

**Evidence to Environmental Audit Committee inquiry  
2007 Pre-Budget Report and Comprehensive Spending Review**

**From Friends of the Earth England Wales and Northern Ireland**

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**Friends of  
the Earth**

**Introduction**

We welcome the opportunity to respond to this inquiry, and the Environmental Audit Committee's continued scrutiny of the Treasury's approach to the environment.

We are deeply concerned that despite the Stern Review's clear conclusion that action on climate change is the "*pro-growth strategy*", and that "*there is still time to avoid the worst impacts of climate change if we take strong action now*", the Treasury is still taking a remarkably complacent and piecemeal approach to tackling climate change. In summary, there are five areas of concern to us.

First, the Comprehensive Spending Review was particularly disappointing in that so few changes were made to reflect the Stern Review's analysis. The Stern Review was very clear that urgent action is needed on climate change, not least to correct many market failures, particularly on energy and energy efficiency policy. In this context it was very surprising to see so little help given to individuals and so few strong signals sent to business and industry wanting to go green, introduce energy efficiency measures or use new technologies.

In a letter to The Chancellor in the run up to the PBR, Friends of the Earth pointed out the importance of such signals for the business community. We cited a recent report by PricewaterhouseCoopers which concluded that just over half of the companies surveyed (51%) are not confident in making long-term investment decisions in the context of the current environmental tax and regulatory framework, and that current environmental incentives in the tax system are seen as unclear, too complex and fail to motivate behavioural change.

Second, on taxation more generally there was again very little progress, after the encouraging signs at Budget 2007. Friends of the Earth welcomed the decision at the Budget to announce in advance 3 years of above inflation increases in fuel duty. The Chancellor missed an opportunity to send a very strong signal to households and industry by not stating that these rises will continue after 2009.

There were in addition no tax breaks or spending announcements for households wanting to invest in energy efficiency, despite Stern's firm conclusion that major policies are needed to overcome market failure in this sector. The latest official figures on tax shifts show that the environmental tax take is just 7.7% of total taxes (2005), down from 9.4% in 1997, despite the Government's commitment to increase this percentage share.

Third, the "implementing the Stern Review" document is largely a rehash of existing measures, with nothing to suggest that the urgent message in the Stern Review is going to translate into strong policies. It does not set out new policies to address the concerns of Stern regarding market failure in the energy sectors and energy efficiency. In addition the report presents a purely one-sided view – it trumpets the good measures the Government is doing, but fails to address the policies which negatively affect the UK's carbon emissions.

This relates to our fourth major concern, which is that climate change still appears to be seen within Government as predominantly an environmental issue; which misses the strong

connections with other Departments' policies. This failure to connect the environment with broader policy is a main reason for the UK's failure to cut carbon emissions in the last ten years. Chapter 4 of the PBR, on future economic prosperity, makes only cursory passing mentions to climate change - despite the Stern Review making it absolutely clear that tackling climate change is a central economic issue, and a critical determinant of the UK's future growth (eg "tackling climate change is the pro-growth strategy"). There is little to suggest that Govt is looking to pick policies which integrate progress on multiple PSAs - instead we are most likely to see the continuation of existing practice, where failure on one PSA is treated as the price worth paying for progress on another. This would be unacceptable policy-making in normal circumstances, but even more so in the face of a threat as urgent as climate change.

Finally, we are disappointed that the Government still continues to hide behind its conjuring trick of not including emissions from international aviation and shipping in its assessment of progress. These are real emissions - their non-inclusion gives an extremely misleading and rose-tinted picture of what policies are required in future for the UK to do its part in preventing dangerous climate change. Hiding behind the UNFCCC's failure to come up with a methodology for assigning emissions to countries is a simply unacceptable response for a Government wishing to proclaim itself a world leader on tackling climate change.

### **Areas in detail:**

#### **1 HM Treasury's report on implementing the Stern Review.**

We are concerned that Treasury is misapplying the Stern Review's conclusions on the use of price. Stern is quite clear that the purpose of the price mechanism, and other policies, is to deliver on an overall goal: "*A long-term stabilisation target should be used to establish a quantity ceiling to limit the total stock of carbon over time. Short-term policies (based on tax, trading or in some circumstances regulation) will then need to be consistent with this long-term stabilisation goal*" (p315). In other words, the carbon cap determines the price and other policies. However, the Treasury's October 2007 Implementing Stern document says the opposite. It argues that the basis of the carbon price is "*to reflect the damage caused by emissions and to require Governments businesses and individuals to meet the costs they impose on the environment*" (p10), in other words, the price determines the cap. The implications of this fundamental difference between Treasury and Stern are highly significant.

You only need to look at the surface transport sector - where for example the effective price of carbon is far higher than the stated damage costs, and where emissions continue to rise - to see that such an approach does not in any way guarantee that the Stern Review's "long-term stabilisation target" will be met. One reason for this is that the economics on which "damage costs" is based is highly flawed - the Social Cost of Carbon (which is also at the heart of the Government's proposed new "shadow" price of carbon) is based on monetising climate impacts - a process which is inherently bankrupt. It is not possible to monetise many of the impacts of climate change. For example, many impacts are too uncertain (will the Greenland ice shelf melt? How fast?), unmonetised (what are the financial impacts of millions of environmental refugees?) or unmonetisable (what is the value of a coral reef, or the Amazon rainforest?). DEFRA's reviews on this subject are explicit that there are large categories of impact which are simply not monetised - damage cost figures are gross underestimates and an extremely poor guide for effective policy making. One peer reviewer for DEFRA described the social cost of carbon as having "*neither a robust central estimate or a plausible upper bound...the policy usefulness of such a concept with such characteristics is effectively zero*". It is time that Treasury stopped seeing "internalising the externalities" as the policy goal for use of carbon price. The policy goal for using carbon price should be instead "ensuring the country's carbon budgets and long-term climate goals are met". The failure of the internalising externality approach is most blatantly apparent when looking at the DfT's recent emissions costs assessment, where it is stated that the purpose of measuring carbon emissions

is simply to compare the monetised value of these emissions with the tax take from aviation, not to deliver any environmental objective.

In effect, carbon price is determined by the cap for EUETS, but in other sectors it is crucial to ensure that price is used to help deliver on an overall economy-wide cap, not simply to internalise a poorly calculated externality.

We are also concerned that the paper does not provide a coherent overall picture of action on climate change. Section 4.66 for example mentions savings of “up to 1.1 MtCO<sub>2</sub> per year” from APD measures. However, these are savings against a baseline which assumes major increases in aviation emissions, increases which are in large part due to Treasury taxation policy which has meant that in the last ten years aviation has got cheaper in real terms. In order to meet the targets in the proposed Climate Bill, the Government needs a strategy which considers all of its policies, not just the positive ones.

## 2 Comprehensive Spending Review

The Nov 2006 Treasury document Long term opportunities and challenges for the UK set out that, for example, the annual costs of flooding to UK homes and businesses and infrastructure could increase... “...a range of costs from 2 to 27 times current spending levels by the 2080s, depending on emissions trajectories...”. This report also outlined that impacts would be worse in developing countries. The Stern Review also advocated major policy measures to tackle market failures, including global quintupling of spending support for deployment of new technologies, and doubling of R&D spending, as well as setting out that the costs of inaction would be around 5-20% of annual GDP, with costs of action at 1% of GDP.

In this context it was deeply disappointing that so little priority was given to climate change at the CSR. The majority of DEFRA’s extra spending is to flood defences (ie dealing with the impacts of climate change, not preventing it). The details of the Environmental Transformation Fund are still very vague, but even if this is new money, or going to sustainable technologies, it would be an order of magnitude too low. There is also no sign, despite some extra money for greener transport modes, that the DfT’s overall spending will be any less carbon-intense than it was before. Neither was there any spending help for householders or business wanting to implement energy efficiency improvements or install cleaner technologies.

We note that according to Treasury figures 2006-2007 spending on “non-fossil fuels and sustainable energy” was £73 million (compared with £517 million spent on nuclear<sup>1</sup>), and that DEFRA spending on fuel efficiency grants was just £332 million. Overall, annual Government spending is £587,000 million. The Prime Minister said this week: “*The climate change crisis is the product of many generations, but overcoming it must be the great project of this generation*”. In this context, Government spending on climate change is pitifully low, given its acknowledgement of the scale of the problem. This CSR was a massive opportunity missed.

On energy efficiency, the Government’s failure here is absolute – years and years of reviews and consultation, and at this autumn’s pre-budget and spending review almost no incentives to help people and businesses be more energy efficient, despite this being the most cost-effective strategy for the UK to pursue. The Government is well aware of the massive market failure in this area, frequently refuses to take action in other areas using the excuse that it is not “cost-effective”, yet repeatedly fails to act in this the most cost-effective and least politically controversial area of all. DEFRA has recently announced the launch of a green homes service and one stop shop for energy advice. On the face of it this seems a very

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<sup>1</sup> Primarily on decommissioning nuclear power stations and support for British Energy.

positive step and sits well with the need for it to be cheaper and easier to cut carbon emissions for homes. The scheme outlined by DEFRA in its press release looks ambitious but the funding to make it happen is not. A figure of £100m is mentioned but it is unclear whether this is new money or over what period it will apply.

It is one thing to have a service which directs householders to grants and financial assistance but this assistance needs to be available in more than token amounts. The farcical state of the Low Carbon Buildings Programme is a case in point. This sort of activity cannot be done on the cheap.

On renewable energy policy, we remain concerned that the Government is not behind this major economic opportunity. The Prime Minister may have recommitted the UK to meeting its share of the EU renewables target, which we welcome, but we are concerned that the UK will still be lobbying for this share to be as low as possible. We feel the leaked BERR memo on renewables over the summer is indicative of an old-fashioned anti-renewables mind-set – the document asserts high costs of renewables, ignoring the economic and job benefits of a rapidly expanding new sector of the economy, the economic benefits of reduced climate impacts, and the potential for stronger policies on energy efficiency to massively reduce those costs (the targets is for a % of demand; energy efficiency policies reduce demand and therefore the amount of renewables needed). They also neglect to mention that the reasons costs for renewable energy technology can appear to be higher than more established technologies is because of existing market failures, which the Stern Review devotes whole chapters to outlining. If BERR think there are high costs, it should amend its policies to correct the market failures that cause these high costs, not use them as an excuse to water down its commitments. This is the amend-policies approach favoured in the Treasury's Implementing Stern report, which argued *“One of the important roles for complementary policies on technology and behavioural change is to make it less expensive to reduce emissions overall, although such policies can also have other important co-benefits. Where caps are not yet at the optimal level for the desired environmental outcome, such cost reductions can help to set them at a more ambitious level in future.”*

The leaked memo also states that meeting a 20% renewables target would be bad because it would mean the EU would be delivering more than its total 20% carbon reduction target. This view is indicative of the can't-do attitude apparently rife within BERR on climate change – the possibility of over-achieving a target is an argument for not implementing a policy, but the converse – under achieving a target - is an argument for dropping the target.

The recent speech by Gordon Brown seemed to draw a line under the leaks. This was welcome but the extent to which it follows through into policy changes has yet to be seen. The forth-coming Energy Bill and the Budget will be key indicators. Willingness by the Government to look seriously at a feed-in tariff would also indicate that the rhetoric is translating into action.

### **3 Public Service Agreements (PSAs)**

We are extremely concerned that the new PSAs will not help ensure all sectors play their part in tackling climate change. In particular we do not see how the delivery strategies for the PSAs are compatible with the targets to be set in the Climate Change Bill. For example, PSA 27 on Climate change states that the DfT's role is to ensure only that *“transport policies balance the increasing demand for travel against protecting the environment”* (our underlining). Yet we have seen from experience that “balancing” these demands in, for example, the Aviation White Paper sees a strategy which allows for a greater than doubling increase in carbon emissions. PSA 5 on delivering reliable and efficient transport networks has a tiny section on climate impacts, which merely restates the need to “balance” these

objectives. Given that the key indicator of success of PSA 5 is benefit-cost ratios which have an inherent bias against environmental concerns, it is in our view extremely unlikely that climate change concerns will be given adequate weight in transport policy making and in PSA5.

It is a continuing major omission that the Government's strategy on productivity, set out in PSA1, focuses so narrowly on labour productivity. There are other aspects of productivity which can help the UK's competitiveness, and also environmental goals – resource and energy productivity. While it may have been the case in decades past that resource inputs were a minor element of productivity, this situation has now changed. It is becoming increasingly important for all economies to make rapid improvements in the efficiency with which they use resources and energy. This point was acknowledged by the then DTI in its old sustainable development strategy (*“improving resource productivity is an overriding priority”*, DTI SD Strategy; *“Resource Productivity is the key priority in the DTI Sustainable Development Strategy, and will be an increasingly significant area of opportunity for business for the future.”* Patricia Hewitt, DTI, 2001), however the current productivity strategy focuses entirely on labour productivity. This is a major opportunity missed, for UK businesses and the environment.

We are also concerned about the use of the “shadow price of carbon” in PSA 27 on climate change as a measure of whether a policy is effective or not. The shadow price of carbon is based on the social cost of carbon, the flaws of which are highlighted earlier in this evidence. It is right to look at cost-effectiveness, and Government should pick the most cost-effective measures unless other core Government targets are compromised. But the “cut-off” point must not be defined by the shadow price of carbon, because of its inherent flaws, but instead by being the point at which the UK's overall carbon budget is delivered. We agree that cost-effectiveness should be monitored – however there are many measures which have a very low or even negative cost, and yet these are not implemented. A policy focus should be to overcome the barriers to implementing these very cost effective measures, again, as identified by Stern.

We are also concerned about the impact of the new rules on Impact Assessment set out by Cabinet Office (and now implemented by BERR). The new guidance does state that climate change impacts must be included in policy appraisal, but insists on monetising these impacts in a way which ensures they can always be traded-off. Treasury and DfT's recent reviews of the Social Cost of Carbon and of transport appraisal also do not appear so far to have taken into account the need for emissions not to be exceeded. This is a fundamental clash of an old-fashioned approach that different objectives can be traded-off, and a post-Stern approach where objectives have to be integrated. We see policy structures which lead to continued trade-off of objectives rather than integration as being one of the major problems of delivery of the new set of PSAs.

#### **4 Budget measures - General**

Budget 2007 included increases in all the main environmental taxes, and it was hoped that this signalled a post-Stern realisation of the need to strengthen environmental tax policy. However this PBR was a major set-back. This was especially disappointing given positive speeches at Labour Party Conference by the Prime Minister, Chancellor and Secretary of State for Business, Enterprise and Regulatory reform (see appendix).

In addition to the failure to send strong signals to the business community about the future direction of policy the Government's continuing refusal to use environmental taxation to make it easier for people to go green in their homes is disappointing – for example measures such as Stamp Duty Rebates. Lack of basic insulation measures affects over 8 million households. There were no financial incentives for people wanting to install green

energy or electricity in their homes – such as announcements on feed-in-tariffs, or increases to the grants available to people. There was almost nothing to help people go green.

Overall, although the Government has some good environmental tax initiatives, they are more than balanced by tax policies acting in the opposite direction – such as aviation taxation. There is not a coherent strategy here to use taxation in conjunction with other policies to deliver on a carbon budget. We feel that such a strategy will be an essential and urgent requirement for delivering the Climate Bill's targets.

We also feel that the Government continues to miss the opportunity to sell green taxes better. Environmental taxes are repeatedly portrayed as being stealth taxes, which makes it harder to justify them politically. We advocate that the Government recommits itself to its 1997 statement of intent on environmental taxation, and sets out a strategy for increasing taxes on pollution, explicitly linked to cuts in other taxes – the Environmental Tax Reform agenda. Polls repeatedly show that green taxation is far more publically acceptable when linked to cuts in other taxes. A recent BMRN poll for the new Green Fiscal Commission found 77% support for green taxes if other taxes are reduced at the same time. Opposition was at 9%.

Finally, we note the Government's determination to implement "cost-effective" policies on climate change. We believe this offers an additional justification for stronger environmental tax policies – in a 2006 DEFRA study of cost-effectiveness in the transport sector, the road fuel duty escalator was by far the most cost-effective policy – at minus £250 tC saved – compared with major costs for policies such as the industry's voluntary agreement on new car fuel efficiency.

## **5 Budget measures - Aviation**

The decision to reform APD was welcome, if it ensures that aviation taxation as a whole increases - aviation is currently massively under-taxed through its exemptions from VAT on duty on kerosene. But the decision to freeze APD in the interim rather than raise it does not send a strong message that the Government intends to curb aviation's spiralling emissions.

We welcome the Government's work in pressing for the inclusion of aviation in EUETS. Assuming the current problems with EUETS can be rectified, it will still be necessary for an increased use of aviation taxation – aviation will not be included in EUETS for some years, and the current proposals are for aviation to receive permits based on the average of 2004/06 emissions – representing a 100% increase over the 1990 cap imposed on other sectors in the ETS. As the October 2007 Treasury paper on Stern also points out, other measures beyond trading are in any case needed to help reduce costs in future years: *"One of the important roles for complementary policies on technology and behavioural change is to make it less expensive to reduce emissions overall, although such policies can also have other important co-benefits. Where caps are not yet at the optimal level for the desired environmental outcome, such cost reductions can help to set them at a more ambitious level in future."* (section 1.17)".

In this context, a reformed APD taxed per plane rather than per passenger could improve passenger loading levels and also drive improved plane efficiency, helping to reduce future costs. This reformed APD should raise higher revenues than the present APD – to help ensure that there is an overall effect to combat overall demand increases.

## **6 King Review on cars**

We welcomed the commissioning of the King Review of Low Carbon Cars and believe that the interim report, published alongside the Pre-Budget Report, is a good starting point. We believe that low carbon cars must make a significant contribution to cutting carbon emissions

from transport. We look forward to Part 2 of the report and to action in next year's Budget to help the move towards low carbon cars.

However, in helping to create the longer-term pathway, the Government must not take its eye off the short-term priority of ensuring that the EU sets tough, mandatory targets for cutting carbon dioxide emission from new cars over the next decade. The Government's support for a target beyond 2012 is welcome as this is needed to give the car industry a clear target that fits in with its R&D timelines. However we are dismayed that the Government is calling for a target that new cars emit on average no more than 100 grammes of carbon dioxide per kilometre (g/km CO<sub>2</sub>) by a date somewhere between 2020 and 2025. We believe that the target date should be set for 2020 and that average emissions by this date should be no more than 80g/km CO<sub>2</sub>. This is technologically feasible, gives the industry plenty of time for R&D, and given the scale of cuts required, essential to ensure the car industry makes a real contribution to cutting carbon emissions from transport.

## **7 Silo treatment of the environment**

Our final point is to raise concern at the continued "silo" treatment of the environment, particularly climate change, within HM Treasury's reports. Stern is clear that climate change is a major economic threat, and that action on climate change is the "pro-growth strategy", yet climate change is still confined almost entirely to Chapter 7 of the PBR. Chapter 4 of the PBR on "sustainable growth and prosperity" is in some ways far more important for tackling climate change. Chapter 4 of the PBR mentions in passing that tackling climate change "presents opportunities for business", but set out no details of how businesses can be helped to take those opportunities, as Stern advocated. The productivity PSA does not even mention resource or energy productivity.

Here was a great opportunity to set out how the Government will lead the UK's transition to being a world-leading low-carbon economy, creating hundreds of thousands of jobs in new technologies, delivering massive productivity gains from energy efficiency, and making the UK economy far more resilient to global shocks in oil prices, having a better balance of payments and greater security of energy supply from reducing our dependence on imported fuel. This major economic opportunity has not yet been grasped by Government. Setting out this positive economic vision and policies to deliver it would have two major additional benefits. First, it would signal that climate change is no longer an issue to be treated just as an economic threat, but as an economic opportunity. This would transform the current political climate where every action on climate change is seen through a false frame of being "bad til proven otherwise". Second, it would signal to the public at large that although climate change is a big issue, it is one that the Government is genuinely committed to lead upon. Many people feel fatalistic about the likelihood of stopping climate change, or that their own efforts would have much effect. Overcoming this fatalism is to a large degree about showing that it can be done, that individual efforts are part of a genuinely bigger whole. Ultimately it is the Government which must lead the way, and with action, not rhetoric.

**ENDS**

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## **Appendix**

### **Quotes from senior Labour politicians, September 2007**

#### **Gordon Brown speech to Labour Party Conference:**

*“As we set out on the next stage of our journey this is our vision: ... a world leader in energy and the environment from nuclear to renewables...”*

*“Perhaps the biggest challenge for the new politics is to show how we as a community can join together to safeguard the environment, to turn the silent, rising tide of global warming...”*

*“And by investing in energy efficiency, renewables, carbon capture, clean fuels and new environmental technologies, I want Britain to lead in carbon-free vehicles, carbon-free homes and carbon-free industry. And I want the new green technologies of the future to be the source of British jobs in British businesses.”*

#### **Alistair Darling to Labour Party Conference:**

*“We are committed to a low carbon future, here and abroad. That's why we must encourage more low carbon industries. That's why we want all new houses to be zero carbon by 2016. And, that's why we will be the first country in the world to introduce legally enforceable carbon budgets.”*

*“On energy, the three big imperatives are to maintain security of supply, ensure affordability and drive down carbon emissions. To deliver all three at the same time, is one of the great challenges of the 21st century.”*

*“Our spending plans will help us to do more to meet our environmental obligations. That must now be one of our guiding priorities. The Stern Report has shown us how economic growth can be environmentally sustainable.”*

*“Let me give you a practical example of how that can be achieved. In transport. Britain's railways are already carrying record numbers of passengers because of the investment we are making. Good for passengers. Good for the economy. Good for the environment. That's the kind of virtuous circle we have to pursue in every sector of the economy.”*

#### **John Hutton to Labour Party Conference:**

*“A country of change must be capable of confronting the most fundamental challenge of all - not simply sustaining economic growth in Britain in the years ahead, but tackling the immense challenge of climate change. Nothing is more fundamental to our economy or our*

*society than how we source our energy.*

*“We must now make the transition to a low carbon economy. Government will play its part.*

*“The Government Gordon Brown leads will not be among those who say they want to tackle global warming by moving to low carbon energy sources but then oppose every opportunity to do so.*

*“And the Government Gordon Brown leads will drive forward with delivering a step change in our use of renewable energy.*

*We must lead at home as well as abroad. A country of change must be prepared to embrace tomorrow's energy sources...*

*...I want British companies to lead the way in developing those new technologies and seizing those opportunities. I want to consider how best we can equip British companies to maximise the potential of new markets in green business.*

*“A thriving manufacturing sector - supplementing the blue and white collar jobs of today with a new wave of 'green collar jobs' tomorrow.*