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New Instruments for Environmental Policy in the EU

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in the UK

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British economists were prominent in developing the intellectual case for environmental taxation in the early years of the century, and again in urging the shift from "command and control" to market mechanisms in the 1970s and 1980s. Yet few green taxes have actually been implemented in Britain; we are lagging well behind the more advanced and adventurous countries of Northern Europe. Other instruments - voluntary agreements, tradeable permits, eco-labels - have also been notable mainly for their absence. This is mainly due to the relative indifference towards environmental issues among British politicians and decision makers - there is a shortage of *any* instruments of environmental protection, new or old. However, it reflects also the original suspicion among many of the UK's leading environmentalists of market-based instruments, which were seen as compromising ecological integrity by placing a monetary value on environmental quality, and as offering less certainty than regulation.

The regulatory approach

As in most countries, the environmental protection regime in Britain has traditionally been based on regulation. The use of coal in London was first restricted in 1228, and the first regulation of sewers was in 1531. Regulation of water pollution was systematized in a series of acts in 1847-48. The Alkali Act of 1863 required cuts in noxious emissions of 95%; The second Alkali Act of 1874 introduced for the first time the concept on Best Practicable Means to abate emissions, and also contained the first statutory emission limit - for hydrogen chloride. The 1956 Clean Air Act - a belated reaction to the infamous London smogs - gave local authorities powers to control smoke and other emissions from domestic sources. The Control of Pollution Act 1974 updated the regulations regarding air and water pollution (NSCA 1994). The 1989 Water Act created a new statutory framework for water pollution, and created the National Rivers Authority (NRA) to implement it. This was the first time the job of regulator had been separated from the suppliers, and was a result of pressure from opposition political parties and environmental groups. The 1990 Environmental Protection Act introduced the concept of Integrated Pollution Control, under which a single regulator controlled pollution to air, water and land. The 1995 Environment Act created an Environment Agency, bringing together the NRA, the Pollution Inspectorate and the waste regulation functions previously carried out by local authorities. The most recent prominent innovation in UK environmental policy, therefore, has been to strengthen the machinery of regulation. In the climate of deregulatory zeal which dominates UK politics, this must be counted a considerable triumph for environmentalists and their allies in the civil service and Government. The opposition parties had long supported the creation of a single environment regulator.

The emergence of 'new' instruments

Talk of alternatives to regulation has always been present in environmental debate, but it came to the fore and began to have an impact on policy practice only in the 1980s. Even in recent years there has been considerably more talk than action and where instruments such as green taxes or voluntary agreements have been used, they have not replaced existing regulations but been additional policy tools.

Green taxes and subsidies

It has been in the field of market mechanisms where there have been some significant policy measures in recent years. A number of British airports charge higher landing fees for noisier aircraft. In the fiscal area, a price differential of just under 1p a litre between leaded and unleaded petrol was introduced in 1987; this has increased gradually to just under 5p a litre. The Government has recognised the scope for increasing petrol prices, both to encourage fuel efficiency and to raise revenue. Chancellor Norman Lamont announced in his March 1993 Budget that fuel duties would increase in real terms by 3% in every subsequent budget. No cut-off point was given. His successor, Kenneth Clarke, increased this "escalator" to 5% in November 1993. In July 1996 Environment Secretary John Gummer suggested that it should be raised yet again, though it was not clear whether he was speaking for the Government as a whole.

Lamont also announced that VAT would be extended to domestic energy, first at 8% and then at the full rate of 17.5%. He argued that this would help deliver the Government's commitments to reduce CO₂ emissions. Following a sustained and high-profile campaign, the Government was defeated in Parliament on its attempt to raise the rate from 8% to 17.5%.

From 1996 there has been a tax on landfilled waste of £7 a tonne, with a lower rate of £2 a tonne for inert wastes. About 70% of all controlled waste (ie. excluding agricultural waste and mining spoils) is currently sent to landfill; the figure for household waste is 90%. Waste disposal companies will be able to avoid up to 20% of their liability by paying money into special environmental trusts. This is the first new tax introduced specifically for environmental reasons in the UK.

In the 1995 Budget the Chancellor announced that he was considering a number of other environmental tax changes, including creating an incentive to use gas-powered vehicles and making Vehicle Excise Duty a banded tax to reflect a vehicle's impact on the environment. Vehicle Excise Duty, currently a flat rate

of £140 a year for cars, could be reformed to reflect environmental impacts, with lower rates of tax for smaller, less polluting vehicles.

Since the 1989 Water Act, a system of discharge "consents" has been operated by the NRA. Companies pay for the right to discharge pollutants to water or to the air. HMIP operates a similar system with regard to IPC. However, the fees are set purely on the basis of recovering the administrative costs of the regulator and are not directly related to the volume of pollution. Industry, therefore, views the charges as paying for the 'regulatory service' rather than internalising external costs of their processes. There is no sense that reducing pollution would necessarily reduce the charges paid to the regulator. They cannot therefore be described as green taxes, although they could relatively easily be converted into taxes (Smith 1995).

Road pricing and tolling

The Government has stated for a number of years that it is considering introducing motorway tolling - most generally in the context of "privatising roads" - that is to say allowing a private company to build a new road and then recoup the cost through charging. However, there are obvious difficulties with this approach: Britain is a small country with a good network of non-motorway trunk roads, so motorway tolls introduced in isolation would divert a great deal of traffic onto less suitable roads, with damaging environmental consequences. The proposals have also aroused considerable political opposition and the Government can hardly be said to be proceeding with alacrity: in its 1996 White Paper on Transport, some years after the Government had first floated the idea, it had still only got as far as "plans for trials of electronic tolling on motorways" (DoT 1996)

Urban road pricing is also on the agenda, but not making much headway. The Government has sponsored research, and though some of the technical problems are held up as obstacles (despite the successful introduction of road pricing elsewhere in the world), the White Paper states that "the work has confirmed the Government's view that price signals are a highly efficient way of influencing demand for transport". But it has no intention of introducing road pricing itself, and attracting the opprobrium which it is assumed would follow (there is no evidence to support this view, but it is almost universally held). Instead, it plans to "discuss with the Local Authority Associations the case for taking the necessary legislative powers to enable interested local authorities to implement experimental schemes". A more non-committal formulation is hard to imagine. For their part, even the most progressive local authority leaders are wary of introducing road pricing, again because they assume it would cost them votes.

Subsidies

The other side of the coin is environmental subsidy, and there have been examples of this too, even from a Government under pressure on public spending and committed to cutting taxes. There have been a number of schemes to subsidise householders wishing to install energy-saving measures: the latest is the Home Energy Efficiency Scheme, which targets support for insulation at low-income households. This came from general budget expenditure, other subsidies have been funded by de facto levies on consumers, administered through the price regulation system which operates in the UK's privatised energy industry. The Energy Savings Trust, a joint Government/industry body, has subsidised low-energy light bulbs and gas condenser boilers. All of these examples, however, are very small in cash terms.

A more substantial subsidy arrangement is the Fossil Fuel Levy/Non-Fossil Fuel Obligation. Consumers pay a levy on the final bill (it has been around 10%) and the money is given to electricity companies to compensate them for buying fuel from "clean" sources at above market rates, which they are obliged to do. Environmentalists' enthusiasm for this scheme is greatly tempered by the fact that over 90% of the levy goes to the nuclear industry (non-fossil fuel, certainly, but hardly clean), but it has nevertheless given a very significant boost to renewable energy generation. With the introduction of liberalisation into UK energy supply and following complaints from the European Commission, this nuclear portion of this levy is to be phased out by 1998. The support for renewable energy, however, is likely to continue with the blessing of the Commission.

Unlike many other countries, the UK does not offer low-interest loans for installing cleaner technologies. There is some support for R&D in this area, but the amounts of money are negligible. There is also some support for small and medium sized enterprises (SMEs) but limited to the provision of information on pollution reduction and 50% grants for the costs entailed in registering on the EC eco-management and audit scheme (EMAS).

There is a growing lobby representing the interests of the environment industry in the UK and they are quick to point out the many areas where other countries support clean technology and the UK does not. In particular there are calls for tax allowances for replacing old 'dirty' technologies with new cleaner ones, export credits for UK environment technology companies and an assessment of the tax system to attract more investment in innovative clean technologies (Wilkes 1995). As yet, however, there has been little government action in this area.

Water metering

A failed attempt to introduce a new instrument was the plan to change the basis of charging for domestic water supply, from the current property-based system to volumetric charging through metering. Since the abolition of domestic rates in the late 1980s, there have been no rateable values for new houses, so the current system of charging cannot be used. All new properties are therefore fitted with meters. But the Government wished to speed up the change-over, partly to provide consumers with an incentive to use water more sparingly and so reduce the problems caused by over-abstraction. Some of the water companies - notably Anglian, which has particular problems with water shortages - attempted to move all its customers onto meters. Other companies were persuaded by the regulator to offer reduced tariffs for customers choosing meters. It is likely that increasing numbers of customers will opt for a meter. However, compulsory metering has proved extremely unpopular, and those companies which adopted it as policy have been forced to back down. The Labour Party campaigned hard against compulsory metering, and their case was strengthened by evidence from National Metering Trials which suggested that reductions in consumption were uncertain and might not last, and that metering was extremely expensive - between £165 and £200 per property. (Water Services Association 1993). A more cost-effective means of conserving water, Labour argued, would be to spend money plugging leaks in the distribution system.

Tradeable permits

The privatisation of the electricity industry, and the break up of the monopoly generator into competing companies, necessitated a rethink on acid rain regulation. Each generating company was given emissions caps for SO₂. Companies can transfer emissions quotas between themselves. This is a *de facto* tradeable permits system, though it has not been described as such, and the move to introduce more competition into generation will probably require the introduction of a more formalised system. Indeed, the Government has consulted on the possibility of a sulphur trading system for the UK, building on US experience.

Exhortation and voluntary agreements

There have also been a number of attempts to secure environmental change through voluntary agreements with industry or through changing consumer behaviour (without offering a fiscal incentive). In 1991 the Government launched the latest in a series of public campaigns to persuade people to use less energy in

the home. Called "Helping the Earth Begins at Home", the campaign featured a series of somewhat kitsch advertisements in which a child exhorted everyone to think about her future. The Government argues that the campaign has had some impact on increasing knowledge of the link between energy use and climate change, but does not even claim that the campaign actually had any impact on consumer behaviour. In 1994 the campaign was renamed "Wasting Energy Costs the Earth" and re-launched, but it seems unlikely that the new version will be any more successful.

In the corporate sector, the Government runs an Energy Efficiency Best Practice Programme which spreads the word about possible savings. It claims it has delivered annual reductions in carbon emissions of 2 million tonnes. The Government also runs a campaign called "Making a Corporate Commitment" under which companies promise to reduce energy use. By 1995 1850 businesses had signed. But the impact appears limited. 23% of signatories said they had no plans to implement energy efficiency measures in the next year; an increase from 15% the previous year. There were also no obligations for the companies to report progress towards their targets. Under a separate scheme, UK car manufacturers have signed up to a target of a 10% improvement in vehicle efficiency by 2005.

From a policy perspective, the more interesting developments have been where government has been involved in negotiating agreements with trade associations representing whole sectors of industry. Assessments of such agreements must be case by case as the details and commitments vary widely.

The first agreements, signed by Government and trade associations, have dealt with the use of HFCs in industries including aerosol, foam and refrigeration. Neither government nor industry regard the agreements as binding. Industry promises to minimise the use of HFCs and government has declared it will not impose reduction targets whilst the agreements are in place. There was very little transparency in the negotiations with little or no involvement with NGOs, although given that some are calling for a ban on the substances that is perhaps not surprising. More worrying is that not all the agreements have reporting requirements, and those that do have no requirement for independent monitoring.

A more robust set of agreements are taking shape as part of the government's waste management strategy. Under the heading 'Producer Responsibility', the government is negotiating with manufacturers and sellers of products and their packaging to ensure they "should take an increased share of the responsibility for making productive use of the materials once they have served their original purpose" (DoE 1996a). The first sectors to be involved are packaging, vehicles, newspapers, tyres, batteries and electronic equipment. The first to publish targets

for consultation have been the packaging industry, which promised to recover 50 per cent of packaging waste by 2000. This is within the range of 50-70% by 2001 set by the EC Packaging Directive.

The producer responsibility initiative has a specific base in legislation, through the Environment Act 1995, and it appears that government has been much more explicit about threatening to use other instruments if industry doesn't produce results. In some cases, including packaging, industry itself has requested legislation to back up voluntary agreements to prevent the problem of 'free riders'. There has also been discussion that the packaging agreement will incorporate a levy to help finance some of the recovery schemes, but it is still not clear whether this will be introduced. The fact that the government are now drafting regulations, of course, means it would be inaccurate to describe 'producer responsibility' as voluntary agreements any more. The best way of characterising the policy instrument would be 'negotiated regulations', in as much that the industry voluntarily requested regulation.

The Chemical Industries Association are currently in negotiations with the government over energy efficiency, but at the time of writing these talks were still in progress, no details or targets are available. This is an extension of the industry's 'Responsible Care' programme which is a more general attempt by the industry to encourage best practice and is not a negotiated agreement with government.

The final area where a voluntary approach is being mooted is in the enforcement of current regulations. The pollution inspectors have floated the idea that if a company is signed up to an environmental management standard, EMAS or BS7750, then there may be a reduced need for monitoring of actual emissions. A senior pollution inspector has recently described this as "a risk-based approach to the setting of inspection and monitoring programmes" (Duncan 1996). This is undoubtedly being driven by the pressure of financial resources on the Environment Agency, and there are some questions being raised about its legal basis.

Reasons for the shift to new instruments

Some of the changes were made necessary by the Conservative's radical programme of reform. Tradeable permits, as we have just seen, were introduced as a response to privatisation and the introduction of competition. Compulsory water metering for new houses became inevitable when the Government abolished domestic rates (to which the previous charging system had been tied) in

favour of the poll tax. Motorway tolling, if it ever materialises, will be a result not of an attempt to manage demand but of the desire to attract private finance into road building.

Other changes have been introduced under the guise of environmental concern but have in reality been straightforward revenue raisers., Lamont's claim that VAT on fuel was part of the Government's climate change strategy was ridiculed by the Labour politician Robin Cook, who noted that it had more to do with the public finances going red than Treasury ministers going green (a consultation paper on the climate change strategy, published just three months earlier, had not mentioned extending VAT even as a possibility). With some measures both environmental and revenue-raising motives were present (and there is nothing wrong with that; the Government has to get its money from somewhere). The road fuel escalator is an excellent environmental measure, but it is also an extremely nice earner for the Exchequer: Lamont estimated that his 3% escalator would net him an extra £1 billion in the third year. Of course some of the income would be eroded by changes in behaviour, people driving less to reduce fuel costs, but as the duties are set to increase every year then predicting the revenues is essentially a balancing act. The two objectives of raising revenue and changing behaviour need not contradict each other.

Even where structural reform or fiscal pressure has not required new environmental instruments, the pressure for a move away from "command and control" has not come from Britain's environmentalists, most of whom were reluctant to abandon the tried and tested role of regulation. It has not come from the opposition Labour Party, which has been generally indifferent to environmental issues and frightened of opening up debate on the thorny subject of taxation. It has partly come from British industry, which pays lip-service to the superiority of market mechanisms to regulation but in general opposes both, and now argues that voluntary agreements are the best way forward.

Such initiative that there is, has come almost entirely from the Government itself, supported by academics and the right wing think tanks which have been highly influential with the Thatcherite wing of the Conservative Party. The intellectual antecedents can be traced back to Pigou's *Economics of Welfare*, published in 1920, but the modern debate came to prominence with a minority report from the Royal Commission on Environmental Pollution, signed by the Oxford Economist Wilfred Beckerman and the scientist Lord Zuckerman, in 1972, which urged the Government to introduce pollution charges. Beckerman subsequently outlined his arguments in a paper for the Institute of Economic Affairs (Beckerman 1975), a free market body close to the newly-elected Conservative leader Margaret Thatcher. Thatcher was not much interested in

environmental issues *per se*, but clearly her Government was to be so anti-regulation that it would favour the use of market mechanisms in most areas of policy - environment included.

The free market think tanks retained an interest in market mechanisms for environmental protection through the 1980s and 1990s - as for example in the Adam Smith Institute's 1992 publication *The Market in Environment*. Their role was not wholly constructive, however. An equal amount of their research was directed at attacking the science behind some major environmental issues, particularly climate change. (Bates and Morris 1994).

The issue of 'market vs regulation' was also used by the Right to further denigrate the role of the European Commission, who, at the time, were mostly concerned with regulatory mechanisms. As we will see later, however, when the Commission came to propose its own market mechanism, the UK government opposed that as well.

As noted above, little was done to introduce environmental taxes. The first significant move came in 1987, with the introduction of the tax differential between leaded and unleaded petrol. This was hardly revolutionary, in the context of the boldness (or foolhardiness, depending on one's perspective) of other Conservative tax reforms. (For example, Geoffrey Howe had reduced the standard rate of income tax and doubled the rate of VAT in his first Budget). It was essentially a reactive move; the Government was under pressure from a well-organised group called the Campaign for Lead Free Air (CLEAR) and felt it had to do something. Nevertheless, it is significant that the response chosen was fiscal rather than regulatory. A tax differential fitted more comfortably into the ideological framework. It was less unacceptable to industry than the alternatives - in particular the mandatory fitting of catalytic converters (which require unleaded petrol), which the British motoring industry was strongly opposing. Environmentalists were on the whole happy that *something* had been done, though there was scepticism about how effective it would prove and some criticism of the fact that duty on unleaded petrol had been reduced rather than duty on leaded being increased.

After 1987, environmentalists had to wait another six years for the next significant fiscal measure. By 1993 the combination of the momentum of the post-Rio process and (more importantly) the Government's fiscal crisis was enough to persuade Norman Lamont to introduce the fuel escalator and VAT on domestic fuel. Debate was not absent, however. The intellectual case for market mechanisms was given a boost by the publication of a Government-sponsored report called *Blueprint for a Green Economy*. The European Commission

proposed its carbon-energy tax. The Government published its first white paper on the environment *This Common Inheritance*. In the face of all these developments, opposition parties and environmental groups were compelled to face up to the changing agenda.

Each of these developments will be examined. First, however, it is worth pointing out that the main event in British environmental politics in the period 1987-1993, the 1990 Environmental Protection Act, was almost entirely concerned with the strengthening of old instruments - the air, water and soil pollution control regimes - combining them into a single Integrated Pollution Control system. Despite its deregulatory zeal, the Government appeared to lack the courage of its convictions, fearing to dismantle environmental controls for fear of alarming the public. Indeed, the quote which appears at the front of *This Common Inheritance*, appears to confirm the triumph of the old approach:

"Is there not the Earth itself, its forests and waters, above and below the surface? These are the inheritance of the human race...No function of government is less optional than the *regulation* of these things." (emphasis added).

The quote is from John Stuart Mill, an interventionist liberal who tended in later life towards socialism - a strange choice of authority for a free market government.

Nevertheless, *This Common Inheritance* did engage the Government firmly in the debate about the merits of market mechanisms. The previous year a group of academics led by David Pearce of University College, London published a study of environmental economics which, significantly, had been sponsored by the Department of the Environment and which they called - effectively in marketing terms - *Blueprint for a Green Economy*. Pearce and his colleagues argued, first, that "business as usual" was not a sustainable proposition; second, that taxes were a more efficient means of changing behaviour than regulation; and third (and more controversially) that the proper level of such taxes could be calculated by placing a monetary value on environmental quality.

Blueprint was widely acclaimed and even more widely debated. The Government, and in particular the Department of the Environment, seemed sympathetic. Yet by the time of the 1990 White Paper, enthusiasm had cooled. The paper stated that

Regulation [has] limitations. It can be expensive to monitor and difficult to up-date quickly in response to scientific and technical advance. It cannot always pitch controls at the level which strikes the most effective balance between environmental benefits and compliance costs...Regulation has always been required and is still required, but it has

its shortcomings. For these reasons the Government, along with other governments throughout the world, has begun to look for ways to control pollution which avoid some of these problems by working with the grain of the market (DoE 1990).

Yet most discussion of Pearce was confined to an annex on Economic Instruments for Environmental Protection. Despite numerous promises to consider this, explore that and consult on the other, there were no commitments to action.

What were the reasons for this timidity? The main factor was undoubtedly industry pressure. To the extent that generalisations can be made, it is fair to say that British industry has adopted a negative attitude towards environmental policies. Despite mounting evidence that, in the CBI's phrase, *Environment means Business*, that there is money to be saved or made in taking the environment seriously, British industry has generally regarded proposals for new environmental polices with hostility, seeing them as inevitably leading to higher costs and reduced competitiveness. Companies and their associations have accepted the general case that market mechanisms are more efficient than regulations, but proceeded to argue against virtually every specific market mechanism that is proposed. A good example of this being BP who produced a discussion paper praising the efficiency of market mechanisms whilst flatly opposing the main proposal on the table (BP 1995).

This was a proposal which came not from London but from Brussels, the European Commission's proposal for a carbon/energy tax. Every effort was made to accommodate the concerns of the business sector: the tax would be fiscally neutral, with the proceeds returned to companies via lower social security contributions; energy-intensive sectors would be exempted; border tax adjustments would be used to prevent unfair competition from outside Europe; and to make absolutely sure, the entire package would be made dependent on similar action being taken by Europe's main competitors. Yet still industry cried wolf - or rather "damage to competitiveness", which to modern ears is even more alarming. In opposing the carbon/energy tax, industry was certainly not supporting a regulatory approach instead. What it wanted - and got - was in effect no European action to combat climate change, to be allowed to go on polluting in its merry, profligate way. (In fairness to British industry, it should be said that industry lobbies from most other member states were not much more enlightened). Over the last two years, industry have concentrated on other policy instruments. The CBI now recommend that "business-led, market based voluntary action should always be the first recourse of Government when seeking environmental improvement" (CBI 1994).

The carbon energy tax dominated debate about environmental taxes in the period up to 1993, just as VAT on fuel has dominated debate since 1993. It was the litmus test; if one opposed this specific proposal, one had to oppose green taxes generally. And the British Government did oppose it; not only because its industrial backers asked it to, but also because the proposal emanated from Brussels. Even worse, it was associated with Margaret Thatcher's *bete noire*, the man trying to reintroduce socialism to the newly-liberated Britain, Commission president Jacques Delors. Thus sensible debate about green taxes was an early victim of the extraordinary internecine warfare which broke out within the ruling Conservative Party over Europe and which has continued to this day.

But if the Government moved swiftly to relegate Pearce to an appendix, *Blueprint* did succeed in focusing the minds of the Opposition and the environmental movement on green taxes. So too did a 1990 publication from the prestigious and non-aligned Institute for Fiscal Studies (IFS) *Taxation and Environmental Policy: some initial evidence* (Pearson and Smith 1990) which again argued the superiority of taxes over regulation.

The Labour Party, in schizophrenic mode, halfway between its command economy phase and the unquestioning neo-liberalism of "New Labour", appeared unconvinced that taxes were better than regulations. Though its 1990 environment policy statement *An Earthly Chance* accepted the polluter pays principle, it argued that "not all environmental damage can readily be costed in financial terms and billed accordingly. The "polluter pays" principle is a means of attributing responsibility. It leaves open the question of whether it should be implemented through the price mechanism or through regulation". More positively, it stated that "we are attracted to the concept of 'green taxes' as a substitute for other forms of taxation so they are fiscally neutral but directed towards environmental objectives". But it specifically ruled out the carbon/energy tax which, it was argued, would drive the UK into recession, reduce our competitiveness and, without compensation, fall heavily on the poor.

The think tanks of the Left, however, were attempting to emulate their right-wing counterparts by pressing the case for green taxes. The newly-created Institute for Public Policy Research (IPPR), which had close links to Neil Kinnock and other Labour "modernisers", produced a paper in favour of road pricing in 1989 and a "Budget Memorandum" on green taxes in 1990, while the Fabian Society published *Sustainable Development: greening the economy* the same year. Both challenged the view that green taxes were inherently right wing and regulation left wing. Both are based on a recognition that intervention is needed in the operation of free markets and argue that the choice of instruments should be made simply on grounds of appropriateness for particular issues.

Rethinking was also underway in environmental pressure groups; particularly one of the largest, Friends of the Earth. *Blueprint* had been greeted with scepticism bordering on hostility, particularly for its argued that a valuation could be placed on environmental quality. Regulation was seen as a tried-and-tested method, producing secure and predictable outcomes. The argument that taxes are more cost-efficient than regulations cuts little ice with many environmentalists, who see the private sector as rapacious and extremely rich. Cost-benefit analysis is regarded with great suspicion because of a particularly perverse and indefensible form of it which has been used by the Department of Transport to justify building new roads (public open spaces, because they cannot be built on by anyone except Government, are given zero value). The inclusion in the 1995 Environment Act requiring the Environment Agency to take account of the costs of its proposed actions - a fairly common-sensical proposition - caused outrage among environmental lobbyists.

Nevertheless, it was recognised that taxes would have to play a role, particularly in persuading consumers to be less profligate. Friends of the Earth's contribution was to confront the issue of equity: would environmental taxes penalise the poor? FoE commissioned the Institute of Fiscal Studies to look into this, resulting in a report called *The Distributional Impact of Environmental Taxes* (Johnson et al 1990) which remains the most influential work in the area. The IFS authors argued that higher petrol prices would be progressive across the population as a whole (though regressive among car drivers), higher food prices would be somewhat regressive, and higher domestic energy prices highly regressive. They also recommended various options for compensation packages.

The various reports and research projects did succeed to an extent in changing the intellectual climate, and blunting some of the previous opposition to green taxation among social policy groups, trade unions and left politicians. The Labour Party's 1994 environment policy document *In Trust for Tomorrow* was more open to the use of environmental taxes, arguing that they should be used to create markets for certain products, to raise money to fund the clean up of contaminated land and to encourage fuel efficient cars and lower car use (Labour had not opposed the fuel escalator). Labour subsequently supported the landfill tax. *In Trust for Tomorrow* rejected the carbon/energy tax because it would increase domestic energy prices - this stance was inevitable given the Party's successful campaign against VAT on fuel - but stated that it might be prepared to consider a tax shift in the non-domestic sector, increasing energy prices while reducing employment taxes.

The smaller Liberal Democrat Party was (and remains) the most enthusiastic of the three main parties. This is partly because it has inherited from its

predecessor the Liberal Party a tradition of radical locally-based activist politics which is sympathetic to environmentalism, and partly because, as the name implies, it has a commitment to liberal economics which makes it predisposed to favour market mechanisms over regulation. Indeed, an issue combining market economics with environmental concern could have been designed for the Liberal Democrats. It is also fair to say that the Liberal Democrats, a party with very few seats (though a much higher proportion of the popular vote), can afford to be much more open and radical in its policy positions than either of the main parties. Its proposals attract much less scrutiny and criticism, because everyone knows that they will not be implemented - at least not by the Liberal Democrats. The Party is in the unenviable position of a glorified think tank or pressure group, seeing its ideas adopted by others with never a word of thanks. The fact that the Liberal Democrats have embraced environmental taxation, gives some grounds for optimism that a Conservative or Labour government might move in a similar direction at some stage. This process could be greatly accelerated were a Liberal/Labour coalition to emerge.

Increased interest in voluntary agreements

More recently, the UK government has become increasingly interested in the use of 'voluntary agreements' with industry to implement environmental improvements. As discussed earlier, the term 'voluntary agreement' is used very broadly in the policy context. It can be mere exhortation to industry to use best practice or implement environmental management standards. However, the most significant from our perspective is where government and an industrial sector, represented by a trade association, are negotiating specific environmental targets. The government have had a policy to seek such agreements with industry since 1993 but the first of these was only signed in January 1996.

The interest in voluntary agreements is almost completely down to the influence of industry on government policy. Business has been hostile to new environmental regulations and, whilst supporting the principle of market mechanisms, has generally opposed specific green tax measures as well. In a number of sectors, Government has allowed itself to be convinced by industry that both of these types of measure will damage competitiveness. In that sense the move to voluntary agreements is very reactive and has been strongly criticised by environmental NGOs. (FoE 1996).

One should not dismiss the initiatives out of hand, however. In a number of cases the agreements are linked to legislation, either implicitly by government threatening to regulate the sector if progress is not made voluntarily, or explicitly where the sector itself has called for regulation to prevent 'free riders' or a levy to

support the necessary changes. Ironically, some uses of the voluntary approach, such as producer responsibility, have reinforced the arguments for regulation or fiscal measures.

Have green taxes been beneficial?

It is generally asserted that the Government's first foray into green taxation, the price differential between leaded and unleaded petrol, was a resounding success. The percentage of petrol bought which was unleaded increased from less than 5% to over 50% at the start of 1993 (when the mandatory fitting of catalytic converters to new cars was introduced, making it impossible to attribute further increases in unleaded sales between market and regulatory measures). Lead emissions fell by half. This success is not surprising. For most motorists, substitution was extremely easy, so even a small incentive was enough to change behaviour. There is a *prima facie* case for saying this was a successful use of a market mechanism, but it is not entirely clear that it was more effective or even more cost-efficient than a regulatory approach (mandatory catalytic converters or bans on sales of unleaded). This was a new instrument altogether, not a market instrument replacing a regulation. So any attempt to compare the two would necessarily be counter-factual. It has not, to be our knowledge, been attempted.

This is true for all of the UK's implementation of 'new' policy instruments. Despite government rhetoric about deregulation and efficiency of market mechanisms, to our knowledge no regulatory approaches have been replaced by taxes or voluntary agreements. The substitution has only occurred where there is a choice between a 'new' regulation or a new market mechanism.

Has the fuel escalator, a more significant environmental tax, been beneficial? This is again hard to judge, since the things it is trying to affect - fuel efficiency of vehicles and vehicle use - are subject to myriad other factors. Overall petrol consumption fell by 4% in the first year after the escalator was introduced. But this is unlikely to have been much due to the escalator, which is *intended* as a long term, gradualist policy. Indeed, the fall had begun in 1991. The escalator has little short term impact on fuel prices, particularly as compared to fluctuations caused by changes in world oil prices.

This is, however, one of its great virtues. Incremental change has proved a relatively painless way of increasing environmental taxation. The escalator has united the political parties (though the Liberal Democrats are concerned about its impact on rural motorists - most of their MPs represent rural constituencies). It provides a good model for how to introduce a new tax. However, it is not clear

how widely known it is, and therefore how widely the expectation of higher prices in the future is affecting model choice or location decisions. Anecdotal evidence suggests that hardly anyone is aware of it, though the manufacturers are and may be altering their plans accordingly.

The new landfill tax is also a good model of how a tax ought to be introduced. It was announced in 1994, details were announced in 1995 and extensive consultation was carried out. The original proposal from the Government was for an ad valorem tax which was easier for the Treasury to administer but did not accurately reflect environmental costs. Both the waste industry and NGOs told the government that a weight-based tax would make more sense. Faced with this near unanimous response, the government changed its mind and a weight-based landfill tax was implemented in 1996. This is a new departure, not only for environmental policy, but for British tax policy generally. Again all political parties have supported it, and all environmental groups. Even business has not complained too much, although there has been much lobbying of what should constitute inert waste and so be liable for a lower tax rate.

Which green taxes have failed?

VAT on fuel

Mention environmental taxation to a British politician and they will think of VAT on domestic fuel, shudder and change the subject. The episode is a sorry saga of political incompetence, which has set back the cause of environmental taxation - and environmentalism in general - and may have helped lose the Conservatives the last election.

The main area of concern is with the taxation of domestic energy, and with transport taxes. Environmentalists and opposition politicians may have argued, correctly, that the British Government's decision to impose VAT on domestic fuel and power was motivated by financial rather than environmental considerations. But the fact remains that the other proposals for energy taxation, such as the European Commission's carbon/energy tax proposal would have had a broadly similar impact on domestic energy prices (albeit phased in over a longer period).

The Government justified its proposal to levy VAT on domestic fuel on the grounds that this was necessary to meet the carbon emissions reduction target agreed at the Rio Summit. However, it estimated that the new tax would cut emissions by just 1.5 million tonnes of carbon a year, less than 1% of the total.

The Government also argued, correctly, that most other European countries have a tax on domestic fuel, ranging from over 90% for domestic electricity in Denmark to 17.5% in the Netherlands. But it ignored a crucial difference. Other Northern European countries with climates similar to or colder than Britain's have far stricter regulations governing the insulation standards of their housing stock. They simply do not have the draughty, damp and impossible-to-heat properties which are so common in the UK. Energy use is therefore much more closely correlated to income - those who use more energy do so because they own more appliances or indulge in more luxuries. Until Britain reaches similar levels of energy efficiency with our housing stock, comparisons with domestic energy taxation in other Northern European countries will be entirely bogus.

Public support for the concept of "fair taxation" remains strong, as the Conservatives discovered when they attempted to introduce a poll tax - an approach which had offended medieval conceptions of social justice, and was therefore unlikely to appeal in the more enlightened twentieth century. The concept of progressive taxation is supported by 85% of the British public. And it soon became clear that VAT on domestic fuel would be a very unfair tax.

The social impact of higher fuel bills is illustrated by a study carried out at the University of York's Social Policy Research Unit (Hutton and Hardman 1993). The survey found that those households with incomes in the top 20% spend 4.2% of their budget on fuel, while those in the lowest 20% spend 12.1%. The burden is therefore nearly three times greater for low income households than for more affluent households. Low income households are less able to cut back on fuel use by changing equipment or installing energy efficiency measures, which can have a high capital cost. Only 46% of those in the lowest quintile have gas central heating (the most energy efficient form of space heating); the figure for the highest quintile is 75%.

There are also different impacts for different types of household. Families with children spend over £13 a week on fuel, while pensioners and single householders spend £8-£10 a week. Single pensioners spend 16.36% of their budget on fuel, but lone parents with children under five spend 16.42%. Those living in private rented accommodation - the most energy inefficient form of tenure - also have proportionately high fuel bills, and less incentive to invest in efficiency measures, since they may not stay in the property long enough to reap the benefits. These figures illustrate the difficulty of designing a targeted compensation package.

Once it realised the unpopularity of the proposed tax increase, the Government attempted to overcome the problem of regressivity by increasing the

budget of the Home Energy Efficiency Scheme, which gives grants to low income households to install insulation and pipe-lagging. The scheme was also extended to include all pensioners, which had political advantages but reduced the funds available to low income households. Energy conservation groups estimated that it would take over a decade to insulate the dwellings of all low-income households - a decade in which the fuel-poor would be faced with higher bills.

The Labour Party, which had always opposed the carbon tax (the effects of which would have been similar), savagely attacked the extension of VAT - its task made easier by the fact that the Conservatives had fought and won the recent General Election on a promise not to increase taxes generally and VAT in particular. The Liberal Democrats also came out against the VAT increase, even though they had supported the carbon/energy tax. Environmental groups were generally agreed that the tax should have been accompanied by regulations and other measures to increase its efficacy, and by a compensation package. But they split in terms of presentation. Friends of the Earth welcomed the tax but called for the accompanying measures to be added. Greenpeace condemned the tax but said it would support it if the other measures were introduced. This led to a farcical exchange in the House of Commons, with the Prime Minister quoting Friends of the Earth, and the then Leader of the Labour Party, John Smith, quoting Greenpeace back (probably the only time he did quote Greenpeace).

In the event the Government succeeded in imposing the tax at 8%, but was defeated in a vote on its attempt to increase it to 17.5%. It raised virtually no revenue - most had to be conceded to pensioners and the poor in grudging compensation packages. The political price was high; Government popularity plummeted and a series of spectacular by-election losses followed. The environmental price, in terms of the political feasibility of implementing other measures, was also high, and cannot yet be assessed. The scope for sensible debate about environmental taxes was radically reduced. The impression of a trade-off between environmental protection and social policy, which environmentalists have been striving to overcome for a decade, was reinforced. So too was the widespread view that environmentalism equals sacrifice and so will not be popular with the voters, another myth which environmentalists have sought mightily to bury. Deservedly, in the light of all this, Norman Lamont lost his job.

Have voluntary agreements been a success?

There is a great deal of concern about the environmental effectiveness of voluntary agreements, and the lack of transparency and targets can only reinforce that concern. So far, the most concrete results to have come from a UK voluntary

initiative seem to be from the producer responsibility in packaging: it has clear targets and public documents. But, in the end, the industry felt they couldn't deliver without back up in terms of regulations and/or levies. The initiative therefore ceased to be voluntary. The targets are also taken from the EU Packaging Directive, which is mandatory for all member states. It is debateable whether the same results would have been reached without the Directive. Other agreements seem to bear out this concern. They are far less transparent and so far have no binding targets. Without these elements they are little more than warm words, and to reach any ambitious targets it appears you need more than just a voluntary agreement.

Prospects for new instruments

The Liberal Democrats have committed themselves not only to a number of new product taxes, but also to a significant shift in taxation, involving increases in energy taxes and reductions in VAT. This concept of a fiscally-neutral "environmental tax reform" has been gaining support gradually in recent years, though it is not nearly as widely debated in the UK as in many other European countries. Conservative Chancellor Kenneth Clarke signed up to the principle when he linked the new landfill tax to a reduction in employers' National Insurance Contributions, saying: "I want to increase the tax on polluters, and make further cuts in the tax on jobs." (He also accepted the arguments that environmental taxes can make the economy work better: "in some cases, taxes actually do some good, by helping markets work better and by discouraging harmful or wasteful activity"). But the landfill tax raises a comparatively small amount of money, so the shift cannot be said to be significant, and his 1995 Budget contained no new taxes on polluters.

A number of Government Advisory bodies have supported the principle of environmental tax reform. The Panel of Sustainable Development, set up by John Major after the Rio Summit to advise him on environmental matters, has called for "wider use of economic instruments, and a gradual move away from taxes on labour, income, profits and capital towards taxes on pollution and the use of resources, including energy," The Panel is chaired by Sir Crispin Tickell, former ambassador to the UN and one of Britain's leading environmentalists - he is credited with the temporary greening of Margaret Thatcher in 1988. He did not achieve the same feat, even temporarily, with John Major.

Another Government-sponsored body, the Advisory Committee on Business and the Environment (ACBE), which includes representatives from major energy, construction, retailing and financial services companies, has stated that "ACBE

welcomed the Chancellor's statement in his 1994 Budget that in future the Government would be looking to shift the burden of taxation from wealth creation to resource use and pollution." The recently launched Real World Coalition, which brings together environmental and social policy groups (itself a significant development) strongly supports a tax shift. Labour has committed itself to:

a long term, gradual change to the way in which the economy is organised, to ensure that it encourages "goods" such as employment, value added, investment and savings, and discourages "bads" such as pollution and resource depletion (Labour Party 1994).

This sounds encouraging. But the language is hardly indicative of firm commitment, and a pledge to encourage good things cannot really be described as a radical policy innovation. It is much easier to sign up to a principle, as all these groups have done, than to support and implement specific reform packages. The left-wing think tank IPPR has attempted to push the debate forward by publishing specific proposals, costed and modelled to predict their macroeconomic and sectoral impact (Tindale and Holtham 1996). But a significant reform such as has been undertaken in the Scandinavian countries does not look imminent in the UK.

Conclusions: how should responsibility for new instruments be divided between the EU and member states?

Like any other policy instrument, the way in which market mechanisms and voluntary agreements are applied will depend on the environmental problem to be solved. One of the strengths of the debate over green taxes is the constantly growing list of examples from around Europe, being implemented at member state level. And still more at local and regional level. Innovation in the use of market mechanisms should be encouraged, but should the EU itself take a lead?

The fate of the carbon/energy tax proposal, and the role of the UK in that debate, does not bode well for action on green taxes at an EU level. The UK, not alone in the EU, has a very strong belief that fiscal matters should be left to the nation state. The change in government in the UK is unlikely to alter that stance. Indeed the Labour Party opposed the carbon/energy tax and has stated it would not advocate QMV for fiscal instruments of any kind at EU level, including ones dealing with the environment.

The most effective role for the EU, it seems, will be to help co-ordinate the use of market mechanisms at member state level. The review of mineral oil duties is one opportunity where the EU can increase the minimum level, thus indicating

to member states the direction which energy taxes should be heading. Additional information from the Commission on how green taxes impinge on EU internal market rules could also be used as an encouragement for member states to innovate.

The UK government recently used the Climate Change Convention to call for a global tax on aviation fuel (DoE 1996b). One stepping stone towards this goal could be for the EU to remove the tax exemption for air fuel on internal EU flights. Further removal of the exemption would need agreement at international level.

The EU may have a more important role to play in supporting voluntary agreements. It appears that the most effective voluntary initiatives with industrial sectors have been underpinned by EU framework legislation. If implementation of directives could come about through voluntary or negotiated agreements, then member states may be more willing to agree to more ambitious targets. Industry may play a more constructive role if they have greater say in the implementation. Without the regulatory framework, preferably at EU level, such agreements will be impossible to monitor, and are unlikely to deliver significant environmental change.

Market mechanisms and voluntary agreements are useful *additions* to the array of policy tools available for delivering sustainable development. They have not replaced 'command and control' regulations, and are unlikely to do so. The UK government has said a great deal about new instruments but has, so far, not used them extensively. However, as pressure to deal with environmental issues inevitably increases, their application will proliferate. The key is to ensure they are used in a proactive, not reactive, manner.

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