



Tax Working Group
Te Awheawhe Tāke

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This paper contains advice that has been prepared by the Tax Working Group Secretariat for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the Group or the Government.

Coversheet: **Environmental tax frameworks - findings of external reviewers**

*Briefing Note for Session 12 of the Tax Working Group
June 2018*

Purpose of briefing note

This note summarises the findings of two external reviewers that were engaged to critically review the Secretariat's paper *Tax and the environment – Paper I: Frameworks*.

Recommended actions

We recommend that you:

- a **note** that both reviewers were generally supportive of the paper and the frameworks presented.
- b **note** that a third review, focused on a Māori perspective of environmental tax issues, is expected in the late June / early July.

Environmental tax frameworks – findings of external reviewers

*Briefing Note for Session 12 of
the Tax Working Group*

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The Tax Working Group will release its interim report containing its recommendations in September and the views of the Group will be informed by public submissions alongside Secretariat advice.

June 2018

Prepared by the Inland Revenue Department and the New Zealand Treasury

Summary

1. This note summarises the findings of two external reviewers that were engaged to critically review the Secretariat's paper *Tax and the environment – Paper I: Frameworks*.
2. Both reviewers were generally supportive of the paper and the frameworks presented.
3. Neither reviewer explicitly recommended changes to the frameworks. One reviewer implicitly questioned whether "Sufficient scale" was an appropriate criterion to use, given that tax and regulation can be equally administratively burdensome.

Context

4. At its meeting on 5 May (Session 8), the TWG considered the Secretariat's paper *Tax and the environment – Paper I: Frameworks*. It was agreed that the paper should be reviewed by two external reviewers.
5. Two external academic reviewers were engaged. Prof Frank Scrimgeour is a professor of environmental economics at the University of Waikato. Prof Scrimgeour reviewed the 2003 McLeod review. Dr Viktoria Kahui is a senior lecturer at the University of Otago with expertise in environmental economics, and natural resource economics .
6. The reviewers were asked to: critically assess the paper, including the two key frameworks (negative externality taxes, and resource taxes); and provide high level assessments of the potential of tax instruments to be used for selected resources / pollutants. The reviewers were also provided with TWG members' feedback on the frameworks made at the 5 May meeting.
7. Tina Porou has also been engaged to provide a Māori perspective on environmental taxes. Tina Porou is expected to report back in late June / early July.

Key findings of Professor Frank Scrimgeour

8. Prof Scrimgeour outlined his findings in a report (see Appendix A1), as well as a follow-up note (see Appendix A2).

9. Prof Scrimgeour finds “no substantive analytical problems” in the paper, and is broadly supportive of the frameworks.
10. Prof Scrimgeour made particular mention of his agreement with the following aspects of the paper:
 - a) The broadening of the scope of “environmental tax” relative to the McLeod review.
 - b) The discussion of localisation – that devolution in one dimension does not mean devolution in all.
 - c) The discussion of tax concessions, and the potential for adverse effects.
 - d) The consideration of resource rentals.
 - e) The explanation for generally not hypothecating tax revenues.
11. Prof Scrimgeour made the following critiques of the paper:
 - a) Regulation and tax approaches might be equally onerous to design and implement. This suggests the “Sufficient scale” criterion in the proposed framework might not be necessary.
 - b) The paper could have benefited from an expanded discussion of distributional concerns and impacts.
 - c) Hypothecation of the waste levy might not have been effective in improving public trust in the levy.
12. Prof Scrimgeour made the following further comments:
 - a) New environmental taxes should be accompanied by a revision of regulation.
 - b) The revenue potential of environmental taxes is likely to be very limited.
 - c) The circular economy has merit, but zero waste might not be the best objective.
 - d) There is a compelling case for tradeable water rights.
 - e) We should not expect a common international standard for the share of revenues from oil and gas production going to government. Different countries have different risks.
 - f) More work should be done on: improving environmental data; pollution from public infrastructure; and assessing tourist taxes through an environmental tax lens.
13. In a follow up note, Prof Scrimgeour highlighted two further points:
 - a) *Disasters and environmental taxes*: Financial incentives could potentially be developed to help address the trade-off between least cost and quickest infrastructure repair / disaster recovery and environmental quality.
 - b) *Energy taxes*: There is scope to simplify energy related taxes.

Key findings of Dr Viktoria Kahui

14. Dr Kahui’s feedback came as a summary note (Appendix B1) as well as a track-change version of the paper with more detailed suggested edits (Appendix B2).

15. Dr Kahui finds the paper to be a “clear, concise and competent approach to framing environmental issues in an economic framework.”
16. Dr Kahui’s main critique was that the paper could have benefited from a further section on the revenue raising potential of tradeable emission permits. (*Secretariat note*: This topic is included in the scope for Secretariat’s second environmental tax paper.)
17. Dr Kahui also raised the following critiques and recommendations:
 - a. The graphical representation of externalities in the Appendix was not consistent with the text – one showed negative externalities in production, the other in consumption.
 - b. The discussion of inequality and its links to poor environmental outcomes was not adequately supported by the relevant literature.
 - c. Resource rent taxes can, in practice, affect incentives to invest in the long term if not carefully implemented. The Norwegian petroleum is an example where resource taxes were specifically designed to channel a large proportion of the high income from oil to the State without preventing economically profitable investments from being made.
 - d. Water taxes levied on access rights (instead of consented take) can risk exacerbating water scarcity insofar as they incentivise the use of previously unused sleeper permits.