

2 February 2018

Dear Paul Wheelhouse MSP, Lesley Griffiths AM and Noel Lavery,

Business Energy Tax Review and the CRC Energy Efficiency Scheme

I am writing to provide the Committee's advice regarding the impact of the business energy tax review, following Paul Wheelhouse's letter of 20 June 2016, the publication of BEIS's impact assessment, and subsequent request to expand the scope of this advice to Wales and Northern Ireland.

In summary, the net impact of the new package is to provide a small reduction in emissions. An instrument – the CRC – that might have been used to produce further emissions reductions has, however, been lost. There is potential for DAs to use reporting schemes to go further, but it would be best that this is done as co-operatively as possible with UK proposals for Streamlined Energy and Carbon Reporting to ensure the greatest harmonisation of requirements. There is also potential for further ambition in the public sector, including through the devolved reporting schemes.

We expect that the combined new package of measures will lead to a small increase in direct emissions savings relative to the previous policy package: of 0.02Mt CO₂e per annum on average in Scotland, 0.01Mt CO₂e per annum on average in Wales and 0.01Mt CO₂e per annum on average in Northern Ireland, between 2019 and 2035. This small increase is equivalent to additional annual reductions of around 3-6% of the direct emissions currently covered by the CRC scheme. Although the precise impact is uncertain, it is reasonable to expect that the level of abatement will be broadly equivalent to the previous policy package.

The scale of these changes, by themselves, do not suggest a need to revise overall emissions reduction targets. Going further will require strong policy on the public sector and continued close-working with the UK Government on the Streamlined Energy and Carbon Reporting (SECR) proposals. As part of this, there would be benefits if the UK Government develop the SECR proposals (and, where relevant, public sector reporting proposals) jointly with the Devolved Administrations, to ensure that where possible distortions are minimised, and to address the loss of equivalent powers under the CRC scheme relating to the UK reporting framework.

The existing policies and proposals in Scotland, Wales and Northern Ireland to support SMEs to take up energy efficiency measures mean that they are relatively well placed to manage the impacts on energy bills, provided these schemes remain in place. Further support for public bodies in Northern Ireland to take up energy efficiency measures would be beneficial.

Whilst in principle a mandatory public sector target could be combined with a reduction on Climate Change Levy (CCL) rates, it is not clear that the existing Climate Change Agreements (CCAs) are well suited to the public sector as they are designed as sectoral agreements for industry.¹ The lack of a UK-wide replacement for public sector reporting is mainly an issue for Northern Ireland where there is no equivalent reporting scheme in place, or proposals for one.

The subsequent sections set out the context and analysis underpinning our advice.

Background

You sought advice on:

- The impact of the changes on emissions in each of the Devolved Administrations (DAs) and the distribution of impacts (including how the changes have affected costs on businesses and the public sector and how incentives for energy efficiency improvements have been affected).
- Whether the UK Government's proposals to abolish the CRC scheme in the DAs, and extend the CCL regime would have any impact on the incentives for the public sector in the DAs to reduce greenhouse gas emissions, and whether allowing this sector to enter into Climate Change Agreements would help to reduce public sector emissions.
- Whether the UK Government's proposal to abolish the CRC scheme and extend the CCL would have any impact on the DAs being able to meet their emission reduction targets, along with any implications for revising the targets, and whether separate or additional measures would need to be adopted.

We have considered these in turn and outline our analysis and subsequent advice below.

Impact of changes on overall emissions, and distribution of impacts

The abolition of the CRC scheme in April, introduction of the Streamlined Energy and Carbon Reporting (SECR) scheme and extension of the CCL will result in two key sets of impacts:

1. Abolishing the CRC means that the previously forecast reductions in gas and electricity consumption from business and the public sector under the scheme will no longer be realised, leading to higher carbon emissions than if the policy had remained in place.
2. This impact is counteracted through an increase in the level of CCL taxation² and through the introduction in 2019 of SECR³, which should both decrease energy and emissions.

¹ The CCAs are tailored to energy-intensive sectors and based on energy process benchmarking.

² Rates under the CCL are due to increase from 0.195p/kWh currently to 0.339p/kWh by 2019 on gas, and from 0.559p/kWh currently to 0.847p/kWh on electricity. Further details including other fuels and reduced rates are set out at <https://www.gov.uk/government/publications/climate-change-levy-main-and-reduced-rates/climate-change-levy-main-and-reduced-rates>

³ This is based on the assumption that option 3 from the SECR consultation is adopted, which would cover all 'large' enterprises (typically those enterprises employing more than 250 people). If option 2 were adopted

We expect that the combined package of measures will lead to additional direct abatement between 2019 and 2035 of an average 0.02Mt CO₂e a year in Scotland, 0.01Mt CO₂e a year in Wales and 0.01Mt CO₂e a year in Northern Ireland. Table 1 sets out our estimate of the impact of each of the individual policy changes along with these combined totals.

Table 1 : Impact on direct emissions (Mt CO ₂ e per annum on average between 2019 and 2035)					
	CRC abolished	CCL increase	SECR	Total impact	Total impact as a % of emissions from CRC gas use
Scotland	0.04	-0.05	-0.01	-0.02	3.3%
Wales	0.01	-0.02	-0.01	-0.01	4.1%
Northern Ireland	0.01	-0.02	-0.004	-0.01	6.0%

Sources: BEIS (2017) *Impact Assessment of Streamline energy and carbon reporting framework*, DECC (2015) *Updated energy and emissions projections 2015*, BEIS (2017) *Updated energy and emissions projections 2016*, National atmospheric emissions inventory, Environment agency CRC data, CCC analysis.

Notes: The CRC impacts are based on UK-wide estimates presented in the Government's energy and emissions projections. The disaggregation by DA was estimated using data from the SECR Impact Assessment, the National Atmospheric Emissions Inventory and CRC data from the Environment Agency. The emissions from gas consumption covered by the CRC energy efficiency scheme in the commercial, industrial and public sectors in Scotland, Wales and Northern Ireland in 2015 were 0.7 Mt, 0.2Mt and 0.1Mt respectively. Direct emissions from the public, commercial and industrial sectors in Scotland, Wales and Northern Ireland in 2015 were 14 Mt, 16Mt and 3Mt respectively. A table setting out the impact on total emissions (including the impact on indirect emissions from electricity consumption) is included in the Annex.

The **energy bill impact** will not be evenly spread across organisations, with the more significant impact on small and medium-sized organisations that fall below the annual energy consumption threshold for the CRC (Figure 1).

- The increase in CCL rates will be spread across a greater number of organisations. As a result of this change in coverage, SMEs and some smaller public sector organisations⁴ will experience the largest increase in energy costs, on both gas and electricity.
- Organisations that are currently part of the CRC will face combined CRC/CCL electricity costs reducing from around 1.3p/kWh currently to around 0.8 p/kWh to 2020, remaining constant to 2030 in real terms. Combined CRC/CCL costs on

(coverage in line with the current CRC scheme) then the combined package would lead to a smaller increase in abatement relative to the previous policy package.

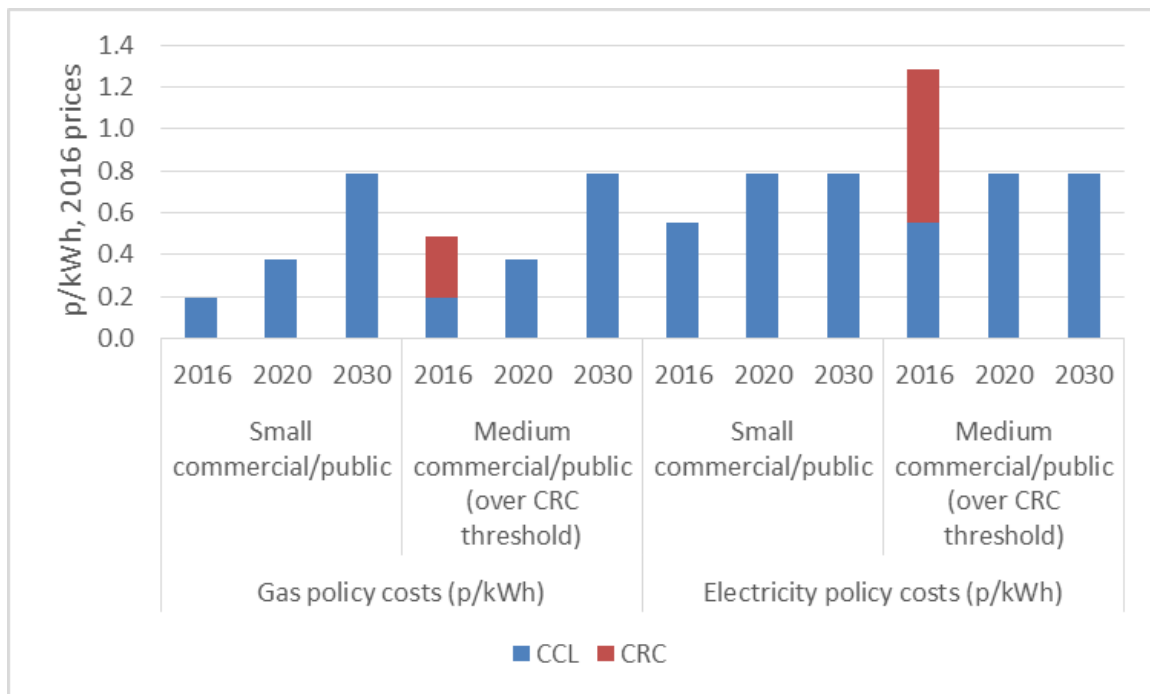
⁴ Broadly, those with energy consumption below 6 GWh/year.

gas will fall slightly to 2020, from 0.5p/kWh to 0.4 p/kWh, before rising to 0.8 p/kWh by 2030, in line with the rates on electricity.

- If the coverage of business reporting is expanded as a result of the move to SECR (i.e. to include all 'large' companies, typically with more than 250 employees) then a new set of organisations will have an increased incentive to reduce emissions (along with the associated administrative costs of compliance).

This increase in costs, particularly for SMEs and small public bodies, underlines the need for strong energy efficiency policy to limit the impacts on energy bills whilst reducing emissions.

Figure 1. Impact of changes to CRC and CCL on gas and electricity policy costs, small organisation and medium-sized organisation within the CRC



Source: Analysis based on CCC (2017) *Energy Prices and Bills*

We have previously recommended in advice to BEIS⁵ that if the CRC Scheme is abolished, then this should be accompanied by measures to enhance the policy landscape to stimulate energy efficiency and carbon reduction in SMEs.

Scotland and Wales currently have policies and proposals in place to support SMEs manage the impacts of the increase in CCL through energy saving measures, including the Resource Efficient Scotland SME loan scheme,⁶ and Carbon Trust interest free loans in

⁵ Letter to Paul van Heyningen, 11th March 2016, Re: Business Energy Tax Review and the CRC Energy Efficiency Scheme, available at: <https://www.theccc.org.uk/wp-content/uploads/2016/03/Letter-from-Matthew-Bell-to-DECC-on-the-abolition-of-the-CRC-Scheme.pdf>

⁶ <http://www.resourceefficientscotland.com/SMELoan>

Wales and Northern Ireland.⁷ **The existing policies and proposals in Scotland, Wales and Northern Ireland to support SMEs to take up energy efficiency measures mean that they are relatively well placed to manage the impacts, provided these schemes remain in place.**

Impact on public sector

In terms of the **energy bill impact**, smaller public sector organisations below the CRC threshold will face increased energy costs, because they were not previously subject to the tax element of the CRC but will pay the increased CCL rates. In Scotland, this higher tax burden applies to around 55% of the public sector's gas consumption, in Wales 40% and in Northern Ireland 55%. For comparison, in England it will apply to 70% of public sector gas consumption.⁸

Scotland and Wales are well placed to manage the impacts on the public sector, with Salix energy efficiency funding available.^{9,10} In addition, for public sector bodies Wales has the Re:fit Cymru scheme.¹¹ However, there is currently no equivalent scheme for the public sector in Northern Ireland.

Further support for public bodies in Northern Ireland to take up energy efficiency measures would be beneficial.

Whilst in principle a mandatory public sector target could be combined with a reduction on CCL rates, it is not clear that the existing Climate Change Agreements (CCAs) are well suited to the public sector as they are designed as sectoral agreements for energy-intensive industry.¹²

In terms of **reporting**, the SECR scheme will not apply to the public sector and therefore not replace the reporting element of the CRC scheme for the public sector. Public sector reporting schemes are now devolved:

- In Scotland the existing Public Bodies Reporting Requirement means that there is less of a risk of a gap on when the reporting requirement for public bodies under the CRC expires in March 2019.
- The Welsh Government has consulted on public sector emissions reporting, as part of a consultation on a public sector emissions target, although it has yet to set out a policy.
- Whilst the UK Government's recent Clean Growth Strategy (CGS) commits to introducing a new voluntary target for the public sector of 30% by 2020/21, together with associated reporting scheme, these proposals only apply to England. The CGS proposals include a potential mandatory target from 2025 to be more ambitious on public sector abatement than current CGS proposals.

⁷ <https://www.carbontrust.com/client-services/programmes/finance/interest-free-loans-wales/>

⁸ These estimates are derived from direct emissions. Public sector electricity consumption data is not available for Scotland, Wales and Northern Ireland.

⁹ <https://www.salixfinance.co.uk/loans/scotland-loans>

¹⁰ <https://www.salixfinance.co.uk/loans/welsh-loans>

¹¹ <http://gov.wales/topics/environmentcountryside/energy/efficiency/re-fit-cymru/?skip=1&lang=en>

¹² The CCAs are tailored to energy-intensive sectors and based on energy process benchmarking.

The lack of a UK-wide replacement for public sector reporting is mainly an issue for Northern Ireland where there is no equivalent reporting scheme in place, nor proposals for one.

Implications for meeting targets and principles for future policy design

There are two potential arguments for revising the Scottish and Welsh targets following the changes to the CRC/CCL framework.

The first consideration is if the changes to the policy framework imply significantly lower abatement, and there is not the ability to make up the shortfall.

Based on current estimates, there is not a case for revising targets, as the new policy framework should deliver an equivalent or increased level of abatement relative to the previous framework.

The second consideration is if the changes mean that there are reduced powers and/or fewer options available for the DAs to reduce emissions as a result of the changes. This is particularly an issue where there is ambition to go further than the UK in reducing emissions.

The changes mean that the DAs have lost the CRC as a statutory instrument. Instead, there are proposals for SECR and they retain the power to set up their own reporting schemes.

Scotland currently has higher overall ambition than the UK. Scotland's overall 2030 emissions target implies ambition to reduce emissions from the public, commercial and industrial sectors by around 64% from 1990 levels, compared to an 63% reduction at UK level.

- Scotland is aiming to go further than the UK average in terms of abatement with a target to reduce total Scottish emissions by 61% by 2030 from 1990 levels compared to 57% for the UK as a whole. We estimate that this corresponds to a 64% reduction from the public, commercial and industrial sectors by 2030, compared to 63% at the UK level.
- Wales has a legislated target of reducing emissions by 80% by 2050 from 1990 levels. Based on our 2017 advice to the Welsh Government, this implies achieving a 45% reduction by 2030. For the public, commercial and industrial sectors this implies a 44% reduction between by 2030 from 1990 levels.
- The Northern Ireland Executive, in its Programme for Government (2011-2015) has set a target of continuing to work towards a reduction in greenhouse gas emission by at least 35% by 2025 from 1990 levels.

Whilst it is within the power of Scotland, Wales and Northern Ireland to set up reporting schemes covering business energy use, it would be preferable to have a smaller number of total schemes, provided that these are suited to the needs of the Devolved Administrations. This reflects that the case for rationalising the policy framework is to ensure consistent price signals that clearly encourage affordable, low-carbon choices, together with streamlined, consistent information and reporting.

There would be benefits therefore if the UK Government develop the SECR proposals and, where relevant, public sector reporting proposals, jointly with the Devolved Administrations, to ensure that where possible distortions are minimised, and to address the loss of equivalent powers under the CRC scheme relating to the UK reporting framework.

In the case of the public sector, the arguments for having a consistent reporting framework do not apply so strongly. Moreover, the ability to go further in terms of public sector ambition and policy is a key lever which the DAs can use in order to go further than the UK in reducing emissions. This could also help demonstrate public leadership and harness the potential of public sector procurement.¹³

On the question of whether there is a basis for revising targets due to the changes in DA powers, we recommend not to revise the targets currently, but to aim to manage the impacts of the changes through strong policy at DA level on the public sector, and continued close-working with the UK Government on SECR proposals.

Given that this letter is relevant for UK policy, I am copying to Michael Rutter, Deputy Director at the Department of Business, Energy and Industrial Strategy.

Yours sincerely,



Lord Deben, Chairman of the Committee on Climate Change

¹³ CCC, 2016, *Next Steps for UK Heat Policy*, <https://www.theccc.org.uk/publication/next-steps-for-uk-heat-policy/>

Technical annex

This supplementary annex includes the data used in our assessment and further detail on our analysis and results. The current coverage of the CRC Scheme within each of the Devolved Administrations is set out in Table A1.

Table A2 shows a breakdown of the impact on emissions at DA level, including indirect emissions.

Our assessment of the comparative emission reduction ambition at DA level is set out in Table A3.

		Scotland	Wales	Northern Ireland	England
Electricity (TWh)	Public sector	2.4	0.8	0.7	10.0
	Private sector	2.1	1.1	0.2	50.1
Gas (TWh)	Public sector	2.6	1.1	0.4	10.3
	Private sector	1.2	0.1	0.1	21.6

Source: Environment Agency

	CRC abolished	CCL increase	SECR	Total impact
Scotland	0.05	-0.06	-0.03	-0.04
Wales	0.02	-0.02	-0.01	-0.01
Northern Ireland	0.01	-0.01	-0.01	-0.01

Sources: BEIS (2017) *Impact Assessment of Streamline energy and carbon reporting framework*, DECC (2015) *Updated energy and emissions projections 2015*, BEIS (2017) *Updated energy and emissions projections 2016*, National atmospheric emissions inventory, Environment agency CRC data, CCC analysis.

Notes: The CRC impacts are based on UK-wide estimates presented in the Government's energy and emissions projections. The disaggregation by DA was calculated using data from the SECR Impact Assessment, the National Atmospheric Emissions Inventory and CRC data from the Environment Agency.

Table A3. Emissions reductions under national targets and/or CCC scenarios (% reduction from 1990 levels)

	Scotland	Wales	Northern Ireland	UK
Targeted % reduction in economy-wide emissions by 2025, from 1990 levels	55%	35%	35%	51%
Targeted % reduction in economy-wide emissions by 2030, from 1990 levels	61%	45%	No target	57%
Targeted % reduction in economy-wide emissions by 2050, from 1990 levels	80%	80%	No target	80%
% reduction in emissions from the combined public, commercial and industrial sectors by 2030, from 1990 levels, under CCC scenarios consistent with overall country ambition	64%	44%	No scenario	63%

Sources: CCC analysis

Notes: Scotland's legislated target for 2050 is 80%. However, in June 2017, the Scottish Government announced its intention to adopt a more ambitious 2050 target for a reduction of 90% on 1990 levels. The economy-wide emissions targets under Scotland's existing climate legislation have been set on a 'net' basis. The percentage reduction in emissions from the combined public, commercial and industrial sectors by 2030, is calculated on an actual emissions basis. All targets for Wales are on an actual emissions basis.