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Fuel Taxes II

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There is trouble ahead. According to one version, favoured particularly by cyclists with PhDs, it goes like this.

Britain should stand firm. We must hope that Radio 4 does not go off the air; that would hurt. A month should do it. With luck, any death toll would be low. We must be prepared to let the fuel protestors eat cake while they block our streets. We can, and should, out-sit them. Eventually they will go home and life will return to normal: all we need is a large supply of Evian and home-made bread. Pass the Camembert.

Logically, this argument has plenty to recommend it. In an ideal world, taxes on fuel should probably be raised rather than lowered.

Such a world exists. If you want to see it, pick up any economics textbook. It is an attractive place: logic rather than emotion rules the waves. Elegant green demand curves cut elegant blue supply curves. Order. Logic. Tranquility. There are no road blocks. The trains run on time, thanks to market pressures not the decrees of mustached despots. No-one ever says the phrase 'this tax is unfair'.

Welcome back. In real life, the question for Europe, and particularly Britain, is much more complicated. What should we actually do?

It seems best to start with the easier part, the theory. As some of us have argued in places like the Financial Times and the Guardian, there is a strong economic and environmental case for high taxes on fuel. There may exist a university teacher or economics journalist somewhere in Europe who does not agree, but if so I have not met him or her.

Unfortunately, it has become clear that many Europeans do not have PhDs and bicycles. They have cars. A few even have lorries -- big ones. These Europeans are willing to block our nations' streets in

protest at such taxes, or to cheer on those who do. It seems unwise, and ethically questionable, to look down one's nose at these people. In any case, they get to vote.

Most policy in Britain is designed by unworldly, academic sorts of folk (Tony Blair went to Oxford, the chief economist at HM Treasury to Warwick). Through no fault of their own, they tend to read the wrong kinds of newspapers. They think -- or at least did at the start -- that the dispute was caused by truckers and farmers. But, bewilderingly for environmentalists and intellectuals, who last month muttered 'bring in the police' under their breaths at their TV screens, in countries like mine the majority of citizens actually supported these actions. That was the confusing bit for the rest of us. It made the police irrelevant and will likely do so again: there is nobody to arrest when no-one is breaking the law and everyone views the level of petrol taxes as horribly excessive.

The British government is behaving sensibly in trying to find ways to force tanker drivers to do their job. Yet in doing so it is still missing the point. People feel that fuel tax has become so high -- 75% of the pump price in Britain -- that it has broken a law of natural justice. A what?, say the critics in their white towers. Read the Daily Mail and get off your high horse, is the reply.

Looking Backwards and Forwards

With hindsight, what is an economist to make of all this?

We could close our eyes and say there is nothing to the concept of fairness, and that people will always complain about paying tax. As responses go, that is not nonsensical, but it continues to miss the point and is not constructive. Moreover, sermons written high up the editorial pages of the broadsheets, by unusually well-paid Tube users who almost never get in a car, become wearying.

Alternatively, we could attempt to educate everyone. Tony Blair will try such a tack, presumably, before the expiry of the 60-day deadline that has been imposed by frustrated farmers and troublesome truckers (who are apparently unaware that decent Englishmen are not meant to block

streets and issue ultimata). This education strategy might have worked if it had been begun a year or two ago, which no doubt it should. Now, however, it probably will not.

European drivers are seriously grumpy. Even if we could offer one-month-to-a-PhD-in-environmental-science courses for all of the continent's citizens, that would likely not be enough to quell trouble over fuel.

A common reaction from politicians is that fuel protestors are just self-interested people (not exactly news). Moreover, protestors' difficulties, according to this line of argument, can be laid at the door of OPEC. It is not the fault of governments but of those who sell the oil. After all, say the politicians perfectly correctly, no-one was making trouble before -- when oil was much cheaper and fuel taxes were proportionately even higher (in 1998, tax was actually 85% of the price of petrol in Britain). Therefore the fuss is not really about tax, they claim.

Maybe. There is certainly a case for saying we should tough it out. And it is not the job of economists to solve political problems. Perhaps we should tough it out.

But it is the economist's job to offer options to politicians – to suggest possibilities to any party leaders who might be interested in listening to alternatives.

Where is Globalisation When you Need it?

If we cannot make high fuel taxes stick, here is one plan.

1. Eliminate inequitable comparisons. Call together the leaders of the main European nations, and agree to harmonise the rates of fuel tax. This does not make sense in an economics textbook but would in the world. Currently, for instance, Britain's rate of fuel duty is far above the others. The reason why this is important is simple: when notions of fairness matter, it is necessary to stop

people making unfavourable comparisons. A little-remarked consequence of globalisation is that people now think it perfectly natural to compare their lives with the lives of citizens in other nations. We need to stop protestors from being able to say 'but fuel duty is only 25 pence a litre in Luxembourg' (which it is, by the way). To begin to do this in Britain might mean bringing the tax on fuel down at least 10 pence a litre, thereby creating a pump price of around 70 pence rather than 80 pence. This would lead to a loss in tax revenue of about 5 billion pounds sterling.

2. Tax air travel more. We then have to find 5 billion of missing tax revenue from somewhere, and it would be important strategically to make OPEC bear the cost. Hence we could agree, in a coordinated way across the European nations, to levy steep air taxes. Currently plane travel is taxed remarkably little, which makes no sense when large amounts of aviation fuel are consumed, when burning that kind of fuel produces the same amount of carbon dioxide as petrol, and when motoring taxes are so high that Western Europe's society is apparently in danger of not functioning peacefully. In Britain, the tax on aviation fuel is 27 pence a litre, which is less than half the rate on petrol. We use in this country about 22 million tonnes of petrol a year, about 15 million tonnes of DERV for trucks, and about 10 million tonnes of aviation fuel. Taxing aviation fuel harshly, but not absurdly harshly, could get us another 1 billion pounds in tax revenue. We are then looking for ways to fill a gap of 4 billion.

Coordination here will be important. Otherwise London aircraft will take off lightly laden with fuel and simply stop in another European city where aviation fuel is taxed less.

We could also remove the current VAT exemption on international passenger transport. The logic supporting the exemption was and is weak; this loophole costs approximately 2 billion pounds a year in lost tax revenue. That is a lot of cash. So now we are down to looking for a further 2 billion to make up the loss of 5 billion.

3. Tax more heavily the power stations that burn coal and the domestic users of power. Coal is the worst polluter in western society. Unit for unit, it is a much more important source of greenhouse gases than other sources, especially unleaded motor fuel. Currently Britain charges a reduced rate of VAT on domestic fuel and power, and the loss from that to the Exchequer is approximately 2 billion. If we fix that, we have closed the 5 billion gap. Arithmetically at least, there is thus a way to pay for a 10 pence per litre reduction in taxes on motor fuel. This does not make it right, merely feasible.
4. Use this as an opportunity to get a cross-European agreement to begin to move to road pricing. That would be a much more effective way to cut traffic congestion than relying simply on a high price of fuel. It would help us build something valuable out of the fuel protests that we have seen across our continent.

My four-point plan is not perfect. Giving in to protests is inherently unattractive. But if fuel taxes simply have to be cut -- I think they should not be but my opinion is utterly unreliable because I have 3 degrees and 4 bicycles and read the Financial Times 5 times a week --- because voters demand it for the sake of fairness, and they get to make the rules, then the four-point plan would at least be largely immune to standard criticisms.

Plus many of us could sign up to the idea that, if it were absolutely necessary, democracy with lower fuel taxes is better than having the army delivering optimally-priced petrol.

Would the 4-Pronged Approach Cause Problems?

A check-list is useful.

One, we know that OPEC is watching, and that it would be a mistake strategically to let the cartel come to believe that if it raises the price of crude oil the western nations will capitulate by lowering tax on petrol. But the four-point plan above would continue to penalise oil producers. It would tax (aviation) fuel heavily, and would raise taxes on home heating oil.

Two, we know that volatility in taxes is undesirable. Firms and citizens need to plan. But the four-point plan, because it would be coordinated across nations, would, with luck, be left alone through the years. It might offer stability.

Three, tax revenue is self-evidently a price paid for publicly funded schools and hospitals. But the four-point plan would continue to raise the same amount of taxation. Less would come in the short run from motorists, admittedly, but more from those who travel on planes or use electricity and coal in their homes.

Four, we know that air travel and electricity consumption are not greatly responsive to prices, so, from the point of view of economic efficiency, little allocative harm would be done by the new taxes. There would not be too much substitution – though as usual in this field that also means that the pollution benefits from energy taxes are smaller than often imagined.

Five, burning gasoline pollutes, which is one reason why high fuel taxes are sensible. But burning aviation fuel does also; and burning coal is worse. Again the four-point plan looks reasonably sensible.

Six, on congestion, the ideal would be road pricing (or 'congestion charges'). Maybe this fuel crisis across in Europe might be the trigger that, in exchange for lower fuel tax, takes road pricing out of the economist's desk drawer and puts it into toll booths on our highways.

Seven, taxing petrol is equitable. It is a progressive rather than regressive fiscal strategy. Having high excise duty on petrol penalises the rich more than the poor, and that is usually taken to be a desirable characteristic. But the four-point plan gets around some of this too. Taxes on air travel also hit especially the rich. Ditto for road pricing. But taxes on coal fires and coal-fired electricity will, it has to be admitted, hurt the poor as well as the well-off.

Eight, fuel taxes are good because they somewhat slow the rate of oil depletion and thereby spread the availability of petroleum more evenly across generations. But the four-point plan does not do badly there. Aviation taxes have a similar effect.

Where From Here?

If we lived in the ordered world of the economics textbook, Mr Blair and other leaders would be fine. They would be free to ignore this four-pronged plan. In that world, high fuel tax would be completely logical. No sensible person would find it objectionable. But such a reaction is now in danger of being irrelevant. Feelings of fairness, not logic, may determine the future of fuel taxes in Europe. Democracy can be infuriating but so far we have not found anything better.

In October 2000, nobody knows what will happen next. Prudence, to coin a word, suggests that it might be wise to order the Camembert while one can.

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