



House of Commons  
Environmental Audit  
Committee

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**Government Response to the  
Committee's Seventh Report  
of Session 2006–2007:  
Beyond Stern: From the  
Climate Change Programme  
Review to the Draft Climate  
Change Bill**

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**Ninth Special Report of Session 2006–07**

*Ordered by The House of Commons  
to be printed Tuesday 30 October 2007*

## The Environmental Audit Committee

The Environmental Audit Committee is appointed by the House of Commons to consider to what extent the policies and programmes of government departments and non-departmental public bodies contribute to environmental protection and sustainable development; to audit their performance against such targets as may be set for them by Her Majesty's Ministers; and to report thereon to the House.

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### Powers

The constitution and powers are set out in House of Commons Standing Orders, principally Standing Order No. 152A. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk).

### Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at: [www.parliament.uk/parliamentary\\_committees/environmental\\_audit\\_committee.cfm](http://www.parliament.uk/parliamentary_committees/environmental_audit_committee.cfm).

A list of Reports of the Committee in the present Parliament is at the back of this volume.

### Committee staff

The current staff of the Committee are: Mike Hennessy (Clerk); Sara Howe (Second Clerk); Richard Douglas (Committee Specialist); Oliver Bennett (Committee Specialist); Susan Monaghan (Committee Assistant); Caroline McElwee (Secretary); and Jonathan Wright (Senior Office Clerk).

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### References

In the footnotes of this Report, references to oral evidence are indicated by 'Q' followed by the question number. References to written evidence are indicated by page number as in 'Ev12'. number HC \*-II

# Ninth Special Report

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## **Beyond Stern: From the Climate Change Programme Review to the Draft Climate Change Bill— Government Response**

1. The Environmental Audit Committee published its report on *Beyond Stern: From the Climate Change Programme Review to the Draft Climate Change Bill* on Monday 30 July 2007 as HC460.
2. The Government's Response to the Committee's Report was received on Thursday 4 October 2007 in the form of a memorandum to the Committee. It is reproduced as an Appendix to this Special Report.

## Appendix - Government response

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I am grateful to you and to your Committee for your considered report, published on 30 July, into the review of the Climate Change Programme and the draft Climate Change Bill.

Phil Woolas wrote to inform you that the Government response to the Committee's recommendations on the Climate Change Bill will be handled by means of a Command Paper, due to be published this autumn, which will also contain our response to the EFRA and Joint Committee Reports. I am pleased to attach the Government response to the rest of the recommendations (numbers 1 – 15).

### **Introduction**

(i) The Government welcomes the Environmental Audit Committee's comprehensive report into the emissions projections and cost-effectiveness analysis for the 2006 Climate Change Programme, and the draft Climate Change Bill.

(ii) The Government also welcomes the Committee's recognition of the importance of the Climate Change Bill, and agrees that it will significantly strengthen the UK's efforts to tackle climate change.

(iii) The Government welcomes the Committee's support for the main elements of the Climate Change Bill, in particular:

- pushing emissions cuts in the short, medium and long-term, through establishing emissions targets for 2020 and 2050 as well as a system of five-year carbon budgets to control emissions;
- creating the new independent Committee on Climate Change to advise Government on the optimum trajectory towards our 2050 target; and
- increasing accountability and transparency, through annual reports by the Committee on Climate Change to Parliament on progress.

(iv) The draft Bill has been subject to consultation and pre-legislative scrutiny. We are carefully considering the results of the responses to the consultation, the pre-legislative scrutiny report of the Joint Committee published on 3 August, the report of the EFRA Select Committee published on 4 July, and the relevant sections of this Report. We will publish a formal response to each of these, as well as a summary of the public consultation, ahead of introduction of a revised Bill to Parliament later in the autumn.

(v) The Government also welcomes the Committee's recognition of the valuable work being done by the Office of Climate Change in helping to improve the quality of climate change policy. To date the Office of Climate Change has completed a number of important projects, including development of the Draft Climate Change Bill, an analytical audit of issues and priorities in climate change and a review of governance structures that drive climate change policy making in government.

(vi) The Government's responses to the specific conclusions and recommendations of the Environmental Audit Committee's Report numbered 1 to 15 are set out below. The rest of the recommendations and conclusions will be addressed in the response to the Parliamentary reviews of the Climate Change Bill, noted above, expected to be published in late October.

## Conclusions and recommendations

### *Introduction*

**1. Climate change is on a different scale from any other political challenge. Its potential effects could be both physically and economically devastating. It is not just the size but the timing of these effects that poses such a challenge. The lag between emitting CO<sub>2</sub> and experiencing the resulting rise in temperatures means we must take bold action today in the hope of preventing dangerous climate change occurring in the future, the impacts of which could be irreversible. Timing is also an issue given the long term planning and investments required to roll out new technologies and infrastructure, and thereby decarbonise the economy. (Paragraph 9)**

The Government agrees with the need to take action now to reduce future risks associated with climate change, as set out most recently by the Intergovernmental Panel

on Climate Change in its 4<sup>th</sup> Assessment Report. We agree that action taken now must take account of the potential irreversibility of climate change impacts and the potential magnitude of the losses involved, both human and economic, for biodiversity and physical impacts. The Government accepts the need for long term planning in the development of low emitting technologies. This is why the Government has adopted an emissions reduction target for 2050 that is already ambitious, and we anticipate, through the draft Climate Change Bill, possible amendment of the long-term target to take account of developments in climate change science or international law. It is also why the UK, via the United Nations Framework Convention on Climate Change, the G8 and bilateral contacts, plays a leading role in the international negotiations to secure the widest possible participation in international climate change agreements since without this participation, whatever action the UK takes will have little effect on the level of greenhouse gases in the atmosphere.

**2. These challenges underline the vital importance of getting the structures and systems which support UK climate change policy right. The UK's carbon reduction framework must be firmly embedded in the structures of government and the economy, so as to provide long term certainty and continuity. This necessitates policy-making which seeks to establish and draws on political consensus, which is based and updated on the best available science, and which draws on a detailed understanding of the impacts of policies on emissions, the economy, and everyday behaviour. (Paragraph 10)**

The Government agrees with the points that the Committee makes. Political consensus and sound policy development can only be based on the best scientific and economic information available, which is why the UK has been one of the strongest supporters of the Intergovernmental Panel on Climate Change since its inception, and why in 2005 we initiated the comprehensive Stern Review of the Economics of Climate Change. The 2006 UK Climate Change Programme was developed following extensive consultation, is based on detailed analysis and covers all significant sectors of the economy. In 2002, the UK pioneered the world's first economy-wide greenhouse gas emissions trading scheme in order to gain experience with the institutions and infrastructure necessary for emissions trading, and we strongly support development of the EU Emissions Trading Scheme as a broadly based framework to facilitate emissions reduction nationally and internationally.

## **The Climate Change Programme Review**

### ***Forecasting future emissions***

**3. Forecasting the future rate of an economy's carbon emissions is a complex business, fraught with inescapable uncertainties. As the review by the National Audit**

**Office shows, the UK's forecasting processes have received approval from reviewers acting on behalf of the UN, and have been in line with assumptions and projections made by external bodies. However, while the NAO explains that a degree of change in projections is to be expected, it also notes that in this case the extent of change was greater than the Government modelling teams had expected. Naturally, there should be continual efforts to improve the models on which projections rely. But it also underlines the need for the Government to treat forecasts for future years with caution, and ensure they are not presented—either to decision-makers within the Government, or to the public—with undue certainty, as though they were concrete descriptions of the future. This applies especially to emissions forecasts which project many years into the future, such as to 2050. (Paragraph 32)**

The Government is conscious of the need to present projections with a degree of uncertainty and has in the past always published emissions projections based on a range of price assumptions to reflect fuel price uncertainty and include a section specifically on overall uncertainty. Published projections also explore other sensitivities to key assumptions. Longer term projections to 2050 are based on scenarios, which assume a much wider range of assumptions, to reflect the greater level of uncertainty over the longer time horizon. However, the Government will consider how to demonstrate and raise awareness of the levels of uncertainty associated with UK emissions projections, and consider the range of fossil fuel prices assumed for the next set of updated projections, which the Government aims to publish in the summer of 2008 as the first in its annual exercise to update the projections on a regular basis.

**4. We consider it unacceptable that it took so long after 2000 for Government projections to catch up with reality. As late as the 2003 Energy White Paper, the Government was still projecting that the 2010 target would be met in full. The delay in producing more accurate forecasts severely retarded and impaired the ability of the Climate Change Programme Review to come up with policies that would get the 2010 target back on track. The Government should perform much more frequent revisions to emissions forecasts. (Paragraph 33)**

The NAO review concluded that the delay in publishing revised projections did not severely impair consideration of possible policies and measures for the revised Climate Change Programme. Revised projections, while not published at the time, had been produced internally and were available to inform decision making. Although information was emerging at the time that some policies may not have been delivering the carbon savings estimated at the time they were introduced, the main reason that emissions projections tended to drift upwards was because changes in trends of fossil fuel prices tended to favour much more coal use in electricity generation. The Government has now put in place plans to revise and publish projections annually.

**5. Even if many of the Government's key forecasting assumptions were broadly in line with those made by external organisations, the fact that the movement of oil and gas prices in recent years has repeatedly been higher than forecast demonstrates that the consensus view may sometimes be wrong. The Government's forecasting model should consider a wider range of assumptions and scenarios, especially regarding fossil fuel prices. (Paragraph 34)**

The recent higher degree of uncertainty associated with projected fossil fuel prices has presented difficulties for all organisations providing emissions projections. The Government will in future consider a wider range of assumptions and scenarios to reflect this greater uncertainty.

**6. The Government does open up the assumptions it uses in its forecasting model to consultation and review. However, while there may be external input into this modelling, its inner workings remain opaque to the outside world. The Government should make its forecasting models publicly available as open source software. This would allow external analysts to test the Government's forecasts by inputting their own projected values for fuel prices, economic growth, energy demand from households, and so on. (Paragraph 35)**

Officials are currently engaged in developing a new version that will be more transparent, with a view eventually to making it available as open source software. However, officials continue to provide detailed model background to external enquirers and academics, and work with a panel of external experts (Projections Advisory Group). The model is also open to inspection by formal bodies including the United Nations Framework Convention on Climate Change. The Government continues to review ways to improve transparency of the projections.

**7. The Energy Saving Trust has called for the Government to develop a new and bespoke model to forecast carbon emissions, rather than simply adapt the DTI's energy demand model. We recommend that the Government should now do so. (Paragraph 36)**

The Government will consider the suggestion made by the Energy Saving Trust (EST). In response to the specific points made by the EST in its evidence we note that the existing modelling approach is already consistent with the historical inventory data prepared in accordance with IPCC Guidelines and required for international reporting to the United Nations Framework Convention on Climate Change. We note also that the detailed understanding provided by the DTI model of the energy supply system, and of energy demand by economic sector, would be essential features in any projections model. The fundamental question (which the Government will consider) is whether we are using the most appropriate modelling approaches, rather than whether we develop a new model. The EST suggests that a new model might focus more on emissions

reductions rather than demand projections. In the Government's view both are essential, and there is a danger that focussing more on reductions could increase optimism bias.

**8. We recommend that the Government should admit the uncertainty range of its emissions projections. It should also regularly publish a review of its previous projections, comparing them against outturn data and latest projections, and analyse what it got right, what it got wrong, why it did so, and what lessons it has learned. These reviews should be consistent in format and categories of data they present, so that it is easy to compare one year with another. (Paragraph 37)**

The more recent projections exercises have included formal analysis of projections uncertainty and considerable effort has also been made to describe the reasons for changes from previous baseline projections. The key focus of past projections exercises has been to inform longer term policy impact and results were usually presented in five yearly increments. The presentation of results was generally designed with the specific policy in mind making comparison of "forecast performance" sometimes difficult. However, the Government will consider what further enhanced analysis of projections performance may be possible. Needless to say, in moving to a regular annual publication of updated projections, comparisons of projections will become easier.

**9. The downward revision, by some 16-26%, of the expected impact of carbon reduction policies in the 2000 Climate Change Programme shows, first of all, that the Government must eliminate "optimism bias" from its initial design of climate change policies. Secondly, it highlights the risks inherent in the Government's current approach, whereby it seeks to implement policies which will deliver only just enough carbon savings to span the gap between a "Business As Usual" projection of where emissions are going to be in a certain year and a target level of emissions for that year. Government forecasts of "BAU" emissions have so far consistently been too low, while its forecasts of the impact of carbon reduction policies have consistently been too high. The moral is that the Government should err on the side of caution, and aim to overachieve its targets. (Paragraph 38)**

The guidelines on evaluation and appraisal produced by the Inter-departmental analysts group (IAG) in April 2006 noted the risk of optimism bias and directs analysts to the guidance in HM Treasury's Green Book on how to handle this. The peer review of the appraisal of new measures introduced in the 2006 Climate Change Programme and the 2007 Energy White Paper, which was overseen by the IAG, should have reduced the risk of over-estimating benefits or under-estimating costs.

The extent of optimism bias from past appraisals became clear during the review of the Climate Change Programme as the majority of existing policies were evaluated. As a result, analysts are more alert than previously to the potential for such bias and the need

to take it into account in fresh appraisals. Furthermore, detailed study about specific measures, such as the performance of loft and cavity wall insulation in situ, allowed for more accurate appraisals than were previously possible.

The IAG guidelines also suggest that, when considering a package of policies, risk analysis is done to construct a confidence interval to help understand the worst and best possible outcomes if all policies perform well or badly against expectations. Given a large number of policies are now in place, some are likely to over perform and some under perform so the central case still provides the most likely outcome. A continuous process of evaluation, for significant policies at key stages in their implementation, will give Government an understanding over time if a disproportionate number of policies are over or under achieving carbon savings compared to initial appraisals.

### *Cost-effectiveness analysis*

**10. Many of the technical aspects of the cost-effectiveness analysis (CEA) used in the Climate Change Programme Review were done well. As the NAO noted, CEA was appropriate to be used to help decide among different policy options, its use was more consistent and comprehensive than in the original CCP 2000, the assumptions used in it were in line with the analysis of external organisations and their uncertainties recognised, and in the Review it produced evaluations which were reliable enough for different policies to be compared with each other. (Paragraph 46)**

The Government welcomes the Committee's recognition that the analysis was done consistently and comprehensively, and the approach chosen for evaluation and appraisal was appropriate. We will continue to use cost-effectiveness analysis to inform decisions on policy choices.

**11. At the same time, there were some weaknesses in the way CEA was used. Because the Review was focused on meeting the short term target of 2010, it did not consider policies which would have a bigger but longer term impact. This represents a missed opportunity to advance UK climate change policy, and, to some extent, a waste of the Review teams and their resources. Some options were not appraised fully or at all because the Review itself was running short of time and resources. This lack of time was compounded by the delay in the Government's identification of how far short of the 2010 target it was projected to fall, and thus how many more policy options were needed. This highlights the need for annual reassessments of progress towards short, medium, and long term emissions forecasts and the carbon reduction policies that can help us achieve them. (Paragraph 47-48)**

It is true the scale of policy intervention, and hence the cost-effectiveness analysis, was determined by the 2010 domestic goal and Kyoto commitment timeframes – as the

focus of the review of the Climate Change Programme was on policies that could feasibly be introduced in order to meet these goals. However, the focus of the Review on the 2010 target did not mean that new longer-term policy ideas were ignored. The Review did consider policies and scales of intervention beyond those finally included in the revised Programme, some of which were taken forward in the Energy Review and considered further in the 2007 Energy White Paper.

The Government committed, in the 2006 Climate Change Programme, to introduce an annual report to Parliament. Subsequently, the Climate Change and Sustainable Energy Act 2006 also placed a similar obligation on Government to report to Parliament on the levels of greenhouse gas emissions in the UK and the steps the Government has been taking to reduce these emissions. The first report, published in July<sup>1</sup>, included the latest emissions projections and an assessment of our progress towards both the 2010 and 2020 targets. The Climate Change Bill also proposes an annual reporting framework, which includes a duty on the Secretary of State to lay before Parliament a response to the annual reports of the Committee on Climate Change.

**12. Future use of CEA should ensure that it focuses on different scales of policy implementation, across different timescales, thereby enabling policy-makers to better choose different ways and combinations of implementing certain policies. There should also be more public scrutiny of and debate about the assumptions and calculations which result in CEA indicators for each policy. Most importantly, emissions targets should be determined by climate science, and CEA only used to help achieve these targets in the most cost-effective manner; rather than in effect setting targets itself, through being used to determine what level of emissions cuts is “affordable”. (Paragraph 49)**

The Government agrees that CEA should be used within the framework of climate science. This was the approach for the 2000 and 2006 Climate Change Programmes, where the 2010 target was a step on the way to a 60% reduction in CO<sub>2</sub> by 2050, determined by the scientific data available at the time the target was set. The Government also, in its previous work, sought to analyse policies in combination to avoid double counting and provide the most cost effective approach to emissions reduction. As mentioned in the response to point 11 above, the Climate Change Programme Review (CCPR) did consider policies and scales of intervention beyond those finally included in the revised Programme, some of which were taken forward in the Energy Review. Longer term assessment is provided by ongoing policy development and review, for instance, the policies and measures announced in the Energy White Paper. This will provide the framework for the Government’s future use of CEA. The Government notes that, once the targets are set, proper use of CEA takes account of affordability.

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<sup>1</sup> <http://www.defra.gov.uk/environment/climatechange/uk/ukccp/index.htm>

As this Report acknowledges, the NAO report was complimentary on the use of cost-effectiveness analysis during the CCPR. The UK's use of cost effectiveness analysis is, in international terms, extensive. The Energy Review and Energy White Paper processes used a similar approach to cost-effectiveness analysis developed in the CCPR. The technical guidance will be continuously updated, e.g. to take account of latest advice and ensure consistency in evaluation across Government Departments, and, where possible, better integrate the short-to-medium term and long-term analysis.

**13. The overruling of the CEA indicators in the case of major policies such as the Renewables Obligation and fuel duty escalator suggests that the CCPR was still significantly guided by broader political considerations. It is not necessarily wrong for the Government to overrule the recommendations generated by a particular methodology such as CEA; Governments must always take wider political considerations into account. What we recommend is that the Government is braver about the extent of action on climate change that is politically possible. We hope the Government is already moving in this direction, given that having excluded tighter building regulations from the CCPR, it subsequently introduced a policy for Zero Carbon Homes in Pre-Budget 2006. In future, the Government should be bolder about consulting on potential climate change policy options, to test public opinion on their acceptability, and encourage public debate on alternative measures. (Paragraph 50)**

The cost-effectiveness analysis framework was developed to compare how cost effective different policies across Government are in abating carbon emissions. Thus, it can be used to rank policies in terms of their economic effectiveness in achieving their prime objective: carbon abatement. The CEA indicator does not provide a complete assessment of a policy. It was not designed, or intended, to be the sole basis for approving or rejecting policies. Hence, simply because a policy seems relatively expensive on the CEA does not mean that the CEA indicator has been overruled. Policies such as the Renewables Obligation and the fuel duty escalator have additional objectives other than reducing carbon, for example driving innovation, improving air quality or reducing congestion - these are also important in determining the value of the policy. Renewables are emerging technologies, hence there is a rationale for support where the cost effectiveness of these technologies is above the SCC/SPC, as this support may be able to leverage a lowering of the abatement cost of these technologies over time. As such, while wider political considerations play a role in guiding climate change policy, there are also wider economic concerns to consider, as described above.

The Government believes that climate change is one of the most serious challenges facing the world in the 21<sup>st</sup> century. The UK has been at the forefront of developing policies to mitigate climate change, (for example, the Renewables Obligation, the EU ETS) and is seeking international agreement on binding emissions reductions targets. The Government will continue to develop policies that help the UK achieve its 2050 goal of at least 60% CO<sub>2</sub> reduction and it will seek to do so in the most cost effective way.

### *Social cost of carbon*

**14. We have queried the Government's use of the Social Cost of Carbon (SCC) in a number of inquiries. We were interested to learn that, as the NAO put it, the cost-effectiveness analysis in the CCPR "sensibly excluded the social cost of carbon", and that one of the main reasons why the Review opted to use cost-effectiveness analysis in the first place was "because it is not reliant on a firm valuation of the social cost of carbon". We conclude from this that the Government has doubts as to the reliability of the SCC in policy-making. In the light of this, the Government should explain clearly how it intends to use SCC in the future. (Paragraph 52)**

In cost-effectiveness analysis, the Social Cost of Carbon (SCC) is necessarily excluded. Cost effectiveness aims to give an indication of the economic cost incurred in order to bring about a one tonne reduction in carbon emissions. As such, the net economic cost of a given option is the numerator, while the carbon savings of that option is the denominator. It would not make sense to include the SCC in the net cost of the option as this would effectively double count carbon benefits (which would then appear in both the numerator and denominator). Further, it would not make sense to compare the cost-effectiveness of options against the SCC if the SCC was already included in the calculation.

Although cost-effectiveness analysis does not include a valuation of the SCC, the cost-effectiveness of options is often compared against other options and the SCC in order to determine the approximate relative/absolute cost-effectiveness.

Government has recently published new interim guidance for the revised valuation of carbon benefits in appraisal. The SCC has been replaced by the new Shadow Price of Carbon (SPC), which is based on modelling done for the Stern Review (2006). It is intended that the new SPC will be factored into all Government appraisals. For those policies for which reductions in carbon emissions are of primary importance, cost-effectiveness analysis will continue to be used in order to compare the net costs of carbon savings to the new SPC. For those policies across Government for which carbon savings are not the primary objective, it does not make sense to use cost-effectiveness analysis. For such policies (e.g. the building of hospitals or schools) the new SPC must be factored into the decision-making process through the cost-benefit analysis. Appraisals will be expected to determine the expected carbon emission reductions/increases, which will then be valued according to the new SPC and included in the CBA. The SPC will therefore be included in the decision-making process even when carbon emission reductions are not the primary objective.

Defra will provide the EAC with a full paper on the new SPC in the next 2-3 weeks. This will also be made available on the Defra website.

**15. The Climate Change Programme Review involved the joined up work of officials from several different Departments, as well as key external bodies. But one major failure in this joined up approach was the exclusion of fiscal policy, consideration of which remained the preserve of the Treasury. In the future, there must be an integrated approach to climate change policy-making, which considers the use of taxes and incentives alongside other measures. (Paragraph 58)**

The Government is committed to taking a coordinated approach to protecting the environment, and all departments continue to work closely together to develop an appropriate mix of instruments - including regulation; emissions trading; voluntary agreement; spending and fiscal measures - to tackle climate change effectively. This coordinated approach has seen the introduction of an innovative range of measures to date that has enabled the UK to make significant progress on reducing emissions whilst supporting wider economic and social aims.

Fiscal policy plays an important role in the Government's overall efforts as seen by the significant contribution being made by the Climate Change Levy and, in line with its 1997 Statement of Intent on Environmental Taxation, the Government will continue to consider ways in which the tax system can support environmental policy. However, decisions on fiscal measures for environmental purposes need to be considered as part of overall fiscal policy to ensure that any such action is consistent with the tax system as a whole, wider aims to support sustainable economic growth and maintain sound public finances. As such, it is important that fiscal measures with environmental purposes are considered within the Budget process just as all other fiscal measures are.

October 2007

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