

Policy Submission

Proposal for Recycling of Revenue from a Carbon Tax to Tackle Fuel Poverty

**Submission to the
Commission on Taxation**

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Combat Poverty is a State advisory agency that develops and promotes evidence-based proposals and measures on all aspects of social and economic planning in relation to poverty in Ireland

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1. Summary of proposal

The terms of reference of the Commission on Taxation require it to investigate fiscal measures to protect and enhance the environment, including the introduction of a carbon tax. Carbon tax is a policy instrument to reduce CO₂ emissions as required under the Kyoto Agreement. It is estimated that a carbon tax of €20 per tonne of CO₂ (the level needed to meet Kyoto requirements) would cost on average €246 per household per year, and would generate tax revenue of c €510 million (net of emissions trading). The impact of the tax would be regressive, with low-income households paying up to three times the average cost as a proportion of disposable income. Households experiencing fuel poverty would be the worst affected.

Combat Poverty is supportive of policy to tackle climate change, especially as low-income households are most vulnerable to the negative effects of climate change. To address the negative distributional outcomes of a carbon tax, Combat Poverty proposes that the revenue arising from the tax is used to tackle fuel poverty and to redistribute resources towards low-income households. In the first instance, a proportion of the revenue should be used to compensate low-income households for the higher fuel costs arising from a carbon tax. Second, resources should be invested in domestic energy efficiency measures (both insulation and heating systems) to reduce the number of households at risk of fuel poverty. Funding for energy-efficiency measures should also be provided for community facilities, with a priority on those in low-income areas. Third, the remaining revenue should be recycled in ways which redistribute resources towards low-income households, such as reducing indirect taxes. Some funding should also be ring-fenced to increase the subsidy for public transport use.

The specific proposals for recycling carbon tax revenue are as follows:

1. *Compensatory measures for low-income households*

- 1.1 Enhance the national fuel allowance to include all low-income households, including recipients of short-term welfare payments and the family income supplement. Also, taper the withdrawal of the allowance where a household member takes up employment and index the value of the allowance with the price of fuel.

- 1.2 Provide a general increase in welfare rates to compensate for higher energy costs.

2. *Investment in energy-efficiency measures to reduce fuel poverty*

- 2.1 Support the full retrofit of energy efficient measures in all low-income private households over five years through an expanded *Warmer Homes programme*.
- 2.2 Ensure that existing social housing stock is equipped with energy efficient heating systems within five years.
- 2.3 Ensure that private rented housing supported under the Rental Allowance Scheme (RAS) and SWA Rent Allowance Scheme meets energy-efficiency standards within three years. In support of this, provide a tax rebate of up to €1,500 per housing unit to landlords who invest in approved energy-efficiency measures, contingent on continuing to participate in subsidised rental schemes for five years.
- 2.4 Introduce an enhanced fit out specification for new social housing based on modern energy efficiency technology (future-proofing).
- 2.5 Provide subsidised access to reticulated gas systems for residential households in parts of the country currently not served by suppliers.
- 2.6 Provide financial assistance with the installation of energy-efficiency measures in community buildings, such as family and community resource centres, community halls, sports centres, schools

3. *General recycling of remaining carbon tax revenue*

- 3.1 Reduce the lower rate of VAT.
- 3.2 Increase the subsidy for public transport passengers.

Proposed costings

<i>Revenue raising</i>	€510 million
Carbon tax of €20 per tonne of CO ₂ (net of emissions trading)	
<i>Compensation</i>	€200 million
<i>Investment in energy-efficiency</i>	€100 million
<i>General revenue recycling</i>	€210 million

2. Supporting documentation

2.1 *The nature and extent of fuel poverty*

Fuel poverty can be comprehensively defined as 'the inability to heat the home to an adequate (safe and comfortable) temperature owing to low income and poor (energy inefficient) housing'.¹ Fuel poverty can be measured in a number of ways, but generally includes the following indicators

- paying substantially more than the national average for fuel and energy,
- living in temperatures lower than 18° Celsius in winter,
- confining one's activities to only one or two rooms,
- the inability to install or run efficient means of heating,
- inability to afford energy saving items in the home,
- lack of central heating.

The most recent findings on fuel poverty relate to 2002.² These indicate that

- 62,000 households (4.7% of the total) experience persistent fuel poverty;
- A further 165,000 households (12.7% of total) experience intermittent fuel poverty.
- In total, 227,000 households (17.5% of total) experienced some degree of fuel poverty

Certain households have a greater risk of fuel poverty than others depending on the composition.³ Households containing lone parents (with all children under 16 years) are more likely to suffer fuel poverty than any other group, with almost 20% in chronic fuel poverty.⁴ Other households with lone parents (with at least one child aged 16 or more) have the second highest risk of chronic fuel poverty. The third highest group is households containing men over 65 years, who have a risk of fuel poverty of almost 12%.

Where does Ireland rank in terms of fuel poverty levels in Europe? The average incidence of fuel poverty is 14%. Ireland with a 9% rate of fuel poverty has a middle-ranking position, along with the UK and Belgium. This rate is higher than the average for the colder northern European countries at

¹ Clinch, J.P. and Healy, J.D. (1999). Alleviating fuel poverty in Ireland: a program for the 21st Century. *International Journal for Housing Science*; 23(4): 203-15

² Sustainable Energy Ireland (2003), *A review of fuel poverty and low-income housing*, Dublin: SEI.

³ Healy, J. (2003) *Op cit.* and Healy, J., (2003) *Lone Parent Fuel Poverty In Ireland*. Dublin: One Parent Exchange Network..

⁴ Chronic fuel poverty refers to participants in the study who when asked about their ability to heat their home answered that they were 'usually unable' or not at all.

6.7%, which includes best performing countries such as Denmark and Luxembourg at 4% or less. Comparing the socio-economic profile of groups experiencing fuel poverty in Europe, Ireland stands out with its high incidence of fuel poverty amongst households in rented accommodation, lone parents and unemployed households.⁵ These rates are higher than colder countries such as Austria, Denmark and Germany, which are likely to have better housing standards, in particular in their social housing sectors. What is distinctive about Ireland then is not its overall incidence of fuel poverty, but the concentrated nature of the problem among low-income groups.

Fuel poverty results from a combination of factors:

- low incomes,
- energy inefficient housing,
- a reliance upon expensive heating appliances and/or expensive fuels,
- a greater need for warmth due to ill-health, disability, old age or longer periods spent at home due to caring or unemployment.

Energy consumption is largely income inelastic. This means that households demand energy regardless of income, with an average of over 7% of household income being spent on fuels.⁶ For those in the four lowest income deciles this increases to around 10% of their income, and this increases to over 15% for those in the lowest decile.

Contributing factors of the lack of energy efficient homes include a housing stock with the following characteristics: a high proportion of single storey detached residences, a significant number of houses built before the Draft Irish Building Regulations in 1976 and insulation levels amongst the lowest in northern Europe.⁷ The income required to heat these homes, on average, is three times higher than that which is spent on fuel by average Irish households.⁸ Also relevant is that all households do not have access to more energy efficient heating systems such as with gas central heating. This is

⁵ Healy, J (2003), *Fuel poverty and policy in Ireland and the European Union*, Dublin: The Policy Institute in association with the Combat Poverty Agency.

⁶ Scott, S & Eakins, J. (2002), *Carbon Taxes: Which households gain or lose?* Dublin: ESRI

⁷ See Clinch, J.P. and Healy, J.D. (1999), *Op cit.*

⁸ Brophy, V., Clinch, J.P., Convery, F.J., Healy, J.D., King, C. and Lewis, J.O. (1999) *Homes for the 21st Century: The Costs and Benefits of Comfortable Housing in Ireland*. Dublin: Energy Action Ltd and University College Dublin

because gas reticulated systems are only found in the main urban areas and mainly in the newer housing stock.

The type of fuel purchased by households is another contributor to fuel poverty. Low-income households 'buy dearer, dirtier and less efficient fuels'.⁹ In contrast, higher income households purchase cleaner, more efficient fuels such as gas. These fuels are cheaper to burn than those used by lower income households. To illustrate this variation, a household in the lowest income decile spent 28% of their fuel budget on coal and slack in contrast to only 7% by those in the highest income decile.

2.2 The health and social costs of fuel poverty

The effect of fuel poverty ranges from uncomfortable living conditions to negative impacts such as 'poor physical / mental health, increased debt, and a decline in the physical state of their home'¹⁰. The reality of fuel poverty was highlighted in Combat Poverty's study *Against All Odds*¹¹, which examined the experience of family life on a low income. One of the mothers noted *I remember one night that I just happened to wake up and I picked up one of the children. He was only a few weeks' old. The child was freezing.*¹² Another mother also talked of her children having to go out on a periodic basis to collect firewood.

Fuel poverty can also be reflected in mortality rates. Healy¹³ reveals a strong correlation between fuel poverty, the standard of housing and the 2,000 excess winter deaths which occur each year. He calculates that Ireland has the second highest excess winter deaths amongst a sample of countries.

2.3 The rationale for a carbon tax

Central to the carbon tax philosophy is the 'polluter pays' principle. The implementation of this principle means that the onus is on the polluter to pay for emitting greenhouse gases into the atmosphere. Underlying the principle is

⁹ Clinch, J.P. and Healy, J.D. (1999). *Op cit*

¹⁰ Sustainable Energy Ireland, *Low Income Housing Programme Strategy 2002-2006*

¹¹ Daly, M. & Leonard, M. (2002) *Against All Odds* Dublin: IPA

¹² *Ibid*

¹³ Healy, J.D. (2003). "Excess Winter Mortality in Europe: A Cross-Country Analysis identifying Key Risk

the objective that payment (in this case a carbon tax) will, over time, modify people's behaviour in respect of carbon consumption and consequently lead to a reduction in emissions. The carbon tax can bring about a more efficient allocation of resources as people will now have to cover the costs on the environment of undertaking their activities.

The *National Climate Change Strategy* (NCCS) outlines a number of measures to be implemented in order to achieve the reduction in emissions required to achieve the targets set out in the Kyoto Protocol. Included in this are market-based instruments such as taxation (carbon taxes) and emission trading within the EU. There are also more specific measures for sectors such as agriculture, transport and forestry. Within the residential sector there will be efforts to increase the energy efficiency of homes, particularly for those in fuel poverty.

It is estimated that a carbon tax of €20 per tonne of CO₂ is necessary to meet Kyoto requirements. This would generate tax revenue of €850 million gross or €510 million net of emissions trading.¹⁴ The average household cost of a carbon tax would be €246 per annum, equivalent to 1% of disposable income.¹⁵ Most of this additional cost is related to increases in residential fuels, with a smaller proportion due to higher transport fuels.

2.4 The impact of a carbon tax on low-income households

The introduction of a carbon tax will have both a direct and indirect impact on low-income households. The direct impact arises from an increase in the cost of all fuels. Because the tax will be apportioned in relation to the carbon content of fuel, the prices of high carbon content fuels will rise more. They will have a greater impact on low-income households for three reasons:

- They spend a higher proportion of their income on fuels;
- They live in less energy efficient houses; and

Factors". *Journal of Epidemiology & Community Health*, 57 (10): 784 - 789

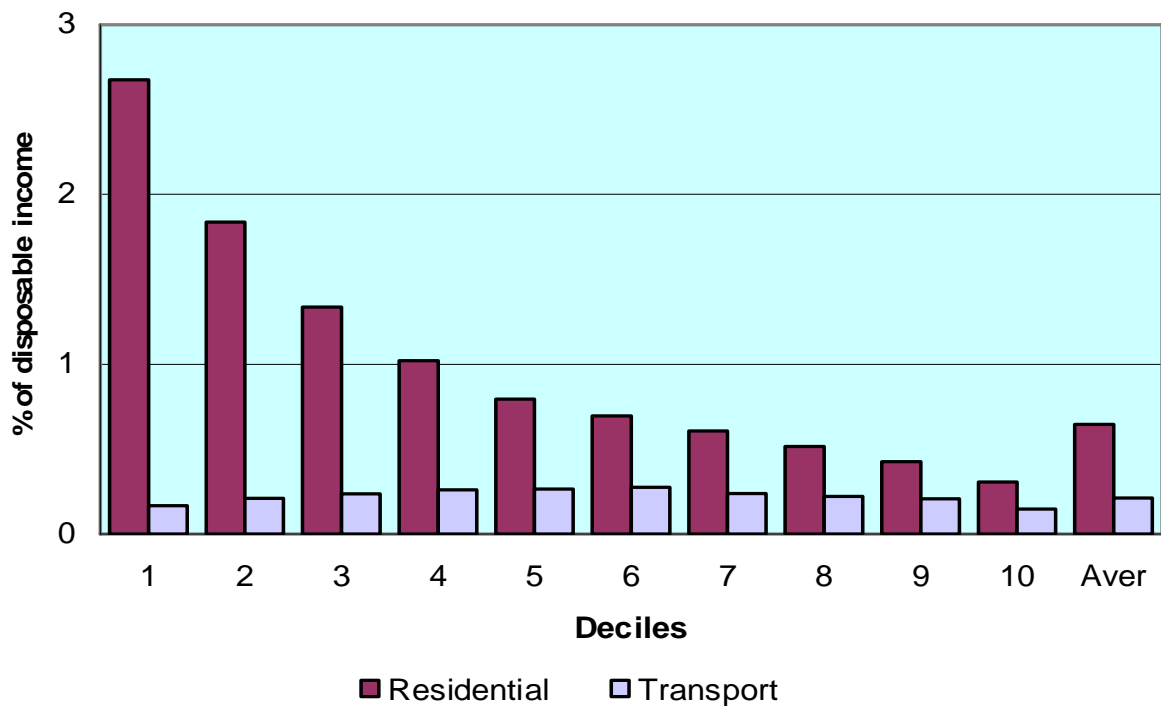
¹⁴ Bergin, A, Fitz Gerald J, and Kearney, I (2004), *The macro-economic effects of using fiscal instruments to reduce greenhouse gas emissions*, Environmental Protection Agency. Accessed at www.epa.ie.

¹⁵ Scott, S & Eakins, J. (2004), *Carbon Taxes: Which Households Gain or Lose? Final Report*. Environmental Protection Agency. Accessed at www.epa.ie.

- They are more likely to consume certain fuels such as peat, coal and oil which have higher carbon content.

Figure 1 shows the effect of carbon tax in relation to disposable household income. For households in the bottom three deciles, a carbon tax would be equivalent to 1.5 to 3% of disposable income, a sizable burden and a potential source of hardship.¹⁶ Fuel poverty is therefore likely to increase following the introduction of a carbon tax given its link with low-income.

Figure 1: Carbon tax as a %age of disposable household income¹⁷



If the impact on lower and higher income groups is compared we find that those on the lower deciles pay up to twice the share of household income as better-off households. Thus, carbon tax will be a regressive tax, as people on low incomes pay a higher proportion of their incomes than those on higher incomes.

¹⁶ *Ibid*

¹⁷ *Ibid*

Along with the direct implications of the tax, there are likely to be indirect impacts which will again disproportionately impact on low-income households. The economic effects of the carbon tax are dependent on whether it is introduced just in Ireland or throughout Europe. Should the tax be introduced unilaterally there would be ‘a loss of profitability and lower output’¹⁸ within sectors which trade overseas. As these sectors in Ireland are “price takers”, they will not be able to pass on the increased costs and companies on the margin may close and unemployment could increase. Over time this loss of competitiveness may be mollified as other countries introduce carbon taxes and/or Irish companies reduce their energy related costs, through the introduction of more energy efficient technologies.

In general, there could be a rise in prices as businesses pass on the increases in their costs (mainly energy and transport) which arise because of the carbon tax and emissions trading. This would again have a greater impact on low-income households as these households consume a higher proportion of their incomes than higher income households. Higher income households have a greater saving power than those in lower income households.

It was noted earlier that fuel poverty is found to be a contributing factor in high winter mortality rates. With an increase in the cost of fuel due to the carbon tax, households in fuel poverty will be further affected in terms of ill health and consequently there may be an increase in mortality rates, which are already high.

2.5 Fuel subsidies within the social welfare system

There are three social welfare payments which assist households with fuel costs: 1) the National Fuel Scheme and 2) the Smokeless Fuel Allowance and 3) the Household Benefits Package.¹⁹ The National Fuel Scheme is a means-tested benefit for households in receipt of long-term social welfare payments. The allowance is a household payment valued at €18 per week for

¹⁸ Bergin, A., Fitzgerald, J. & Kearney, I (2004), *op cit*

¹⁹ The National Fuel Scheme is the main policy instrument, with the other two schemes limited to specific locations (where coal is banned) or to demographic groups (over 65s).

30 weeks (the winter period). In 2007, 296,000 households received the payment at an exchequer cost of €157 million. The value of the fuel allowance has doubled in recent years and is the equivalent of 10% of the basic personal welfare rate in 2008, which is a significant 'top-up' amount.

There are some difficulties with using the National Fuel Allowance Scheme to compensate for higher fuel prices arising from a carbon tax:

- it does not apply to shorter term welfare schemes such as unemployment or disability benefit;
- it has a sharp withdrawal rate if non-welfare income is received;
- it is only payable for a limited period of the year;
- it may be perceived as encouraging fuel consumption rather than fuel conservation and energy-efficiency.

The Smokeless Fuel Allowance is a supplement to the National Fuel Scheme for households in urban areas where there is a ban on bituminous (smoke causing) fuel. It is awarded in respect of the additional cost of purchasing smokeless fuel and is valued at €3.50 per week for 30 weeks. The smokeless fuel allowance is a top-up for households in already in receipt of the National Fuel Scheme in the designated areas. The combined fuel allowance for eligible households is thus €21.50 per week for 30 weeks.

The Household Benefits Package which is made up a three allowances, one of which is for the consumption of a specified amount of electricity or gas (eg 2,400 units of electricity). This package is mainly payable to older households in receipt of long-term welfare payments.

As well as fuel-specific supports, weekly social welfare payments provide the resources to meet basic living costs, including fuel costs. Social welfare payments have been increased significantly in recent years in line with government commitments to enhance minimum living standards. Increasing the income of welfare recipients to compensate for higher fuel costs arising from a carbon tax provides an alternative compensation approach. This would appear to be a better approach from a general welfare point of view, with the

overall objective being to provide a level of payment which is sufficient to cover minimum living costs. It would also encourage households to look at ways to minimize their carbon-emitting energy use. This approach would result in resources being spread more widely, including households who are not currently entitled to the fuel allowance. However, this is not necessarily a problem given the expected revenue from a carbon tax.

2.6 *Energy efficiency programmes*

Sustainable Energy Ireland is delivering a programme aimed at increasing energy efficiency for low income households (the Warmer Homes programme). The purpose of this programme is to assist with the establishment of a national plan of action to address fuel poverty in low-income households. Within this programme, there is a grant scheme to provide funding to community-based organisations to install energy efficiency measures in the homes of low-income households. Over the period of the programme, the target is that up to 18,000 low-income households will benefit from the improvements carried out to their homes. The focus is on properties in the private rented and home-ownership sectors where the household is experiencing fuel poverty. In addition, in 2007, the Department of Social and Family Affairs provided €2 million to Sustainable Energy Ireland to install central heating in fuel poor homes on a pilot basis in Waterford city.

Combat Poverty and Sustainable Energy Ireland are currently evaluating the impact of energy-efficiency measures in two locations: Donegal and Cork city.

In the social housing sector it is the responsibility of the local authority to install energy-efficiency measures. Local authorities spent €27 million on the installation of central heating in public rented housing in 2006. Other energy efficiency measures for public housing are funded under the remedial works scheme.

2.7 *Policy for promoting social inclusion*

The *National Action Plan for Social Inclusion 2008-2016* (the follow-up policy to the *National Anti-Poverty Strategy 1997-2007*) has a headline commitment to halve the rate of consistent poverty to between 2% and 4% by 2013 and to eliminate it altogether by 2016. Consistent poverty is measuring by a combination of low-income and deprivation of basic necessities, which can clearly include the ability to provide adequately heating in the home.

Government has stated its objective to tackle fuel poverty in recent policy statements on energy and on poverty. Current government actions on fuel poverty include the national fuel allowance scheme, the household benefits package, local authority remedial works and the Warmer Homes programme. Recycling the revenue from the carbon tax is a major opportunity to intensify policy efforts to tackle fuel poverty.

The *National Climate Change Strategy* indicates that all measures implemented to reduce greenhouse gas emissions must be in accordance with 'achieving social justice and overcoming social exclusion'.²⁰ Furthermore, the strategy acknowledges that should any of the measures be in conflict to the *National Anti-Poverty Strategy* (NAPS), 'compensatory approaches will be sought to offset or overcome these effects, and where appropriate, to support the overall objectives of the NAPS'.²¹ This can be achieved by targeting

*households that are on low income that receive payments that qualify them for fuel allowances, and / or that are in possession of one or more medical cards, that receive Family Income Supplement and that receive Unemployment Benefit and so forth. Those that pay non-zero income tax are also targetable, through reductions in income tax.*²²

It is a government requirement under the *National Action Plan for Social Inclusion* that all aspects of government policy at design and review stages are assessed as to their impact on poverty and on the inequalities which lead to poverty, with a view to poverty reduction. Consideration of the distributive and poverty impacts of the tax system should be central to the work of the

²⁰ Department of the Environment and Local Government, (2000) *National Climate Change Strategy*
Dublin: The Stationery Office

²¹ Ibid

²² Scott, S & Eakins, J (2004), *op cit*

Commission. The process of poverty impact assessment was updated by the Office for Social Inclusion in 2005 and new guidelines presented to all government departments for implementation from 2007 onwards.