



Analysis

Two unannounced environmental tax reforms in the UK: The fuel duty escalator and income tax in the 1990s

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ABSTRACT

Environmental tax reform (ETR) is a process of shifting the weight of taxation from socially desirable activities, such as labour and profit-generation, to the use of natural resources and the generation of pollution. The paper calculates the revenues from the UK fuel duty escalator (FDE) (an above-inflation increase in fuel duty implemented from 1993 to 1999), and compares these with the revenues lost from the cuts in income tax in 1995 and 1996, and again in 2001. The paper finds that the lost revenue was roughly the same as the revenue from the FDE. In effect the governments concerned had implemented an ETR without in any way drawing attention to the fact. The FDE was discontinued in 1999 when the oil price rose and, in the face of protests at the level of fuel duty the following year, real revenues from fuel duty subsequently declined. It is at least arguable that, had the fact that FDE had facilitated income tax cuts been established by the government at the time, the FDE and fuel duty generally would have been less unpopular.

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1. Introduction

Environmental tax reform (ETR) is the revenue-neutral shifting of the tax base from taxes such as those on labour and business, which distort the economy and reduce its output and efficiency, to taxes on pollution and the use of natural resources, which reduce environmental damage and resource depletion. By this means ETR seeks to achieve both environmental and economic benefits. [Bosquet, 2000](#) and [Patuelli et al. 2005](#), in their reviews of assessments of the extent to which these joint benefits have been achieved, are in general positive that this has been the case. For example, [Bosquet](#) states that “ETR can, under conditions and subject to the limits inherent to modelling techniques, achieve both environmental and economic improvements.” ([Bosquet, 2000](#), p.29) [Fullerton et al. 2008](#) are more sceptical about the co-delivery of these joint benefits.

ETR was the avowed intent of the new Labour Government, when it was elected in 1997, and in its Statement of Intent on Environmental Taxation published by Her Majesty's Treasury ([HMT, 1997](#)) said: “Over time, the Government will aim to reform the tax system to increase incentives to reduce environmental damage. That will shift the weight of tax from ‘goods’ to ‘bads’.” This paper is not primarily concerned with whether the Government has delivered on this objective, but rather explores the question whether, unannounced and unpublicised, there was actually an ETR in the 1990s and early 2000s involving the fuel duty escalator (FDE) and income tax.

Therefore the aim of this paper is to look at the UK's experience of implementing the FDE over 1993–1999, in terms of the revenues it raised on an annual basis, and the income tax reductions that were implemented over the same period. The focus of debate around the FDE has tended to concentrate on the burden the tax represents to fuel users. Much less attention has been given to the uses to which the significant revenue raised by FDE were put, the possibilities for which include tax cuts elsewhere (when the FDE may be seen as part of an ETR), increases in public spending, or reduced public borrowing or fiscal deficits. The paper therefore asks: did the UK in fact implement an unannounced FDE in the 1990s, using FDE revenues to facilitate a cut in the rate of income tax?

The paper firstly describes the background to the FDE policy, and the controversy that surrounded it, before calculating the FDE revenues. The FDE is then examined in terms of wider government revenues and income tax changes that were implemented under the Conservative Government to 1997 and the Labour Government from 1997. Finally, conclusions are drawn from this analysis, chief among which is that there was indeed an ETR over 1993–1999, involving the FDE and income tax, but that no attention was drawn to it at the time of its implementation over a number of years. The conclusions to the paper discuss why this might have been the case.

2. Background to the Fuel Duty Escalator

Fuel duties are paid on a per litre of fuel basis, at different rates for different fuels (see [Leicester, 2005](#) for a detailed discussion of fuel taxation in the UK). Road fuels, and road fuel duties, are also subject to VAT (the standard rate of which is 17.5%). Prior to the introduction of the fuel duty

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escalator in 1993 fuel duties were set and adjusted along with other taxes in the Budget.

The fuel duty escalator (FDE) was a Treasury policy automatically to increase fuel duty rates above inflation annually in each Budget. It was first mentioned in the Budget of March 1993, when Norman Lamont announced that in future Budgets road fuel duties would be raised by at least 3% in real terms. In his March 1993 Budget Mr Lamont also increased fuel duties by 10% immediately, but this was to compensate for the abolition of car tax in the Chancellor's statement in autumn 1992, so this increase is not considered here as part of the FDE. In November 1993, the new Chancellor Kenneth Clarke announced that he was increasing the FDE to 5% (so that it was never actually applied at the first-announced rate of 3%), and this was implemented in March 1994 and in each year thereafter until, in 1997, the FDE was increased again by the newly elected Labour Government to 6%. It was applied at this rate in the Budgets of 1998 and 1999, but the Pre-Budget Report (PBR) in November 1999 announced its effective discontinuation. This was significantly before the fuel duty protests of September 2000, but after world oil prices had started to rise.

The then Chancellor Gordon Brown stated in his Budget statement in 2000:

"I said last November [1999] that I would, in future, make an annual Budget decision on real term rises in road fuel duties – the money to go to a new ring-fenced fund for roads and public transport. Since the Pre-Budget Report world oil prices have risen rapidly from 23 dollars to 30 dollars a barrel. So, in this Budget I have decided that, beyond the automatic inflation rise of two pence a litre, there will be no real terms increase in road fuel duties." (HMT, 2000a)²¹ March 2000 Budget statement.

In the fuel duty protests of September 2000, a network of British farmers and road hauliers launched a dramatic campaign of direct action to protest at fuel duty. Their campaign followed a similar one by farmers, hauliers and fishermen in France, which had produced some concessions from the French government. The British protesters blockaded petrol refineries, starting with Stanlow in Cheshire, and within days created a fuel crisis that paralysed distribution and brought the country to a virtual halt (Doherty et al. 2003). The immediate impact of the protests was much deeper than the protesters or commentators anticipated. This was principally because they struck at a particularly vulnerable point of the economy, the oil distribution network, which had been organised along 'just-in-time' delivery principles. This, combined with anticipation of shortages by petrol consumers, and thus panic buying, magnified the impact of the protests far beyond the expectations of the protesters (Doherty et al. 2003). The media, politicians and the general public were astonished by the effectiveness and impact of the fuel protest, which was clearly unaffected by the abandonment of the FDE in the 1999 Pre-Budget Report and Budget 2000.

Following the protests, appeasement measures were announced by the government in November 2000 (HMT, 2000b). These included:

- A cash freeze in all road fuel and other oil duties – a real-terms cut in the price of petrol and diesel of 1½ pence per litre, costing £560 million in 2001–2002;
- a cut in the duty on Ultra-Low Sulphur Petrol (ULSP) by a further 2 pence widening its differential with standard unleaded petrol to 3 pence per litre¹;

¹ As announced in the 1999 Budget, the Government introduced a new duty rate on Ultra Low Sulphur Petrol (ULSP) that was 1 pence per litre below the rate on unleaded petrol. To encourage the faster take up of ULSP, the Government promised to cut the duty on this fuel by a further 2 pence in Budget 2001.

- a 3 pence per litre cut in duty on Ultra-Low Sulphur Diesel (ULSD),² costing about £570 million;
- an extension of the 'small' car threshold for vehicle excise duty (VED) from 1200 cc to 1500 cc, backdated to 1 November 2000 costing £250 million a year;
- a 50% cut in, and reform of, VED for lorries, costing £300 million a year;
- abolishing VED on tractors and other agricultural vehicles, and a 50% cut in, and other reforms of, VED for lorries, costing the Treasury £300 million; and
- a ring-fenced fund worth £100 million to include incentives or allowances to help modernisation of the road freight vehicle fleet.

Following the abandonment of the FDE it may be noted that by February 2006, in real-terms fuel duty was at its lowest since June 1997, declining by almost 21% for diesel compared with its peak in March 1999.³ Had duty levels been maintained in real terms at their March 1999 levels, the Institute for Fiscal Studies (IFS) has calculated that revenue by 2006 would have been around £4.2 billion per year higher (IFS, 2006). Outside the remit of this paper, but relevant to the topic, and following the inflation-related increase in fuel duty of 1.25 pence per litre in December 2006 (the first since 2003 [Banister, 2007, p.5]), was the reiteration by Gordon Brown in the Budget of March 2007 of the policy principle that fuel duties should rise at least by the level of inflation ("as the UK seeks to reduce polluting emissions and fund public services," HMT, 2007, p.175), along with the announcement of intended real-terms increases in fuel duty of 2 pence per litre in October 2007 and April 2008 (subsequently deferred to October 2008 and finally implemented in December 2008) and 1.84 pence per litre in April 2009.

3. Fuel Duty Revenues

The UK National (and Environmental) Accounts from the Office for National Statistics (ONS, 2007) detail historical government revenues from environmental taxes. Revenue is broken down into three main groups: energy, road vehicles and other environmental taxes. Receipts from fuel duty are included under the 'hydrocarbon oil duty'⁴ which falls into the energy revenue category.

We can see from Fig. 1 that since the FDE was implemented in 1993, there was an increased and continued upward revenue trend. In 1987 receipts 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 Fig. 1, as the upward trend was not only halted, but receipts reduced, taking around 4 years for receipts again to reach their 2000 levels.

However, the post-2000 plateau in receipts only tells half the FDE story, since the data in Fig. 1 are nominal, not taking inflation into account. There has been, in real terms, a reduction in the level of fuel duty taxation since the abandonment of the FDE. Between 1999 and 2006 there were only three rises in fuel duty, each time only in line with inflation in those years (IFS, 2007: 192). IFS (2006) calculates that after the abandonment of the FDE, over 1999–2005 real fuel duty per litre fell by 16.9% and real fuel duty revenue fell by almost £3 billion, from £30.4 billion to £27.4 billion (index year 2005).

Further, the abandonment of the FDE has meant a bigger decline in receipts from total environmental taxes (due to the relative size of fuel duty) in the UK. Receipts from all green taxes have fallen from 3.4% of national income in 1997 to 2.7% in 2006 having peaked at

² Bringing the ULSD rate in line with the ULSP rate, conditional on the oil companies making ULSD and ULSP widely available.

³ By May 2008 the decline in the real rate of fuel duties was 18.6% for petrol and 23.5% for diesel (Leicester, 2008).

⁴ Including duty on unleaded petrol, leaded petrol, ultra low sulphur petrol, diesel and ultra low sulphur diesel.

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