting rural economies by keeping more of the economic and employment benefits of investment in renewables there. The Home and Farm Wind Energy Systems Act in the United States proposes a 30% investment tax credit for investments in wind power. The welcome but inadequate "Community Renewables" initiative, developed by the Countryside Agency and DTI, suggests that small-scale generators could deliver up to 10% of the UK's renewable energy. The Chancellor should commit to such a measure for Budget 2003 and consult on the best policy design.

- Add renewable energy technologies to the Green Technology Challenge

It is shortsighted not to make renewable energy technologies eligible for the enhanced capital allowance scheme under the Green Technology Challenge (GTC), which aims to encourage innovation and increased investment. Firms are only just waking up to the opportunities of investing in efficient small-scale renewable energy plant, given the climate levy exemption. Reducing cost and investment risk through an enhanced capital allowance will speed market expansion. In the Pre-Budget Report, the Government excluded renewable energy technologies from the GTC. GTC is to be restricted to two types of

technology that already receive or are set to receive tax breaks (energy saving technologies and cleaner fuels and vehicles) and only one (water use/treatment technologies) that does not.

- Reject calls to exempt nuclear power from the Climate levy

As the Cabinet Office Energy Review made clear, renewable energy and energy conservation measures are the key to radically cutting UK carbon dioxide emissions. Nuclear power is not needed to combat climate change. It is uneconomic, unsafe, unpopular and produces highly radioactive waste, which no-one yet knows how to store safely. The Chancellor should immediately rule out providing further public subsidy for nuclear power through the Levy, which would otherwise severely damage the current incentive for investment in renewable energy. The market for nuclear services is in clean-up, decommissioning and safe storage (global market value currently \$300 billion). The DTI should be working with BNFL to secure market leader status in this business, and not distract by trying unsuccessfully to build new nuclear plant.

- Announce a Task Force to examine tax and spend package options to reduce CO<sub>2</sub> emissions from the domestic sector

Friends of the Earth has campaigned vigorously for policies aimed at eliminating fuel poverty, having seen these as a pre-requisite for taxing domestic energy. Significant progress is now being made in eliminating the scandal of fuel poverty - mostly as a result of the FOE/ACE drafted Warm Homes and Energy Conservation Act 2001. But, at the same time, falling domestic energy prices have discouraged energy efficiency measures such as insulation and the use of energy inefficient appliances. This failing has been compounded by the limited application of 5% VAT rates on energy-saving materials and equipment. FOE continues to campaign for 5% VAT - not the full 17.5% rate - to be widely applied on such goods. But another mechanism is needed to encourage better-off households to take action, while protecting those on low incomes. That will require an integrated package of taxation and spending. Given the importance and complexity of this issue we urge the Government to appoint a Task Force immediately to report on options.

## **2. Developing the low waste economy**

**Waste: A package of measures to increase tax incentives to reduce waste, remove loopholes for incineration, and reinvest pollution tax revenues in nationwide household doorstep recycling.**

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 welcome Statements of Intent that aim to increase resource-use productivity. The Treasury must now help Prime Minister reach his goal, announced in a significant pre-election sustainability speech, 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

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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 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 offers little incentive for waste minimisation, recycling and composting. But there are substantial tax breaks for incinerators! Overhauling waste taxes is an urgent task for Budget 2002. FOE's proposals would provide 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. Thus the tax is an incentive to divert waste disposal from one unacceptably polluting route (landfill) to another (incineration). This exemption undermines incentives for waste producers to minimise waste or recycle. The incinerator subsidy must end now. The Treasury is concerned that the administrative costs of removing this exemption would be high, given the small number of incinerators in operation. But, the Government Waste Strategy has already increased the number of local authorities planning to use incineration. The Chancellor should move now to remove the exemption before incinerators are built that undermine efforts to improve waste minimisation and increase recycling and composting.

- Increase the Landfill Tax escalator from £1 per year to £3 per year immediately, and to £5 per year from 2004

An escalator is a useful mechanism for increasing the incentive to reduce waste and recycle in a way that allows businesses and local authorities to adjust in a planned way. But the current £1 per year rate is much too slow. Waste taxes in many European countries are far higher than the £15 per tonne due to be reached in Britain by 2004. The waste industry estimates that a rate over £30 per tonne is needed to make a significant recycling impact. Increasing the escalator to £3 per year gives a £21 per tonne rate by 2004, and to £5 per year afterward will achieve £31 per tonne by 2006.

- Review the potential for new product or material taxes to complement waste taxes

Products or materials which create specific environmental problems not dealt with effectively by existing regulation or waste taxation have been tackled by targeted taxes in some other countries. Ireland's new plastic bag tax is the latest in a range of measures across Europe that cover a variety of problem products and materials. In line with Government's 1997 Statement of Intent on Environmental Taxation, the Chancellor should announce a review of the options for this type of green taxation in the UK.

- Tax incineration to remove the perverse incentive for this disposal route

Exempting incineration from waste taxation is an anomaly that should be corrected immediately. It represents a significant barrier to the Prime Minister's goal of "every local authority offering doorstep recycling"<sup>ix</sup>, and will have an increasingly perverse effect as the

tax rate for landfill increases. Incinerators need constant and high 'waste' (sic, 'wasted resource') streams to stay in business; and burn materials that should be reused or not produced at all (e.g. excess packaging).

- Remove the tax break for incinerators in the Climate Levy

Perversely, incineration is included in the list of renewable energy technologies that are exempt from the Levy. Unlike true renewable energy sources, incineration contributes to climate change. This unjustified incentive most benefits the most inefficient incinerators and diverts investment away from true renewables toward an energy source that wastes valuable resources.

- Commit to reinvesting £200 million per year of landfill tax revenues in recycling and composting for household waste

Funding the door-step recycling of household waste throughout England and Wales needs some £375 million<sup>x</sup>. Comprehensive research into the economies of recycling has shown that the public subsidy required to provide doorstep recycling to every household and significantly boost recycling rates in the UK would require modest reforms on the part of the Treasury. The average net cost of providing a doorstep collection service for dry recyclables, such as plastics, paper and cans, is £9 per household per year, and for compostable materials is £8 per household per year (i.e. £375 million in total - and thus an extra £200 million pa must be found above money already allocated). Reform of the landfill credit scheme to increase support for recycling has failed; the Government can find a new £100 million pa by scrapping the scheme. The remaining £100 million pa can be paid out of Landfill Tax revenues, and will reduce as a percentage of the total revenue, as rates rise. Reinvesting revenues in this way would significantly increase the effectiveness of the Landfill tax.

### **3. Greening agriculture and encouraging urban - rural regeneration**

**Farming: A package of measures to make chemical-intensive farming pay its pollution costs, reinvest revenues to help farmers green farm systems, and reform UK farm subsidies to protect the environment and rebuild local food economies.**

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 since 1945. The Government must transform British farming, away from methods which damage the environment, increasingly fail local economies and consumers, and make it very difficult for small and medium-sized farms/family farm businesses (and produce retailers) to compete with the economies of scale, market share and resources of much larger competitors (e.g. farm corporations and supermarkets). Both revised public spending policies and tax reforms must underpin this strategically achievable transformation.

- Confirm the pesticide tax if the voluntary alternative fails by the Pre-Budget 2003

After much prevarication on this tax, the Financial Secretary to the Treasury recently stated that *"I really do want to stress that we have by no means ruled out a Pesticide Tax"*<sup>xi</sup>. But there is growing confusion about when and how the government will decide whether the voluntary approach is a credible alternative. In order to avoid continual slippage in the deadline for the voluntary approach to prove it can deliver, the Chancellor should make clear

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that unless adequate measured environmental benefits had been achieved by the Pre-Budget 2003 a pesticide tax and reinvestment package would be installed at Budget 2004. He should also publish the two progress reports on the voluntary package that were due before this Budget<sup>xii</sup>. Unfortunately but not surprisingly, the signs are that the voluntary package will do little to minimise pesticide use, and will cost farmers not pesticide companies. There are no significant elements of this package to help farmers replace pesticides with non-chemical control methods.

- Consult on a new Nitrate Fertilizer Tax with revenues reinvested into sustainable farming.

The Government has recognised the potential for a fertilizer tax to reduce both water pollution and greenhouse gas emissions. Several other countries operate such a tax with the revenues reinvested in a package of measures helping farmers to adopt sustainable farming practices, such as organic systems. The Chancellor should consult now on the design and impacts of such a tax package.

- Commit to using the full 20% Modulation option for Common Agriculture Policy subsidies by 2006

Conventional CAP subsidies have encouraged chemically intensive farming and been unevenly distributed (20% of farmers receive some 80% of subsidies). Governments can redirect up to 20% of this money to direct payments for supporting organic farming, positive management of wildlife sites, and rebuilding local food economies. The UK currently plans to redirect just 4.5% of CAP subsidies in this way by 2005. This is bucking the market big-time, given the huge demand for organic food in Britain with over 70% imported from abroad, even as thousands of British farmers go out of business every year, 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 Chancellor should act on the advice of the Food and Farming Commission and increase the 4.5% to 10% by 2004 and achieve the full 20% by 2006. Large-scale farmers would have to fund these disbursements by having less support payments - but then these free marketeers, who employ very few people, should not be subsidised as they wish compete on world markets.

- Use modulation money to help green farming systems, and rebuild a more localised food economy with a shorter and more profitable food chain for farmers

It is vital that the Chancellor signals that improved modulation is as much about how the money is spent, as how much is spent. Greening farm systems require both increased support for conversion to organic farming, and schemes to enhance the environment and minimise pesticide use. Equally important is investment in an infrastructure that, over time, will rebuild a more localised food economy to strengthen rural economies, support local produce retailers and allow farmers to be less dependent on subsidy. This means supporting capacity-building initiatives like small abattoirs, Farmers' Markets and marketing cooperatives for small producers and processors.

- Remove capital gains tax roll-over relief on unearned income from the sale of farmland for greenfield development

At present some 30,000 acres of farmland is lost every year to become development land. When farming land is allocated for development under Local Structure Plans, landowners benefit from uplifted values with rises from £2,000-£3,000 per acre as farmland to £100,000 - £1 million per acre as development land. They can also claim 100% roll over relief on this unearned capital gain (given free by the planning system) when they buy new farm businesses. This un-justified tax break for landowners is estimated to cost more than £1 billion in lost public revenue.

**Housing: A package of tax measures to discourage house building on greenfield sites, encourage house builders to use brownfield sites, and expand the social housing sector.**

Although the number of new homes built on previously developed land is one of the Government's 15 headline indicators of quality of life no progress has been made in reducing the rate of consumption of greenfield land for housing.

- End VAT exemption for new-build housing with full 17.5% for new-build on greenfield land and 5% for new build on brownfield sites

New build housing developments continue to put intense pressure on countryside and greenbelts. Between 2001 and 2021, the number of separate households in England alone is projected to increase by 3 million<sup>xiii</sup>. For the last six years, around 43% of new homes built in England were erected on greenfield sites<sup>xiv</sup>. The exemption of new-build housing from VAT exacerbates the problem by providing an incentive for new-build over renovation, and not discriminating between greenfield and brownfield sites. Varying Stamp Duty, as the Chancellor has done, is not a powerful enough policy response to this growing problem, which simultaneously stifles efforts to regenerate and revitalise urban communities and threatens our countryside and greenbelt. This measure would mean that more prudent use is made of both land and the resources invested in house building. The UK chooses not to charge VAT on new build housing, but to do so on renovation and repairs of existing empty homes. Many EU countries charge VAT on new housing; most at the same rate as renovation. France, Italy, Belgium, the Netherlands, Spain, Greece, Ireland and Luxembourg all charge VAT on new-build housing<sup>xv</sup>. Assuming the policy changes brought in to date do have the effect of meeting the Government's target of 60% of new homes on previously developed land, this reform would bring in £1.8 billion per year of revenue for spending on other priorities such as health and education<sup>xvi</sup>.

- Seek a zero VAT ruling from the EU for social housing schemes

Member States can vary VAT to zero for social objectives. Social housing whether in new buildings or existing ones is the primary source of good quality, affordable housing in the UK. This measure would help low income families meet decent housing needs.

- Review the relative merits of shifting local tax base from business rates to land value taxation

Urban regeneration is hindered by business rates that hit small businesses hardest and exempt landowners who leave land derelict. Taxing land value rather than property/ businesses on the land encourages the development of unused land by penalising

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landowners who leave land idle, discourages property speculation and is a fairer system. Land Value Taxation (LVT) would be a powerful incentive to sustainably reuse, redevelop and refurbish land and buildings. It would remove the current tax exemption enjoyed by landowners who leave land derelict and provide an incentive for clearing and decontaminating land. Together with strong planning regulations, LVT would ensure that landowners did not receive windfall gains from the re-zoning of land under planning regulations. This would reduce the incentive to convert countryside and farmland.

A tax on land value presents an opportunity to replace unfair taxes such as uniform business rate and council tax with a far fairer one, and one which cannot be easily avoided or passed on. It would reinforce the goals of urban regeneration, social inclusion and the prudent use of a vital natural resource, while bringing administrative and revenue collection gains. Installing LVT would be an involved process, but the benefits of successfully doing so are significant. In the spirit of the Statement of Intent on Environmental Taxation, the Chancellor should review this option.

### **4. Delivering a fiscal strategy for sustainable development**

**Policy-making: policies to bring HM Treasury within the Government's Sustainable Development Strategy, promote quality growth and break the addiction to straight quantity measure GDP.**

- Set out a Strategy to shift taxation off jobs and work and onto pollution and resource-use

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. The Chancellor should publish an improved Statement of Intent on Environmental Taxation as a strategy; and not merely a set of principles. This strategy should commit the Government to a significant shift in taxation away from jobs and work and onto pollution and waste, in order to develop a low carbon economy, significantly improve resource productivity, and stimulate thriving green farm and transport sectors. The strategy should be target-led, including general strategic goals such as achieving Factor 10 efficiency gains across economic sectors and specific targets. It should look to develop a range of new polluter pays and virgin material use taxes; new incentives and credits for industry and householders who develop, buy or use (as appropriate) market-leader environmental technologies, products and fuels; and, reductions in employment taxes, where appropriate. It should set out to achieve the three broad aims, summarised at the end of the Introduction to this *Friends of the Earth's eighth blueprint for a green Budget*.

- Improve Treasury assessment of the sustainability/environmental impact of economic, fiscal and monetary policies

The Pre-Budget Report stressed the importance of assessing Budget measures. But, it failed to set out the environmental costs of environmental measures in addition to benefits. For example, the cuts in fuel duty for low sulphur petrol/diesel were only assessed in terms of reductions of urban air pollution, and not increases in CO<sub>2</sub> emissions and traffic congestion. The Treasury need a more rigorous assessment programme, benchmarked against sustainability/environmental policy goals.

- Announce a Task Force to examine how the Government's measurement of economic growth can 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 a straight quantitative measure - GDP. This approach persistently undervalues future generations, the environment and provides no measure of social quality. Reform is vital, but will not be straight-forward. A high-level and high-profile Task Force can kick-start the process of reform to develop a more comprehensive Index of Sustainable Welfare to measure against a basket of integrated economic, social and environmental indicators.

- Redraft the Code for Fiscal Stability to reflect the Government's commitment to sustainable development

There are no clear references to the environment in the Code; and its stated principle of fairness does not accurately reflect the Government's stated commitment to sustainable development (e.g. sustainable development indicators, and the national Sustainable Development Plan).

- Establish a £1,500 Green ISA top-up scheme

Allow ISA's to be increased by a further £1,500 where the investments are made in a list of verified activities that bring clear environmental benefits. This would provide a clear incentive for private investment in environmental industries. A similar scheme has been in operation in the Netherlands since 1995. The list would include investments in renewable energy, organic farming, energy conservation and sustainable woodland and countryside management, for example.

## **Annex 1: Increasing road fuel duty to keep real price of motoring even**

Friends of the Earth commissioned the Institute for European Environmental Policy to calculate both the impact on real motoring costs of increasing fuel efficiency in new vehicles and increases in fuel duty to offset these and keep the real price of motoring even. The effect on fuel cost per kilometre are shown in the first table.

### **Index of estimated fleet average fuel cost per km (1995=100%)**

	<b>Petrol</b>	<b>Diesel</b>
2000	128.3%	127.8%
2001	118.9%	118.5%
2002	117.8%	117.0%
2003	116.5%	115.4%
2004	115.0%	113.7%
2005	113.2%	111.6%
2006	111.1%	109.3%
2007	108.7%	106.7%
2008	106.0%	103.6%
2009	103.0%	100.4%
2010	100.0%	97.4%

In order to calculate the duty increase which would be needed, an upper and a lower price scenario were used. The lower assumed (as did the National Road Traffic Forecasts of 1997) that the underlying price of fuel would remain constant in real terms after the year 2000. The higher scenario assumed, as in the background analysis for the Ten Year Plan, that the real price of oil would in fact fall to around \$16 per barrel and that this fall would be reflected in the pre-tax price of fuel. If this were to occur, then an additional increase in duty is needed to keep the price level. Note that, in all cases, the term 'duty' is taken to cover both duty and VAT taken together, as the two interact.

### **Estimated duty increases needed to keep motoring costs level (p/litre)**

	<b>Lower</b>		<b>Higher</b>	
	<b>Petrol</b>	<b>Diesel</b>	<b>Petrol</b>	<b>Diesel</b>
2002	0.0	0.0	1.2	1.5
2003	0.8	1.1	2.8	3.5
2004	1.9	2.3	4.7	5.6
2005	3.1	3.7	6.7	7.9
2006	4.6	5.4	9.0	10.4
2007	6.4	7.5	11.7	13.4
2008	8.5	10.0	14.6	16.7
2009	10.9	12.8	17.9	20.4
2010	13.5	15.6	21.3	24.1

The resulting additional revenues generated would then be as follows:

**Estimated revenue increases generated (£ million 2002)**

	Lower			Higher		
	Petrol	Diesel	Total	Petrol	Diesel	Total
2002	0	0	0	332.9	72.3	405.2
2003	245	52	297	817.8	166.5	984.3
2004	542	112	654	1354.2	269.9	1.624.1
2005	898	182	1.080	1947.6	383.3	2.330.9
2006	1.318	265	1.583	2602.2	507.4	3.109.6
2007	1.819	362	2.181	3330.4	644.0	3.974.3
2008	2.406	474	2.880	4136.0	793.0	4.929.0
2009	3.047	595	3.643	4984.5	949.4	5.933.9
2010	3.708	718	4.426	5842.7	1107.6	6.950.3

Note that these calculations refer only to revenue from car drivers. There would be additional receipts from vans, lorries, etc, especially if diesel duty were to be raised as indicated.

**Annex 2: Selected Vehicles in the current top band of Vehicle Excise Duty for cars emitting over 185g CO<sub>2</sub> per kilometre**

Make/Model	Details	CO <sub>2</sub> emissions (g/km)	Fuel Consumption (mpg)
Ford Focus	1.6i 4 saloon	186	36.2
Nissan Almera Tino	1.8	186	36.2
Ford New Mondeo	1.8i Zetec	187	36.2
Vauxhall Astra Coupe	1.8i	187	36.2
VW Polo	1.4 Hatch	187	36.2
Peugeot 406	1.8 Estate	187	35.8
Toyota Landcruiser	Amazon 4.7	405	17
Landrover Discovery	Series II 4.0 V8	397	17
Chrysler Jeep	Grand Cherokee 4.7L	385	17.1
Audi S Series	S6	343-348	19.5
BMW 5 Series E39	M5 Saloon	346	19.6
VW Passat W8	Estate, Saloon	319	21.4

Source: <http://www.vcacarfueldata.org.uk>

## **References**

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- i Council for the Protection of Rural England 'Ten Year Transport Plan - A Submission by CPRE' (June 2000)
  - ii Commission for Integrated Transport 'National Road Traffic Targets' para 2 (November 1999)
  - iii Hansard 28 Mar 2001 : Column: 647W
  - iv Friends of the Earth's briefing "*Paying for Rail: funding the railway of the future*" set out why and how the Government should fund rail modernisation.
  - v Council for the Protection of Rural England 'Ten Year Transport Plan - A Submission by CPRE' (June 2000)
  - vi DTLR News Release 2002/0057 18 February 2002.
  - vii The Confederation for Passenger Transport calculate the cost of extending the current rate of fuel rebate to all buses and coaches including private hire and tourist coaches would be £150 million. We estimate that school buses, works buses and express coaches account for around 40% of those bus and coaches not currently covered by the rebate.
  - viii ENS (Danish Energy Agency), 1999. *Wind Power in Denmark: Technology, Policies and Results*. [http://www.ens.dk/Publikationer/Wind\\_Power99.pdf](http://www.ens.dk/Publikationer/Wind_Power99.pdf).
  - ix Speech to Green Alliance-CBI conference on the environment 24 October 2000.
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  - xi House of Commons Environmental Audit Committee, Second report of Session 2001-02, Pre-Budget report 2001: A New Agenda? HC363-I. Para18.
  - xii We join the Environmental Audit Committee in making this recommendation.
  - xiii Projections of Households in England 2021 at [www.housing.dtlr.gov.uk/research/project/03.htm](http://www.housing.dtlr.gov.uk/research/project/03.htm)
  - xiv Headline Indicators H14 Land use. At [www.sustainable-development.gov.uk/indicators/headline/h14.htm](http://www.sustainable-development.gov.uk/indicators/headline/h14.htm)
  - xv European commission Directorate general for Taxation and Customs, 2001. VAT Rates Applied in the Member States of the European Community, DOC/2905/2001-EN
  - xvi HM Treasury, Tax Ready Reckoner and Tax Reliefs, London, 2001. States that extending VAT to the construction of new homes would raise £3,250 million in 2002-03.
  - xvii A copy of the research is available from Friends of the Earth.