

# History and social responses to environmental tax reform in the United Kingdom

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## Abstract

This paper gives a short history of fuel taxation and the Climate Change Levy in the UK. The research described was based around the use of interviews and focus groups to inform the assessment of social responses to ETR policies and the development of improved designs for them. Interviews were conducted with selected policy makers and companies. Focus groups were conducted with quota samples of the general public. The research shows that the problem that ETR faces in terms of public acceptance is not so much outright hostility to environmental taxation as conceptual problems with the design. Similar conceptual problems were also found in the interviews with business people. These can be summarised as lack of *trust* about use of the revenues, difficulty in *understanding* the purpose of a tax shift and a desire for *incentives* for good behaviour as well as perceived ‘penalties’ for bad behaviour.

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## 1. Introduction

The purpose of the research was to develop proposals to improve the design of ETR policies in order to maximise their political acceptability while still attempting to meet the environmental, economic and employment objectives behind ETR. The work was based around the use of interviews and focus groups to inform the assessment of social responses to ETR policies and the development of improved designs for them. Interviews were conducted with selected policy makers and companies. Focus groups were conducted with quota samples of the general public. The policy makers were selected to represent major stakeholders in the policy process. The companies were selected to include a range of different kinds of business affected by ETR policies in

the UK. The focus groups were selected to give a cross-section of different ages and classes.

In the next section, the background to the situation in the UK is described. The interviews with policy-makers and businesses, and the focus groups with the general public are described in a little detail in the following sections. The perspectives of the different groups are then compared. Conclusions are then drawn about the implications of the research for the future development of environmental taxation in the UK.

## 2. Background

Advocacy of environmental taxation in UK policy circles dates back to the 1972 Minority Report of the Royal Commission on Environmental Pollution (*Royal Commission on Environmental Pollution, 1972*). It was firmly set on the British political agenda by the ‘Pearce Report’ to the Department of the Environment in 1989

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(Pearce et al., 1989). Environmental taxes were presented in the report as a means of meeting environmental objectives more cheaply than through regulation and, more controversially, as a way of internalising environmental costs. The subsequent White Paper on the Environment supported this view (Department of the Environment, 1990). The Pearce Report had also argued for a revenue-neutral carbon tax to tackle global warming, but no action was taken by the then Conservative government. However, the Liberal Democrats adopted the policy as part of their programme in the early 1990s, although the Labour Party remained sceptical.

The debate in Britain about environmental taxation was influenced later by the introduction of carbon taxes in the Nordic countries in the early 1990s. In Britain, unlike the Nordic countries, the fundamental stumbling block has been more the attitude of the public than of business. The idea of increasing taxation on domestic energy received a fatal blow from the public reaction to the introduction of VAT on domestic energy in 1993. The Conservative government of the day announced that domestic energy, which had been zero-rated for VAT, would in future be liable, first at 8% and then for the full rate of 17.5%. There was enormous public opposition to VAT on domestic energy. Unlike some other European countries, a history of poor home insulation has left the UK with a significant fuel poverty problem. Because of the impact on the poor and particularly pensioners, the government later added a compensation package based around increasing the budget of the Home Energy Efficiency Scheme, which gives grants to low income households for insulation and pipe lagging. The scheme was extended to include all pensioners, which reduced the funds available for non-pensioners on low incomes. VAT was imposed at 8%, but the government was defeated by a backbench rebellion in its attempt to raise the tax to 17.5%. The compensation packages ended up absorbing most of the revenue raised. One of Labour's five main pledges in the 1997 general election was to reduce the rate. In the June 1997 budget, they reduced VAT on domestic energy to 5%, the minimum rate allowed under EU law.

The political problems with environmental taxation are further exemplified by the story of the road fuel duty escalator. Introduced in 1993, from 1993 to 1997 the escalator increased road fuel duties by 5% in real terms each year. In 1997 the new Labour government increased the escalator to 6% per annum. The tax was for several years remarkably successful at raising revenue, but had a low profile. Very few motorists were aware of it and so it did not greatly influence their driving patterns or their choice of car model or home location. Until 1999, oil prices were falling and the effect of the escalator was largely to prevent the price of petrol at the pump from falling in real terms. However, in 1999

the effect of the escalator started to be noticed at the pumps. Road haulage companies, the Conservative Party and some newspapers started to campaign vociferously against the escalator.

In November 1999, the Chancellor of the Exchequer announced that the escalator was being abandoned. He did not rule out future annual increases in road fuel duty, but pledged that they would not be automatic and *that future increases would be hypothecated for expenditure on public transport and road-building*. As the price of oil increased during 2000, pressure increased to reduce fuel duty. The fuel protests of September 2000 brought enormous disruption and yet had massive public support. The experience led to a shift in the Government's attitude towards motorists.

The pickets had warned that they would return if the government did not announce a reduction in fuel duty within sixty days. At the November Budget, the Chancellor of the Exchequer announced a freeze in fuel duty (with no increase even for inflation) and reductions in road tax which he claimed was equivalent to a reduction of 4p a litre on petrol. He also made wide-ranging concessions to the haulage industry, significantly reducing their taxes. At the March 2001 Budget, the Chancellor announced a 2p a litre cut in the duty on ultra-low sulphur petrol and diesel and a temporary 2p cut in the duty on ordinary petrol and diesel until it became widely available. The small environmental benefit from ultra-low sulphur fuels is in reality more than outweighed by the countervailing effect of the reduction in duty. The measure was widely seen as an attempt to appease motorists. The fuel duty escalator was not a revenue-neutral tax, but like VAT on fuel several years earlier it revealed the sensitivity of the public to increases in energy taxation.

One revenue-neutral environmental tax was introduced by the Conservative government: the landfill tax. It was introduced in 1996 at the rate of £7 per tonne, with a lower rate of £2 per tonne for inert waste. The revenue was recycled by lowering the rate of employers' national insurance contributions by 0.2%. The landfill tax attracted very little attention or protest.

### 3. The climate change levy

Some further progress on the introduction of ecological tax reform measures came after the change of government at the 1997 general election. In March 1998, Lord Marshall (chairman of British Airways) was appointed by the government to examine the potential for economic instruments to reduce greenhouse gas emissions by the industrial and commercial sectors. The Marshall Report (Marshall, 1998) concluded that economic instruments, used appropriately in a package of policies, would be the most efficient way of reducing

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