

# **CORI JUSTICE**

**Submission to the Department of Finance**

**On**

**Options for revising the Vehicle  
Registration Tax (VRT) system to take  
greater account of CO<sub>2</sub> emission levels**

**March 2007**

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### Submission to Department of Finance Public Consultation on Options for revising the VRT system to take greater account of CO<sub>2</sub> emission levels

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#### Introduction

CORI Justice welcomes the decision by the Minister for Finance, Mr Brian Cowen T.D., to undertake a review of the nature and structure of vehicle registration tax (VRT) as announced in Budget 2007. For some time CORI Justice has advocated the need to reform the tax system such that appropriate environmental taxes are introduced.<sup>1</sup> As we have detailed elsewhere, this view is grounded in our belief that all development should be socially, economically and environmentally sustainable.<sup>2</sup>

Reforming VRT is also appropriate in the context of government commitments to address environmental emissions contained within *The Kyoto Protocol to the United Nations Framework Convention on Climate Change* (1997), the *National Climate Change Strategy* (2000), *Sustaining Progress* (2003:39, 49) and *Towards 2016* (2006: 32-33). CORI Justice also believes that these reforms are appropriate in the context of the need to develop a fairer taxation system.<sup>3</sup>

Below, we outline the background to our views on this issue, we highlight a number of key considerations that should inform decision making in this area and we conclude by setting out our proposals to reform the VRT system.

#### Background to our submission

CORI Justice's views on this issue are driven by the following:

##### *The need for sustainable development*

Conventional economic models of development or progress have failed to incorporate the environment into their calculations. Until recently the environment has been seen as a limitless resource that could be used at will by all people without

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<sup>1</sup> See CORI Justice 2004: 69-70; 2004b; 2005a: 73-76; 2006a:78-81 and 2006c.

<sup>2</sup> See CORI Justice 2005a: 159-163; 2005b: 2006: 179-183 and 2006b.

<sup>3</sup> See CORI Justice 2005a: 78-84; 2005c; 2006: 83-91 and Healy and Reynolds 2004.

any fear of long-term damage or cost. More recently there has been a growing, but far from universal, recognition that the environment is being seriously damaged and that the wellbeing of coming generations and of the planet itself is being put at risk.

Central to any model of development which has sustainability at its core must be a realisation of the need to move away from money-measured growth, as the principal economic target and measure of success, towards sustainability in terms of real-life social, environmental and economic variables. Already there has been some progress within mainstream decision-making.

In the environmental context it is crucial that dominant economic models are challenged on (among other things) their assumptions that nature's capital (clean air, water and environment) are essentially free and inexhaustible; that scarce resources can always be substituted; and that the planet can continue absorbing human and industrial wastes which most economists tend to downplay as externalities. A central initiative in this context should be the development of "satellite" or "shadow" national accounts. Our present national accounts miss fundamentals such as environmental sustainability. Their emphasis is on GNP/GDP as scorecards of wealth and progress. These measures more or less ignore the environment; only money transactions are tracked. Ironically, while environmental depletion is ignored, the environmental costs of dealing with the effects of economic growth, such as cleaning up pollution, are added to, rather than subtracted from, GNP/GDP. CORI Justice welcomes the commitment in *Towards 2016* to examine the feasibility of the application of satellite accounts in the area of environmental sustainability for Ireland. This is scheduled to occur during 2007. We look forward to this commitment being implemented.

### ***The development of a fairer taxation system***

The need for fairness in the tax system was clearly recognised in the first report of the Commission on Taxation more than twenty years ago. In that volume it stated:

“...in our recommendations the spirit of equity is the first and most important consideration. Departures from equity must be clearly justified by reference to the needs of economic development or to avoid imposing unreasonable

compliance costs on individuals or high administrative costs on the Revenue Commissioners.” (1982:29)

The need for fairness is very obvious today; a point CORI Justice continues to make.<sup>4</sup> Within the realm of environmental considerations the principle of “the polluter pays” must be central.

The finite nature of our environment demands that we take account of environmental costs along with other factor costs. Measures to protect the environment have necessarily involved intervention in the market, because market forces do not themselves provide for environmental protection. Up to now this “intervention” has been by legislated regulatory measures. In the long run, however, a more comprehensive approach is required. In recent years the sheer increase in the volume of economic activities has often negated regulatory gains. A key step should be to include in prices – and thereby internalise – the environmental costs occasioned by economic activity. Environmental taxes offer a key way of introducing this consideration to people’s decision making.

### ***Current and projected environmental pollution levels***

Over time, Ireland’s air has become more and more polluted. Between 1990 and 2005 the Environment Protection Agency (EPA) reported that Ireland’s greenhouse gas emissions grew by over 25 per cent (see table 1). Total combined Irish emissions of the three main greenhouse gases regarded as having global warming potential amounted to 69.95m tonnes of CO<sub>2</sub> equivalent in 2005, up from 68.46m in 2004 and 55.6m tonnes in 1990. Despite two successive years of reductions – 2002 and 2003 – the 2004 and 2005 figures marked a return to annual emissions increases.

A breakdown of the 2005 pollution figures shows that agriculture is the single largest contributor to the overall emissions, at 27.6 per cent of the total, followed by energy (generation and oil refining) at just over 23 per cent and transport at 19.2 per cent.

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<sup>4</sup> A more detailed discussion of the issues contained in this section can be found in Healy and Reynolds (2004:151-188).

The most recent figures indicate that the current levels of emissions now exceed the limits agreed under the Kyoto protocol. The Irish government and the European Commission agreed a target of an 8 per cent reduction in European CO<sub>2</sub> emissions on their 1990 level by 2012. Within this agreement, Ireland agreed to limit its increase of CO<sub>2</sub> emissions to 13 per cent between 1990 and 2012. Table 1 reports the level of greenhouse gas emissions versus the 1990 level (set at 100 on the emissions index). CORI Justice welcomes Ireland's ongoing commitment to this protocol, despite the refusal of some countries, including the USA, to ratify its implementation. However, these emissions are a major cause of climate change, and it is in all our interests to ensure that the limits agreed in the Kyoto protocol are met.

<b>Year</b>	<b>Emissions Index</b>	<b>+ / - Kyoto Target</b>	<b>% from target</b>
1990	100.00	-13.00	-11.5
1998	117.73	+4.73	+4.2
1999	120.45	+7.45	+6.6
2000	123.34	+10.34	+9.2
2001	126.30	+13.30	+11.8
2002	123.46	+10.46	+9.3
2003	121.99	+8.99	+8.0
2004	122.73	+9.73	+8.6
2005	125.40	+12.40	+11.0

**Source:** EPA (2006 and 2007).

Major changes are required if we are to reduce our emissions towards this target. In particular, the transport sector has a central role to play. While launching the 2005 figures, the EPA noted that the transport sector records the greatest increase between 2004 and 2005 (of 6.9 per cent) and that that sector pollution contribution has grown by 160 per cent since 1990. If simple policy options are available to address this sustained growth in transport related emissions, they should be adopted.

A further concern relates to projections for the future growth of transport emissions. Dealing purely with passenger cars (the primary subject of this consultation) it is worthwhile comparing Irish car ownership levels with that of the other EU member states.<sup>5</sup> As table 2 shows, the latest Irish data shows that there are 494.5 cars per

<sup>5</sup> Comparable data only available for EU-25.

1,000 population over 15 years in Ireland. This remains below the EU-25 average of 555.3 cars per 1,000 population.

<b>Table 2: EU-25 Car ownership per 1,000 population aged 15 years and over</b>			
<b>Country</b>	<b>Cars per 1,000</b>	<b>Country</b>	<b>Cars per 1,000</b>
Luxembourg	792.9	Finland	512.7
Italy	687.5	<b>IRELAND</b>	<b>494.5</b>
Malta	639.0	Portugal	447.0
Germany	638.3	Denmark	432.4
France	602.8	Czech Rep	424.1
Austria	591.4	Lithuania	418.0
Belgium	561.3	Greece	398.1
Sweden	553.3	Estonia	354.8
United Kingdom	546.8	Poland	352.2
Slovenia	540.3	Latvia	316.3
Spain	531.8	Slovakia	303.1
Netherlands	521.1	Hungary	297.2
Cyprus	513.7	<b>EU-25 (average)</b>	<b>555.3</b>

**Sources:** CSO, 2006:68.

**Note:** Data is the most up-to-date available for countries from Eurostat with figures corresponding to the year 2002 for all countries except Ireland. Irish data is for 2004 (CSO, 2006:68).

It would be reasonable to expect that over the next few years Irish car ownership levels will climb to at least reach, if not surpass, the EU average. This implies that car ownership will increase by approximately 55 cars per 1,000 population over 15 years of age. Using CSO population data this suggests *an increase of at least 226,000 cars over the next few years.*<sup>6</sup> These increases alone are likely to add significantly to the increase in transport related emissions.

In the context of these increases, and given the proportion of existing cars being replaced each year, CORI Justice welcomes the recognition by the Department of Finance in its consultation document that although “the car industry is playing a role in reducing the emissions from new vehicles, however, the ongoing technical improvement in new cars will not be sufficient to overcome the increased demand for cars and the effect of the trend to purchase larger cars” (2006:2). It is clear that

<sup>6</sup> In 2005 there were 4,110m people aged over 15 years in Ireland (CSO, 2006:52). An additional 55 cars per 1,000 population implies an increase in car ownership of  $4110 \times 55 = 226,050$ . This figures are based on the 2005 population figures and are likely to be an underestimate given the CSO projections for further population growth.

some intervention is required if a sizeable increase in emission is to be limited.

### **Key Considerations**

CORI Justice believes that the following need to be recognised as key considerations when decisions are being made on this policy reform proposal:

#### ***Linking VRT to CO<sub>2</sub> emissions levels***

It is critical than any reform recognised the need link VRT levels to the level of CO<sub>2</sub> emissions produced by vehicles. This is an obvious development beyond the current VRT structure which purely differentiates vehicles by engine size. In that context, CORI Justice, welcome the CO<sub>2</sub> *Emissions Related Labelling System* as proposed by the Department of Environment, Heritage and Local Government. This system, as outlined in table 3, established seven classifications for cars based on their CO<sub>2</sub> emissions as measured in grams per kilometre (g/km). We welcome this labelling system and recognise it as an important development.

**Table 3: Department of Environment, Heritage and Local Government CO<sub>2</sub> Emissions Related Labelling System**

<b>CO<sub>2</sub> Emissions Bands</b>	<b>g CO<sub>2</sub> per km</b>
A	0-125g
B	126-145g
C	146-155g
D	156-170g
E	171-190g
F	191-220g
G	over 220g

**Source:** Department of Finance Consultation Document (p5)

#### ***Recognise the full fiscal implications of this policy***

CORI Justice is somewhat concerned that the Department of Finance consultation document has adopted a very narrow perspective on the fiscal implications of this proposed policy change. Its concern that any change be “revenue neutral” in at least the short-run suggests that the Department is only concerned with the income/revenue effects of this policy proposal. Such a view overlooks the government expenditure associated with environmental emissions, incurred through the required purchase of carbon credits and the payment of any Kyoto imposed fines.

A full evaluation of this policy change should take into account the full fiscal implications of any change; the income effect of VRT changes and the expenditure effects on carbon credits and Kyoto fines. Such an approach would reflect the Department's own approach to the evaluation of other policy innovations, in particular those associated with capital expenditure.<sup>7</sup>

To make this point clearer table 4 presents a calculation of the cost of CO<sub>2</sub> emissions per 10,000km travelled by a car in each of the aforementioned seven CO<sub>2</sub> emission bands (see table 3). While it is individual motorists who generate the pollution it is the exchequer who either purchases the carbon credits, or will pay any Kyoto fines. The costs are thus incurred by the state.

The costs are calculated on the basis of a mid-point value of emissions for six of the seven categories; the top category is calculated at its entry point (220g). The CO<sub>2</sub> emissions are valued using the figures supplied by the National Treasury Management Agency (NTMA) to the Dáil Public Accounts Committee in March 2006. At that briefing the NTMA suggested that carbon credits will cost the exchequer a minimum €30 per tonne. Given that many European states will record emissions levels in excess of their Kyoto levels, it seems appropriate to anticipate that the market price of these credits will rise above €30. Therefore, figures for €40 and €50 per tonne are also presented.

As there are currently almost 1.6 million registered private cars in Ireland the total exchequer cost of their combined emissions is substantial. These costs, and the possibility of reducing them in the future, ought to be considered when decisions such as the reform of VRT are being made.

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<sup>7</sup> See Department of Finance (2005) *Guidelines for the Appraisal and Management of Capital Expenditure Proposals in the Public Sector*.



<b>CO<sub>2</sub> Emissions Band</b>	<b>gCO<sub>2</sub> per km</b>	<b>Mid-point</b>	<b>gCO<sub>2</sub> per 10,000 km</b>	<b>Cost at different prices per tonne of CO<sub>2</sub> emissions</b>		
				<b>€30</b>	<b>€40</b>	<b>€50</b>
A	0-125g	62.5g	625,000	€18.75	€25.00	€31.25
B	126-145g	135.5g	1,355,000	€40.65	€54.20	€67.75
C	146-155g	150.5g	1,505,000	€45.15	€60.20	€75.25
D	156-170g	163g	1,630,000	€48.90	€65.20	€81.50
E	171-190g	180.5g	1,805,000	€54.15	€72.20	€90.25
F	191-220g	205.5g	2,055,000	€61.65	€82.20	€102.75
G	over 220g	220g	2,200,000	€66.00	€88.00	€110.00

**Source:** Calculated using data from Department of Environment, Heritage and Local Government and NTMA.

**Note:** 1 tonne = 1,000,000g

### **Proposals for Reform**

Given the above background, and taking account of the key considerations we have raised, CORI Justice considered the options raised in the Department of Finance consultation document. We believe that the following should be announced by the Minister for Finance in Budget 2008:

- The Minister should adopt Option 4 as present by the Department of Finance in their consultation document. This proposal would set the VRT level for vehicles taking account of both their engine size and emissions levels.

A more comprehensive classification of engine sizes would be used (five to replace the current three) and the Department of Environment, Heritage and Local Government labelling system would be used to establish the classifications for emissions. Cars in the lower emissions categories (A and B) would receive a discount of 5% against the rate charged to those in the middle emissions categories (C, D and E). While those in the highest categories (F and G) would pay a VRT premium of 5% above the rate charged to cars in the middle category. The Department's option 4 also proposes to increase VRT rates within each of these emissions categories as the engine size of cars increases.

In practical terms, this proposal would look as outlined in table 5. A car in the middle emissions categories (C, D or E) with an engine size of up to 1,200 ccs would have a VRT rate of 15%. A similar car with a lower emissions label (A or B) would have a 10% (15% - 5%) rate while a similar car with a higher emissions label (F or G) would have a VRT rate of 20% (15% + 5%).

<b>Emissions Label</b>	<b>A and B</b>	<b>C, D and E</b>	<b>F and G</b>
<b>Engine Size</b>			
up to 1,200 ccs	10%	15%	20%
1,201-1,400 ccs	15%	20%	25%
1,401-1,900 ccs	20%	25%	30%
1,901-2,400 ccs	25%	30%	35%
2,401 and over	30%	35%	40%

**Source:** Adopted from Table 7 Department of Finance Consultation Document

We note, according to the Department of Finance, that the introduction of this policy reform would be revenue neutral in the short term. We also believe in the long-run it will lead to savings due to substitutions to lower-emission generating cars and in turn the need for government to purchase less carbon credits and pay less in Kyoto fines. Given this, CORI Justice believes that this option should be adopted and fully implemented.

The Department's assessment of the implications of this scheme to current VRT levels reveals that the scheme if implemented would be appropriate in the context of our objectives outlined above. As table 6 shows, this reform would decrease the VRT levelled on cars of lower emissions and increase that on cars with the highest emissions. In particular, there would be significant increases for the highest polluting and largest engine cars.

**Table 6: Changes to current VRT rates if option 4 implemented**

Vehicle Price	Engine Size	Emissions Label		
		A and B	C, D and E	F and G
€10,000	under 1,200 cc	- €1,389	- €82	- €13
€10,000	1,201-1400cc	- €82	- €13	+ €333
€15,000	under 1,200 cc	- €2,083	- €1,324	- €469
€15,000	1,201-1400cc	- €1,324	- €469	+ €500
€20,000	under 1,200 cc	- €2,778	- €1,765	- €625
€20,000	1,201-1400cc	- €1,765	- €625	+ €667
€20,000	1,401-1,900cc	- €1,250	€0	+ €1,429
€25,000	1,401-1,900cc	- €1,563	€0	+ €1,786
€25,000	1,901-2,400cc	- €1,667	€0	+ €1,923
€30,000	1,401-1,900cc	- €1,875	€0	+ €2,143
€30,000	1,901-2,400cc	- €2,000	€0	+ €2,307
€40,000	1,401-1,900cc	- €2,500	€0	+ €2,857
€40,000	1,901-2,400cc	- €2,667	€0	+ €3,077
€40,000	2,401cc and over	€0	+ €3,077	+ €6,667
€50,000	1,401-1,900cc	- €3,125	€0	+ €3,572
€50,000	1,901-2,400cc	- €3,333	€0	+ €3,847
€50,000	2,401cc and over	€0	+ €3,846	+ €3,333
€75,000	1,901-2,400cc	- €5,000	€0	+ €5,769
€75,000	2,401cc and over	€0	+ €5,769	+ €12,500

**Source:** Adopted from Table 8 Department of Finance Consultation Document

- These changes should be introduced from January 1<sup>st</sup> 2008. The government is likely to face heavy lobbying from the car industry to introduce this change in mid-2008; after the peak period of car sales. It is likely that various logistical problems will be cited. However, if the proposal is revenue neutral in the short-term then there is no reason for a delay on the introduction of this proposal. Indeed in the context of the data in table 4, the implications of a delay are only to generate future costs for the exchequer through greater emissions and subsequently greater purchases of carbon credits and Kyoto fines.
- The rates of VRT should continue to be updated on an annual basis with a new rate being introduced from January 1<sup>st</sup> each year. As the Department now proposes to establish a link between VRT rates and emissions levels, it seems only appropriate to link the nominal levels of VRT to the price of pollution (carbon credits). As these increase in cost over the forthcoming years so too

will the cost borne by the exchequer (see table 4) and so in turn should VRT nominal levels.

- CORI Justice also supports the proposal by the Department of Finance to disallow capital allowances and leasing expenses for high CO<sub>2</sub> emission vehicles. We believe that this is a worthwhile development. In particular, all capital allowances and expenses for vehicles in the emissions categories F and G should be totally disallowed.

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