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The Use of Carbon Tax Funds

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The Use of Carbon Tax Funds 2022

As per Sections 27, 28 & 29 of the Finance Act 2020[1], the carbon tax will increase by €7.50 a tonne. The increase on transport fuels is effective from October 13th 2021, while the increase on home heating fuels will not take place until 1st May 2022, after the winter heating season.

As per the commitment in the Programme for Government, all of the revenue that will be raised by this increase in carbon tax will be used to:

- Ensure that the increases in the carbon tax are progressive by spending €3 billion on targeted social welfare and other initiatives to prevent fuel poverty and ensure a just transition;
- Provide €5 billion to part fund a socially progressive national retrofitting programme;
- Allocate €1.5bn of additional funding to encourage and incentivise farmers to farm in a greener and more sustainable way.

This note details the allocation of carbon tax funds in line with the Programme for Government commitments, as well as detail on the programme areas that will receive additional funding.

Available Funds

The Programme for Government commits to additional spending of €9.5bn over the period 2021 – 2030. This figure is based on estimates of the additional revenue that will be raised by the planned increases in carbon tax. Taking into account the allocation of €148m already made in 2021, an even annual allocation of the remaining funds over the course of the decade implies **€174m** in additional spending will be available in 2022 and every year thereafter to 2030. Total carbon tax expenditure will then reach €9.5bn by 2030.

As per the Programme for Government, €5bn of the expected €9.5bn in additional carbon tax receipts will be invested in energy efficiency. This capital funding has been incorporated into the recently published National Development Plan. The total capital made available for the Department of Environment, Climate and Communications to 2030 is €12.9bn. €5bn of this sum is comprised of the additional anticipated carbon tax receipts and will be used to fund energy efficiency initiatives in the residential and community sectors. This is funding that would not have been available without the additional revenues available from the planned increases in the carbon tax.

The remaining €4.5 billion in additional carbon tax receipts will be used to boost the Government's current expenditure levels. Again, as per the Programme for Government, €1.5 billion of additional current funding will be made available over 2021 – 2030 for new schemes that will assist farmers to address the climate and environmental challenges in the agricultural sector. The specific use of the funds arising over the period 2023 – 2027 will be detailed in the Government's implementation programme for the new Common Agricultural Policy 2023 – 2027, which will be published later this year and will take effect from 2023 onwards.

The remaining €3 billion in funding will be explicitly used to ensure that increases in the carbon tax are progressive by tackling fuel poverty and providing for a Just Transition. The Government will continue to be guided by the latest emerging research on how to protect the vulnerable from the impacts of the rising carbon tax. As such, decisions on specific compensatory measures will be

[1] http://www.irishstatutebook.ie/eli/2020/act/26/enacted/en/html

made as part of the annual budgetary cycle. Already, ESRI research[2] has demonstrated that recycling just one third of the revenue raised from the carbon tax increases leaves the lowest income fifth of households on average better off and reduces poverty.

In 2022, the revenue therefore available for investment is **€412m**. This is comprised of the revenue made available in 2021 (€148m) and 2020 (€90m) and the allocation of an additional €174m to meet the Programme for Government commitment to spend €9.5bn by 2030.

The even annual allocation of carbon tax funds results in an additional allocation of **€89m** to the Department of Environment, Climate and Communications in 2022 for investment in energy efficiency, as per the NDP commitments.

An even annual allocation for the Department of Social Protection to reach a spend of €3bn by 2030 would involve the allocation of an additional €56m in every budget to 2030. However, in light of the current upward trend in energy costs, an additional **€105m** in carbon tax revenues will be made available to the Department of Social Protection in 2022, supporting an overall welfare package of €146m to ensure that increases in the carbon tax are progressive.

This additional allocation has been made possible by deferring the €49m that the Department of Agriculture, Food and the Marine would otherwise expect to receive in 2022 from carbon tax receipts. While €1.5bn will still be made available for investments that aid the transition of the agricultural sector over the period 2021 – 2030, the Department of Agriculture, Food and Marine has advised that these schemes will form part of the suite of programmes under the new Common Agricultural Policy and hence will commence in 2023 rather than 2022.

Despite this, the Results Based Agri Environment Pilot (REAP) will continue in 2022, with the funding requirements met directly by the Exchequer, rather than being funded directly by the carbon tax.

The table below details the allocation of the increased carbon tax revenues in 2022:

Table 1: Allocation of Carbon Tax Expenditures in 2022

	€ m - 2022	**Department**	**€ m – 2021**
1. Total Investment in Residential & Community Energy Efficiency *(Cumulative funding from carbon tax increases in 2020, 2021, 2022)*	202	DECC	113
2. Total Targeted Social Protection Interventions *(Cumulative funding from carbon tax increases in 2020, 2021, 2022)*	174	DSP	69
3. Continuation of 2020 & 2021 Carbon Tax Investment Programmes in Other Depts	36	Various	56
Total Expenditure	**412**		**238**

[2] https://www.esri.ie/system/files/publications/SUSTAT98_0.pdf

1. Investment in Residential & Community Energy Efficiency

The residential sector accounts for a quarter of Ireland's total energy usage and approximately 10% of overall greenhouse gas emissions. Irish homes use 7% more energy than the EU average and emit 60% more CO_2. For these reasons, improving the energy efficiency of the housing stock is a core commitment in the Climate Action Plan and the Programme for Government.

To achieve this, the recently published National Development Plan commits to an unprecedented level of investment in retrofit. An additional €5 billion in carbon tax receipts will be invested to support the retrofit of 500,000 homes to a Building Energy Rating of B2/cost optimal or carbon equivalent and to install 400,000 heat pumps in existing homes by 2030.

A new National Retrofit Plan will be published shortly. This will set out the Government's approach to meeting these targets. The plan will be designed to address barriers to retrofit across four key areas: driving demand and activity; financing and affordability; supply chain, skills and standards; and structures and governance.

The Sustainable Energy Authority of Ireland's (SEAI) residential and community energy efficiency schemes will be central to the Government's retrofit plan. Budget 2022 commits €202m in funding for these schemes in 2022. €89m of the additional funding raised from the increase in the carbon tax in 2022 will be allocated towards residential and community schemes. This means that 100% of the residential energy efficiency measures will be funded by the carbon tax in 2022.

In line with the Programme for Government commitment that retrofit plans will be socially progressive, €109m of the total allocation will be used to provide free energy efficiency upgrades to households in, or at risk of, energy poverty.

The remainder of the allocation will be used to fund other SEAI grant schemes and initiatives including a new National Home Retrofit Scheme, which will be launched at the end of this year. The Scheme will support homeowners to achieve deeper (B2) retrofits with heat pumps and will facilitate continuous, year-round working and the multi-year planning which has long been identified as a crucial requirement by the supply chain and homeowners.

It is estimated that this investment in 2022 will support over 22,000 home energy upgrades (including the solar PV scheme), including over 6,000 homes to a Building Energy Rating (BER) of B2 and over 4,500 free upgrades to the homes of those in, or at risk of, energy poverty.

The carbon tax investment will be complemented by significant additional Exchequer funds which will provide for increased staffing levels in both the Department of the Environment, Climate and Communications and the SEAI. Funding will also be provided to support the introduction of a new low-cost loan scheme for residential retrofit. This will enable the credit institutions to offer loans with reduced interest rates to make comprehensive home energy efficiency upgrades more affordable to consumers. The scheme will also signal to the banking sector new viable business opportunities associated with the transition to a low carbon economy.

This investment in residential retrofit will result in a range of benefits including:

- Lower energy bills and reduced energy poverty;
- Improved comfort, health and wellbeing, particularly for younger and older people, though improved internal dwelling temperatures and air quality;
- Reduced greenhouse gas emissions;
- Improved asset values; and
- Increased economic activity and high quality jobs created throughout the country.

2. Targeted Social Protection Interventions

The Programme for Government commits to ensuring that increases in the carbon tax will be progressive. This means protecting the most vulnerable in society from the impacts of the tax and indeed, where possible, ensuring they are better off than before. In 2020, the ESRI examined the options available to offset the impacts of a carbon tax increase on low income households.

The resulting ESRI research paper, "*Carbon Taxes, Poverty and Compensation Options"* found that a €7.50 increase in the carbon tax has no impact on the population level risk-of-poverty rate. However, the impact of a carbon tax increase is not distributed across households evenly. Lower income households spend a higher proportion of their income on energy costs, and in particular, on heating their homes. This is exacerbated by the fact that lower income households typically live in less energy efficient homes. As a result, increases in the carbon tax rate can be regressive in the absence of measures to compensate these households.

The ESRI however concluded that recycling just one third of the revenue raised from a €7.50 increase in the carbon tax would result in a reduction in the poverty rate and could leave the lowest two income deciles better off than before the increase.

In light of the ESRI research and the commitment to ensure that the carbon tax is progressive, the Government has committed to very significant increases in a targeted package of social protection supports in Budget 2022. These supports were selected to counteract the impact of the increased carbon tax on low income households. The specific measures are:

- **An increase to the a Qualified Child Payment of €2 per week for children under 12 and €3 per week for children over 12** - This protects low income families and will reduce child poverty;

- **An increase in the Living Alone Allowance of €3 per week** - People living alone are often the elderly most at risk of poverty or people suffering from a disability. These groups are likely to have higher energy needs than average;

- **An increase to the Fuel Allowance of €5 per week** - This will compensate a broad range of lower income households (since the Fuel Allowance is means-tested) for the additional energy costs they are likely to incur due to an increase in the carbon tax. This will be combined with a broadening of the threshold for Fuel Allowance eligibility and an increase in the income allowed for the means test that is applied to applicants;

- **An increase in the income threshold for the Working Family Payment of €10 per week** – Research has found that children in energy poverty have a greater likelihood of respiratory illness. Using carbon tax funds to compensate low paid employees with children will lead to improved health outcomes, particularly when combined with the qualifying child payment.

The total cost of these interventions is projected at €146m in 2022. This will be funded by the additional carbon tax funds of €105m that have been allocated to the Department of Social Protection, with the remaining €41m cost met by the Exchequer.

Analysis undertaken using SWITCH, the ESRI tax and benefit model, to simulate the impact of the carbon tax increase and the compensatory welfare package estimates that the net impact of the combined measures is progressive. <u>Households in the bottom four income deciles will see all of the cost of the carbon tax increase offset, with the bottom three deciles being better off as a result of these measures.</u> This is a tangible demonstration of the Government's commitment to achieving a Just Transition.

3. Continuation of 2020 & 2021 Carbon Tax Investment Programme

As noted, additional spending of €174m will take place in 2022. This sum is based on an even annual allocation to reach additional spending of €9.5bn by 2030. However, total carbon tax spending in 2022 will be **€412m**. €218m will be spent on the continuation of those measures announced in Budget 2020 and Budget 2021, with €20m being re-profiled from the measure on pilot environmental programmes in the agriculture sector to support additional investment in social protection measures in 2022.

In Budget 2020, the Minister for Finance announced that the projected revenue raised by a €6 increase of the carbon tax in 2020 (€90m) would be ring-fenced to protect those most exposed to higher fuel and energy costs, to support a just transition for displaced workers and to invest in new climate action.

Specifically, ten programmes benefitted in 2020 from the increased funding provided by the carbon tax. These programmes ranged from increases to the fuel allowance and energy efficiency schemes targeted at energy poverty, to the creation of a Just Transition Fund and increases in the allocations to greenways and urban cycling programmes. The Government continued to fund these programmes (with one exception) in 2021 and will continue to fund these programmes in 2022.

The table below illustrates the continued allocation of carbon tax funds to individual programmes:

Table 2: Allocation of Continued Carbon Tax Investment Programme from 2020

	€ m - 2022	Department
Protecting the Vulnerable		
1. Fuel Allowance	21	DSP
2. Energy Poverty Efficiency Upgrades	13	DECC
A Just Transition		
4. Peatlands Rehabilitation	5	DHLGH
5. Just Transition Fund	6	DECC
Investing in the Low Carbon Transition		
6. Greenways/Urban Cycling	9	DoT
7. Continuation of Electric Vehicle Grants	8	DoT
8. Further Investment in EV Charging Infrastructure	3	DoT
9. ODA - Green Climate Fund	2	DECC
10. Green Agricultural Pilots	3	DAFM
Total Expenditure	**70**	

Budget 2021 saw a €7.50 increase in the carbon tax. The resulting revenues were estimated at €148m. In addition, €20m from the revenues generated in 2020 was available for allocation. This reallocation arose as the Local Authority housing upgrade scheme in the Midlands was a once-off pilot scheme to determine the savings that might be obtained through the aggregation of energy efficiency upgrades to larger batches of public sector housing. On its conclusion, the funding provided for the scheme was re-prioritised.

This meant that €168m was available for new carbon tax spending measures in 2021. In 2022,

€148m will be allocated to continue this investment programme. The only change being made is that Budget 2021 allocated carbon tax funds to pilot environmental programmes in the Agriculture sector. The Department of Agriculture, Food and Marine has advised that the results of these schemes will be used to inform the Government's implementation programme for the new Common Agricultural Policy 2023 – 2027. This will be published later this year and will take effect from 2023 onwards.

As such the Department of Agriculture deferred any carbon tax allocation for 2022, save the continuation of the 2020 funding of €3m for green agricultural pilots. This funding is being used to increase the knowledge base and baseline data for climate and environment, identifying our carbon rich soils through a peat mapping project, a soil moisture monitoring network, and the monitoring of greenhouse gas emissions on farmed lands.

The €20m that would be available for the continuation of 2021 agricultural pilot schemes in 2022 has been allocated to additional measures to address energy poverty in the Department of Social Protection.

However, as noted the Results Based Agri Environment Pilot (REAP) will continue in 2022, with the co-funding requirements met directly by the Exchequer, rather than being funded directly by the carbon tax.

The table below illustrates the continued allocation of carbon tax funds to individual programmes:

Table 3: Allocation of Continued Carbon Tax Investment Programme from 2021

	€ m - 2022	Department	€ m - 2021
1. Investment in Residential & Community Energy Efficiency	100	DECC	100
2. Targeted Social Protection Interventions	48	DEASP	48
3. Pilot Environmental Programmes in Agriculture	0	DAFM	20
Total Expenditure	**148**		**168**

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