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Press Response

Green Fiscal Commission

THE BURDEN OF GREEN TAXES - THE TAXPAYERS' ALLIANCE IS WRONG

The TaxPayers' Alliance today released a report 'The Burden of Green Taxes' that presents a flawed case that green taxes and charges in Britain are too high.

Paul Ekins, Professor of Energy and Environment Policy at Kings College London and Director of the Green Fiscal Commission (1) has considered this report and considers its analysis to be flawed and to contain a number of examples of quotation out of context and misrepresentation to the extent that it is positively misleading. Detailed points illustrating this are given at the end of this press release.

Commenting on the report Professor Ekins said:

"The UK, with other countries, faces the historic challenge of climate change and at present is struggling, largely unsuccessfully, to bring its carbon emissions under control. Experts generally agree that green taxes may have an important role to play in addressing climate change and other environmental problems. In particular, a well designed green fiscal reform, which involves increasing green taxes but making equivalent reductions in other taxes on income, labour and profits seems to offer promise in terms of delivering less pollution and broadly neutral or slightly positive economic effects. It could have a major role to play in reducing carbon emissions, which will soon be a statutory requirement."

He continued:

"It is essential that such policies to address climate change receive rigorous and detailed examination in an atmosphere conducive to clear thinking and policy learning, something which the report from the TaxPayers' Alliance does nothing to foster. The report is so deeply flawed analytically that it would not be worth responding to, were it not for the unfortunate fact that many will accept its arguments at face value without probing their validity in any detail. I would therefore encourage readers of this and any future reports coming from this source to adopt a suitably critical approach."

Notes to editors

(1) The Green Fiscal Commission is an independent body formed to break the political logjam on green fiscal reform. It is not affiliated to any political party and its membership includes experts from business, leading academics, senior MPs from all three main UK political parties, three members of the House of Lords, and representatives from consumer and environmental organisations.

It is chaired by Robert Napier, Chairman of the Met Office and former Chief Executive of WWF. Its Director is Professor Paul Ekins, Professor of Energy and Environment Policy

at King's College London and formerly Head of the Environment Group at the Policy Studies Institute.

The Commission's work will cover three broad areas and collate and communicate the evidence:

- How green taxes/ Environmental Tax Reform(ETR) work
- The environmental, economic and social implications of ETR
- Attitudes to green taxes and ETR.

SOME DETAILED POINTS CONCERNING THE REPORT FROM THE TAXPAYERS' ALLIANCE (TPA)

1. Misrepresentation of the Views of the Intergovernmental Panel on Climate Change (IPCC)

These are the most serious flaws in the TPA report from the point of view of intellectual honesty. On two occasions the TPA report cites the IPCC has having views in support of its arguments. In neither case is this in fact true.

1a: On p.8 the TPA report states: `The Intergovernmental Panel on Climate Change states that "if taxes were used then they should be set equal to the SCC (Social Cost of Carbon)"'

In fact the relevant passage from Parry et al. 2007 (Ch.20, p.823) reads as follows:

`According to economic theory, if the social cost calculations were complete and markets were perfect, then efforts to cut back the emissions of greenhouse gases would continue as long as the marginal cost of the cutbacks were lower than the social cost of the impacts they cause. If taxes were used, then they should be set equal to the SCC. ... In the real world, markets are not perfect, calculations of the SCC are far from complete, and both mask significant differences between regions and types of impacts.'

It is clear from this passage that the IPCC is stating the view of economic theory, rather than its own, and then saying why the assumptions of economic theory are not realised in the real world. This of course means that the conclusions from the theory do not necessarily apply either.

1b: On p.9 the TPA report states: `Its (the IPCC's) estimate of the social cost of CO_2 is an average (mean) of over 100 peer-reviewed studies.'

In fact the relevant passage from IPCC (2007, p.22) reads as follows:

`Peer-reviewed estimates of the social cost of carbon in 2005 average US$12 per tonne of CO_2, but the range from 100 estimates is large (-$3 to $95/t$CO_2$). This is due in large part to differences in assumptions regarding climate sensitivity, response lags, the treatment of risk and equity, economic and non-economic impacts, the inclusion of potentially catastrophic losses and discount rates. Aggregate estimates of costs mask significant differences in impacts across sectors, regions and populations and *very likely* underestimate damage costs because they cannot include many non-quantifiable impacts.' (Emphasis in the original.)

It is clear from this passage that the IPCC is simply quoting, rather than endorsing, the average estimate from 100 studies, and then goes on to emphasise that in its view this estimate is *very likely* to be too low. The TPA report simply fails to mention this crucial point.

2. The Purpose and Level of Environmental Taxes

One purpose of environmental taxes may be to compensate for environmental damage (to 'internalise the externality'), in which case the tax level should relate to the level of environmental quality that it is desired to achieve. Another, perfectly legitimate, purpose of environmental taxes may be to raise revenues for the government. A tax like the duty on road fuels, which is now called an environmental tax, was implemented purely as a revenue-raising tax before environmental taxes were even on the policy agenda.

An important insight from tax theory is that nearly all taxes incur economic inefficiencies. Environmental taxes increase economic efficiency if they are set below the related level of environmental damage, but introduce inefficiencies (like taxes on labour and capital) if their level exceeds this. Where the level of the environmental damage is uncertain, or covers a large range with potentially catastrophic effects (as with climate change), it would be prudent to set the carbon tax higher than a perceived best estimate of the environmental damage, to take account of the fact that damages might be much greater than this, and thereby risk incurring some inefficiency, but then reduce the taxes on labour and capital, where it is certain that inefficiency will be reduced.

The argument in the TPA report that any environmental tax in excess of the best estimate of environmental damage is 'excessive' is simply wrong. It is in principle as legitimate to raise revenues from green taxes (above their 'optimal' rate) as it is from any other taxes, and whether or not to do so is one of the more complex judgements of tax policy.

3. The TPA Report's Use of Estimates of the Social Cost of Carbon (SCC)

The SCC is defined by the IPCC as 'Net economic costs of damages from climate change aggregated across the globe and discounted to the specified year' (IPCC 2007, p.22). As noted above, the studies reviewed by the IPCC put this in the range - \$3 to \$95/tCO_2, with an average of \$12/tCO_2, but thought that this was *very likely* to be too low.

In 2005 DEFRA published a long report by a number of academics which took a closer look at the uncertainty in the SCC (Downing et al. 2005). One of the main conclusions of this study was as follows:

'The range of estimates of the social cost of carbon:

- Estimates of the social cost of carbon span at least three orders of magnitude, from £0/tC to over £1000/tC, reflecting uncertainties in climate and impacts, coverage of sectors and extremes, and choices of decision variables.
- A lower benchmark of £35/tC is reasonable for a global decision context committed to reducing the threat of dangerous climate change and includes a modest level of aversion to extreme risks, relatively low discount rates and equity weighting.
- An upper benchmark of the SCC for global policy contexts is more difficult to deduce from the present state-of-the-art, but the risk of higher values for the social cost of carbon is significant.' (Downing at al. 2005, p.iii)

In the TPA report the authors calculate their 'excessive' green taxes against four estimates of the SCC (2007 values, converted to £/tC to compare with figures above: £13.8 (Tol), £16.3 (Nordhaus), £26.5 (IPCC), £93.5 (DEFRA). These four values may be compared with the top value in the IPCC-reviewed studies of £191.4/tC and the top value of more than £1000/tC in the Downing et al. study. It is clear that the TPA report authors took care to choose values for SCC that would give the 'excessive' green taxes that were the desired headline message of the report, and completely ignored 'the risk of higher values for the social cost of carbon' that is explicitly mentioned by the Downing et al. (2005) report and thought *very likely* by the IPCC (2007). This is analytical cooking of the books of a fairly extreme kind.

4. The Real Purpose of the Report?

On p.6 of the TPA report the author states: 'The real problem is excessive spending by politicians, which has led to excessive taxes on income and capital as well as excessive green taxes.'

This gives a clue as to the real tax-cutting agenda of the TPA, which of course is a perfectly legitimate political position, but which is not helped by the kind of spurious arguments on green taxes with which the TPA seeks to support it. It would also have been helpful if the TPA had identified the £21.8 billion savings in government expenditure, and related cuts in services, which removal of their 'excessive' green taxes would entail.

The Green Fiscal Commission takes no position on the desirable level of taxation or public spending, but considers that the evidence is strong that a substantial increase in the proportion of green taxes, whatever the total tax revenues, could achieve very significant environmental benefits, like cuts in carbon emissions, in an economically efficient way. The cuts in carbon emissions, especially, are sorely needed if the UK is to make its envisaged contribution to avoiding the worst dangers of climate change.

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References

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