

Environment, Food and Rural Affairs Committee Inquiry: Climate change: the “citizen’s agenda”.

Evidence from Friends of the Earth, January 2007.

Introduction

We welcome the opportunity to give evidence to this inquiry. Our response focuses on question 6: “*to what extent is “green taxation” an effective driver of behavioural change?*”

Our response has four points:

- Green taxation has an essential role to play in the policy mix for tackling environmental problems, by providing clear financial incentives.
- When designed properly, green taxation is a very effective driver of behavioural change. In particular, the design must integrate tax with other policies such as public spending, regulation, information and other market mechanisms - in effective policy “packages”. This integrated policy approach is essential, and can deliver environmental, social and economic benefits.
- To date although there are several examples of green taxes driving behavioural change a lack of integrated environmental policy packages has hindered rather than helped this positive outcome. A much greater effort is needed, from Treasury in particular.
- The Government should use the driving force of green taxation alongside spending and other policies to implement a “New Deal” for households to help them go green. Green taxation can both provide the financial incentives required and the revenues to fund integrated spending programmes that together make the ‘green’ option cheap and easy, rather than difficult and expensive as it so often the case at present.

Taxation in the policy mix

Broad causes of environmental problems are

- lack of adequate protection of public goods;
- the price of polluting activities being too low;
- inadequate information about people’s and businesses’ resource use and its impacts

These are broad examples of “market failure” which was set out by the Stern Report as the key cause of climate change.

Friends of the Earth agrees with Gordon Brown’s 2002 statement that: “*Well designed environmental taxes and other economic instruments can play an important role in ensuring that prices reflect environmental cost – in line with the “polluter pays” principle – and discouraging behaviour that damages the environment*”.

There is already good evidence from the impact of UK green taxes.

- Differentials in road fuel duty to shift consumers to cleaner fuels has been a clear success, first with lead-free and subsequently with low Sulphur diesel and petrol.
- Research into the impact of the landfill tax also demonstrates the ability of a green tax to change behaviour¹. Actions taken in response to the tax not surprisingly varied according to the financial impact of the tax. Companies facing a relatively small increased cost for the first time began to separate some waste materials for recycling and in some case introduced targets for waste minimisation. Companies facing more significant increases and who in general already considered waste as an important cost took a variety of actions including innovation for waste minimisation and seeking markets for recycling their waste products.
- The climate change levy package has also been effective in changing behaviour². The tax itself has been designed in a policy package that includes negotiated agreements for sectors to benefit from an 80% rate cut, exemptions for on-site renewable energy, an enhanced capital allowance scheme for investments in energy efficient products and a information and advice provided through a new Carbon Trust.

However, the effectiveness of some UK green taxation has been undermined by lack of commitment and a failure to augment them with the necessary policy package approach. The most telling example is road fuel duty.

- The fuel duty escalator (had it not been abandoned by the Chancellor) could have been a successful environmental tax (in terms of shifting behaviour) especially if the Government had followed its own 2002 policy and used revenues to invest in public transport and other alternatives. According to the IFS *“a 10 per cent rise in the price of fuel reduces fuel consumption by around 2.5 per cent and the volume of traffic by 1 per cent after a year.”* They show that *“had the real rates of duty been maintained at their peak values since 1999, we might expect current fuel consumption to be around 4–5 per cent lower (and as much as 9–12 per cent lower in the long run).”*

There is also evidence that green taxation has an important role to play in tackling market failure and environmental, social and economic problems such as climate change – by altering prices. For example,

- Oxford University’s Environmental Change Unit’s recent report on aviation³ sets out the annual price rises on a plane ticket needed to slow growth in aviation passenger numbers. In 2006 the Institute for Fiscal Studies (IFS)⁴ said

¹ ECOTEC, 1997. Effectiveness of the Landfill Tax in the UK: Barriers to Increased Effectiveness and Options for the future. Friends of the Earth, London.

² Cambridge Econometrics and Policy Studies Institute for HM Customs and Excise cited in Budget 2005, p159:

and Ekins, P., Monkhouse, C. and Willis, R., 2002. Next Steps for Energy Taxation: A survey of Business Views. Green Alliance/IPPR, London

³ <http://www.eci.ox.ac.uk/research/energy/downloads/predictanddecide.pdf>

⁴ <http://www.ifs.org.uk/comms/r68.pdf>

of aviation: “demand does appear quite sensitive to price, suggesting that there could be scope for using tax incentives to reduce demand for flights”.

- The Department for Transport has published research showing that a £150 differential in Vehicle Excise Duty bands would be sufficient to persuade 55% of car-buyers to choose the less-polluting band.

Policy packages

The Stern Report is quite clear that a wide variety of policy measures will be needed, together, to tackle climate change. Taxation is one such tool to affect prices, alongside other market-instruments such as emissions trading schemes. Other measures – such as Government support for new technologies, and improved information-based measures – like eco-labelling – are also needed. The key to success is that green taxation and other measures are implemented together as integrated packages of policies. Aside for the need for an overall Government strategy to deliver on problems such as climate change, there are two central issues here – the use of revenue, and the levels of taxation:

1. Use of revenue

The use of revenue from increased green taxes is crucial for delivering effective outcomes. There are broadly three issues here:

- In some cases, green taxes need to be linked with spending or other measures – to address distributional issues arising from the impact of the increased taxation, particularly impacts on poorer people. In our view, environmental and social goals are inextricably linked, and policies designed to meet them together – this is a central principle of sustainable development, and set out in the Government’s Sustainable Development Strategy⁵.
- In some cases, revenues need to be used to ensure there are decent alternatives to the polluting behaviour in question – for example, the use of road fuel duty revenues to fund improvements to public transport.
- In some cases, revenues can be recycled back via reductions in other taxes. Green taxes should be part of a broad “Environmental Tax Reform” (ETR) agenda, whereby if green taxes are raised, then other taxes, for example on employment, should be lowered.

The Government clearly recognised these issues in its policy document Tax and the environment: using economic instruments⁶. This states: “Where there is a strong case [for taxation], some or all of the revenue may also be used to reinforce the effectiveness of a tax measure by strengthening incentives for positive action, or mitigating adverse impacts”. [para 1.3]

⁵ <http://www.sustainable-development.gov.uk/publications/pdf/strategy/Chap%201.pdf>

⁶ <http://www.hm-treasury.gov.uk./media/D54/07/adtaxenviron02-332kb.pdf>

It further states that: “*there may also be benefits in using part of the revenue from an environmental tax to help facilitate the desired response to the tax. The benefits of this approach would depend upon a range of factors, including the period of warning given before the introduction of the tax (or before increases in rates) and the ability of taxpayers to respond to the tax quickly. Where the short-term response is relatively inelastic, recycling revenue in this way can help to increase the elasticity of the response in the longer term.*”; and “*Support for innovation and technology development can play a key part in this process. Where a low price elasticity reflects a lack of knowledge among polluters about alternatives, providing information may help to increase the response.*” [para 6.14]

However, in practice apart from isolated successes such as the Climate Change Levy there is little evidence that this approach has been adequately implemented.

Other than effectiveness, there are political reasons for delivering packages, rather than treating tax in isolation. There is a strong danger that “green taxation” will be stigmatised if it is perceived as simply “stealth taxation”. Green taxation will be far more effective, and far more likely to be politically acceptable, if it is part of a policy package which makes clear how the revenues will be spent. £10 on Air Passenger Duty can easily be targeted as “a tax on our holidays”, but if that revenue is recycled back to people via, for example increased grants for people to install energy efficiency measures in their homes, this is altogether more attractive. 2006 MORI polling showed that 60% of people support increased taxes on air travel for environmental reasons, this increased to 73% if the money raised were spent on improving the environment⁷.

There is evidence of the success of policy package approaches – for example the Climate Change Levy. The CCL used a combination of tax rises on energy and tax cuts on national insurance contributions, allied with other measures - such as enhanced capital allowances and funding for the Carbon Trust - to deliver overall economic and environmental benefits⁸. More broadly, the experience in the UK and Europe is that ETR can stimulate innovation and job creation, and overall deliver economic and environmental benefits together.

1. Levels of taxation

At present, levels of taxation are generally far too low to deliver the scale of environmental improvements needed. In many cases tax levels are at levels which do not affect behaviour enough. For example:

- The £20 difference between band F and G for Vehicle Excise Duty is far too small, and has next to no effect on people’s purchasing decisions.
- Air Passenger Duty was raised at the 2006 pre-budget, for the first time in five years, but still at far too low a level to prevent the forecast massive increase in passenger numbers.
- Fuel duty has been largely frozen since the fuel tax protests, ie falling in real-terms. This has been a contributory factor to the rise in road transport

⁷ www.ipsos-mori.com/polls/2006/aet.shtml

⁸ http://www.hm-treasury.gov.uk./media/1E1/03/bud06_climate_169.pdf

emissions, and a major cause of green tax revenues falling from 9.4% of total tax in 1997 to 7.7% in 2005, at odds with stated Government policy⁹.

What is required is the systematic use of green tax escalators, as part of a general programme of environmental tax reforms, as part of policy packages, to tackle major problems such as climate change. These escalators, with revenues used to cut other taxes or to fund improvements to the alternatives to polluting activities, would give a clear signal to people and businesses, time for people to adjust, and would transform the economy.

Transition from current policies

A step-change is needed in climate change policy. The scientific evidence for such a change has been in place for some time. The Stern Report now provides the economic ammunition for Government to deliver such a change. The report has been used so far to bolster the UK's negotiating position at an international level. However Stern also provides a powerful set of economic arguments for action at the national level, through the use of a variety of policy measures. This national economy agenda has been largely ignored by the Treasury so far – but Stern is clear that action at the national level is both necessary and can be good for the economy. It is this national analysis which needs to inform a major change in policy at Budget 2007.

The UK public is far more concerned about climate change than it was 5 years ago. Green taxation has a key role to play in driving behavioural change, but the Government must use packages to ensure that overall this agenda is not, and is not perceived to be, about financial sacrifice or inconvenience.

We would want to see all political parties argue for a “New Deal” for ordinary people to help them go green, a series of policy packages so that the green option was the cheap and easy option, and not expensive and difficult as is so often the case at present. Increased green taxation, and the use of the revenues from that taxation, will be essential to make sure this happens.

ENDS

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⁹ “Over time, the Government will aim to reform the tax system to increase incentives to reduce environmental damage. That will shift the burden of tax from “goods” to “bads”; encourage innovation in meeting higher environmental standards; and deliver a more dynamic economy and a cleaner environment, to the benefit of everyone.” Statement of intent on environmental taxation, July 1997, http://www.hm-treasury.gov.uk/topics/environment/topics_environment_policy.cfm