Let them heat coke

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How green taxes hurt the poor

Illustration by Satoshi Kambayashi

AS SPANISH hauliers and French fishermen have shouted out for all the world to hear, higher fuel prices are not popular. This is uncomfortable for those—including this newspaper—who see increased taxation as a way of fighting global warming. Green taxes tend to fall hardest on the poor.

You could see the rise in the oil price over the past five years as a gigantic carbon tax. It is, at last, succeeding in cutting demand in the developed world (although not yet in the developing one). But it has been extremely painful for some parts of society.

There may be worse to come. Many climate experts favour the ambitious target of cutting carbon emissions by 80% before 2050.

Technological change will help. But encouraging those new technologies may well call for higher energy taxes.

In America the Congressional Budget Office has estimated that a cap-and-trade system, designed to cut emissions by 15%, would reduce the average income of the lowest quintile of the population by 3.3% and the richest quintile by just 1.7%.

The effect on the poor is not uniform; fewer drive cars, for example. But those that do spend a big part of their income on petrol. In 2007 Britain's Institute for Fiscal Studies (IFS) estimated that a 5% rise in fuel duty would cut the income of the poorest decile of Britons by 0.27%; the richest decile would lose only 0.11%.

And although the poor may not all drive, they must all heat their houses in winter. According to an IFS paper last year by Don Fullerton, Andrew Leicester and Stephen Smith, the poorest decile of British households spent 12% of their income on fuel in 2004, compared with just 4% for the richest decile. (It is a safe bet that the share has since risen.) In addition, the wealthy have more money to spend on products that improve energy efficiency, such as insulation and hybrid cars.

The link between fuel and food prices only worsens the burden on the poor. This has caught people's attention because corn is being used as a biofuel. But oil is also a constituent of many fertilisers and the growth of emerging markets is affecting demand for both. Once again, the poor devote more of their budget to food than the wealthy do.

The answer might seem simple. Let the green taxes rip and then compensate low earners by making more benefits available to them. A similar answer has been proposed for the adverse affects of globalisation; rather than restricting trade, governments should instead seek to cushion globalisation's impact on those members of the population that lose.

A report by the Joseph Rowntree Foundation in 2004 suggested several ways to do this, for
example by using a lower energy tariff for those on benefits or granting a free water allowance to some households. But the report came up against one difficulty. You could devise compensation packages that made the average poorer person better off. But widely differing uses of energy meant that around 20% of the poorest households would still lose out. In a way, governments would be faced with a similar problem to the one that bedevilled Gordon Brown, the British prime minister, earlier this year when he sought to abolish the country's lowest rate of income tax. The change produced some losers, and their grievance counted for more than the gratitude of the numerous winners.

There would be other drawbacks with a tax-and-compensate system. If such an approach were means-tested, the effect would be to increase marginal tax rates for the poor (since benefits will be withdrawn as incomes rise). That will reduce incentives to work.

Even if the benefits are not means-tested, they may counteract the effect of higher taxes on energy demand. In Britain, for example, all pensioners are given a winter-fuel allowance. But it seems odd to try to prevent energy use with higher taxes on the one hand and then to subsidise it on the other.

The fundamental problem is difficult to get round. If governments desire people to use less energy, they have to ration supply by price. They can limit frivolous use (gas-guzzling cars, televisions on standby and the like). But there may be a core demand for energy (heat, light, commuting) where consumers will resist cuts. For that part, the rich will always be able to outbid the poor (not to mention the politically powerful middle class). And that will plague green campaigners.

* “Environmental taxes” by Don Fullerton, Andrew Leicester and Stephen Smith. Institute for Fiscal Studies, March 2007

** “Green taxes and charges: Reducing their impact on low-income households” by Paul Ekins and Simon Dresner. Joseph Rowntree Foundation, October 2004