IFS Green Budget 2019
A road map for motoring taxation

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Motoring taxes as a source of revenue

Forecast to raise £40 billion in 2019-20
• 5% of total government revenue

- Vehicle excise duty: £6.5bn
- Fuel duties (+ VAT on duties): £34bn
- Congestion charge: £0.2bn
• Fuel taxes do not hit poorer households harder on average
• Almost one in 20 households spend more than 10% of their (non-housing) budget on fuel taxes
Fuel duties have been frozen in nominal terms for the last 8 years

Pence per litre (2018-19 prices)

June 2010

£5.7 bn

£5.5 bn

Actual

Successive plans

Road map for motoring taxation

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Fuel duty revenue has fallen over time

And will completely disappear in the next few decades
This is more than just a fiscal problem

There are good reasons to tax motoring more than other activities

• Motoring has wider costs to society
• Government estimates: 17p/km on average

Note: Costs in 2019-20 prices
Source: Department for Transport WebTAG Databook May 2019, Table A.5.4.2
This is more than just a fiscal problem

There are good reasons to tax motoring more than other activities

- Motoring has wider costs to society
- Government estimates: 17p/km on average
- Motoring taxes can incorporate these costs into the prices drivers pay so prices reflect the true cost of their activity
- Ideally each kilometre driven would be taxed an amount equal to the social costs it generates
  - Requires taxes to vary as much as the social costs it generates – particularly congestion
Not all kilometres are equal

Source: Authors’ calculations and tables A5.4.1 and A5.4.2 of Department for Transport, WebTAG Databook, May 2019, converted to 2019–20 prices using the GDP deflator.
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Are current taxes well designed to target the external costs of motoring?

**Fuel duties**

- Poorly suited to targeting congestion and other variable costs
- And set too low if targeting all costs

- Well suited to targeting emissions
- But set too high if just targeting emissions
  - Average fuel duty: 7p/km
  - Average cost of greenhouse gas and local air pollution: 1.2p/km
Are current taxes well designed to target the external costs of motoring?

**Vehicle excise duty**
- Annual tax levied on every vehicle registered for road use
  - First year charge linked to car’s CO₂ emissions band

**Company car taxation**
- Income tax and NICs levied on provision of company cars
  - Rate depends on car’s CO₂ emissions band

**Fuel duties better targeted at emissions**
- Provides strongest incentives for those who drive a lot
- Provides ongoing incentives to drive less

**Tax at point of purchase provides better incentive to buy cleaner cars**
Motoring forward: vision for the long term

The challenge

- Fuel duties will disappear in the next few decades
- The government could replace this revenue by taxing other activities
- But there are good reasons to want to tax motoring specifically

A tax per kilometre driven

- Like fuel duties, this provides an incentive to drive less but poorly corrects for other costs
- Could provide a stepping stone to a more nuanced approach

Road pricing

- Ideal system: road pricing where charges vary by time and location
- London congestion charge move in right direction
Managing the transition

Speed is of the essence:
• Easier to bring in new taxes while fuel duties can be reduced in return
• And before expectation of low taxes on electric motoring is ingrained

Trade-off:
• Long run: tax low-emissions motoring
• Short run: encourage transition to low-emissions motoring

One solution:
• Bring in new taxes on motoring as soon as possible
• Encourage take-up of cleaner cars in other ways:
  – Temporary subsidies for buying clean new cars or scrapping dirty old ones
  – Provide funding for infrastructure e.g. charging points
Summary

The government must rethink how it taxes motoring

• Revenue from motoring taxes will disappear in next few decades
• Existing taxes poorly targeted at the social harm driving creates

The ideal system

• Road pricing with charges that vary by time and place

Managing the transition

• Start now
• Use other tools to encourage take-up of cleaner cars

The government might take a different view but it needs a plan

• Long run taxation of motoring
• How to get there