



Lessons from Two Green Tax Shifts in the United Kingdom

Briefing Paper One
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About the Green Fiscal Commission

The Green Fiscal Commission is an independent body and is not affiliated to any political party or government. 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.

The Commission's aim is to assess the social, environmental and economic implications of a substantial green tax shift, such that 15-20 per cent of tax revenues come from environmental taxes. The Commission is reviewing and collating the existing evidence on the implications of a green tax shift as well as conducting new research. The results from this work will be placed in the public domain to stimulate debate and we hope action on this agenda.

This briefing is the first in a series which will summarise the main messages from the work of the Commission. Future briefings will cover a wide range of issues associated with the implementation of a major green tax shift, problems that may arise and how these can be overcome. The series will, for example, cover the impact of green fiscal reform on economic competitiveness, the effectiveness of green taxes, and associated distributional issues. These briefings will be available on the Green Fiscal Commission website where it is also possible to sign up to receive email updates on the work of the Commission.

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The Fuel Duty Escalator – recognising its benefits

The Fuel Duty Escalator (FDE) was introduced by the Conservative government in 1993, and was maintained by Labour until 1999. It entailed an annual increase in fuel duty above the rate of inflation, of 3 per cent in 1993-94, 5 per cent from 1994-95 to 1997-98, and 6 per cent from 1998-99 to 1999-2000.

No measure like the Fuel Duty Escalator that aims to increase annually the duty on a product at a rate significantly above the rate of inflation is ever going to be popular. Public attention focused almost exclusively on the impact of the escalator on the price of fuel, the consequent impact on the consumer and business finances, and the fuel protests of 2000 that followed albeit the year after the escalator was abandoned.

Yet behind the headlines and the spectacle of fuel protests there is a more positive story to tell. With a broader perspective the fuel-duty escalator can be presented as an eminently desirable public policy measure. For example, it raised significant revenues, allowed other distorting taxes to be reduced, penalised pollution and rewarded labour: all of which are desirable policy outcomes. This more positive view of the benefits of the FDE hardly emerged in the public debate to balance the unpopularity of the measure itself. Yet in the context of these broader benefits and the imperative of addressing climate change it shifts the focus to how to introduce measures that are necessary but politically difficult.

Fuel Duty Escalator revenues were balanced by cuts in income tax

Introduced in 1993, as the revenues from the FDE increased the Conservative government simultaneously cut income tax from 25 per cent to 24 per cent in 1995 and to 23 per cent in 1996. The loss in revenue from these cuts in income tax totalled about £4.7 billion in 1997, which was more or less the same as the revenues generated over 1993-97 by the FDE as calculated by the Green Fiscal Commission. Without drawing attention to it, the Conservative government had in fact implemented an environmental tax reform, or green tax shift.

In its first term from 2001, the Labour government also made a number of changes to income tax, including a cut in the standard rate to 22 per cent, which altogether cost about £2.3 billion.

This was more than offset by revenues from the FDE in 1998 and 1999 of at least £2.8 billion. Labour had also introduced an unannounced green tax shift.

Environmental taxes do not need to be spent on environmental measures

It is important to note that the revenues from the FDE were not allocated to environmentally-related spending. It is a widespread view that revenues from environmental taxes should be directly allocated – or hypothecated – to environmentally-related spending and this view is used to define green taxes. Of course, if they are so allocated, then increases in green taxation amount to an increase in public taxation.

The Green Fiscal Commission does not accept an automatic link between the revenues from green taxes and how they are spent. Instead it regards the benefit of green taxes – taxes that are levied on non-renewable resources or pollutants or on activities that use or produce them – as encouraging the more efficient use of resources, and reduced pollution. Revenues may be used to reinforce this effect, but can also be used to reduce other taxes.

This difference is important as the Commission is investigating the impacts of a major green tax shift, such that 15-20 per cent of tax revenues are from green taxes (instead of the current 7 per cent). It is clear that it would be excessive to allocate 20 per cent of tax revenues to environmentally-related spending. The Commission does of course acknowledge that it may be appropriate to allocate a proportion of green tax revenues to spending on environmentally-related expenditure and one aspect of its work is examining the impact this might have.

Impact of fuel duty escalator on tax revenues

Following its implementation in 1993, there was an increased and continued upward trend in revenues from fuel duty as Figure 1 shows. In 1987 receipts from fuel duty were £7.6 billion. In 1993 receipts totalled £12.5 billion, but had almost doubled in value by 2000 when receipts peaked at £23 billion. The effect of abandoning the FDE in 1999 can be clearly seen in Figure 1, as the upward trend was not only halted, but receipts fell, taking around four years for

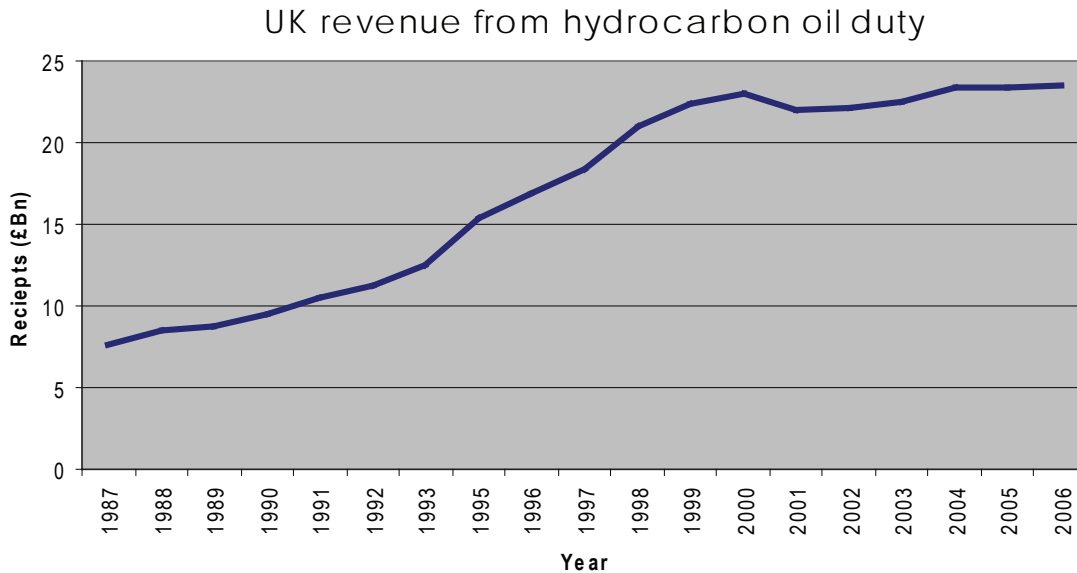


Figure 1: UK revenue from hydrocarbon oil duty (nominal)
Source: data from ONS (2007)

However, the post-2000 plateau in receipts only tells part of the FDE story, since the data in Figure 1 do not take inflation into account. There was, in real terms, a reduction in the per litre level of fuel duty taxation following the abandonment of the FDE. Between 1999 and 2006 there were only three rises in fuel duty, each time only in line with inflation (IFS 2007:192). IFS (2006) calculates that after the abandonment of the FDE, real fuel duty per litre fell by 16.9 per cent and real fuel duty revenue fell by almost £3 billion between 1999 and 2005, from £30.4 billion in 1999 to £27.4 billion in 2005 (index year 2005).

Furthermore, due to the relative size of fuel duty revenues, the abandonment of the FDE has had a wider impact on receipts from all environmental taxes in the UK. Receipts from all green taxes have fallen from 3.4 per cent of national income in 1997 to 2.7 per cent in 2006, having peaked at 3.6 per cent in 1999, and from 9.4 per cent of total government receipts to 7.3 per cent over the same period. In real terms, they now make up a smaller share of total revenue and national income than at any time since 1987.

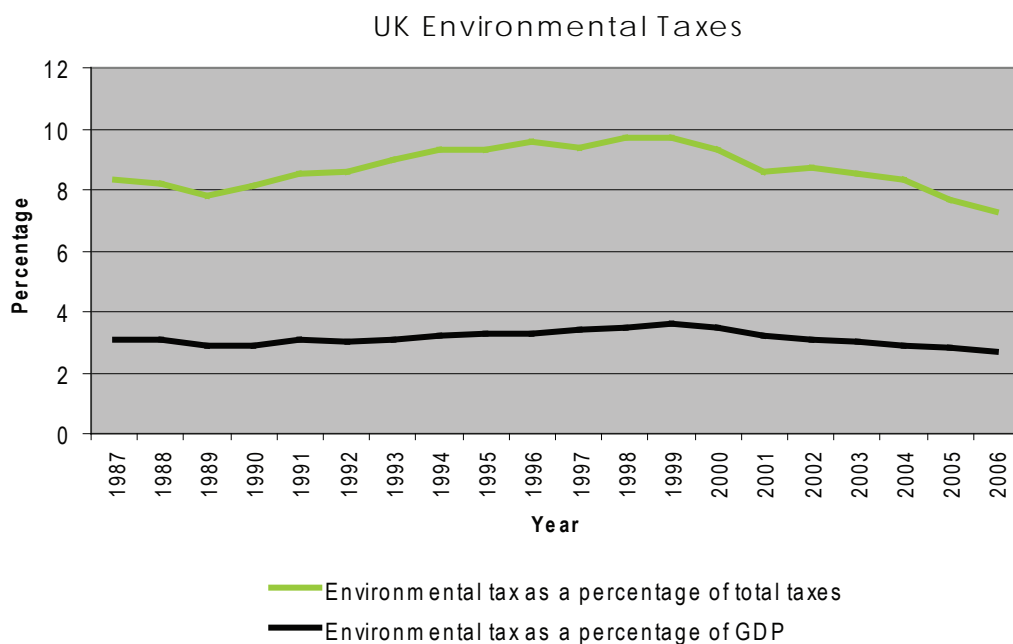


Figure 2: UK Environmental Taxes as a percentage of total tax revenue and GDP
Source: data from ONS (2007)

