House of Commons

Environmental Audit Committee

The 2007 Pre-Budget Report and Comprehensive Spending Review: An environmental analysis: Government Response to the Committee's Third Report of Session 2007–08

Fourth Special Report of Session 2007–08

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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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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.

A list of Reports of the Committee from the present and prior Parliaments is at the back of this volume.

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Fourth Special Report

1. The Environmental Audit Committee published its report on ***The Pre-Budget Report and Comprehensive Spending Review: An environmental analysis*** on 5 March 2008 as its Third Report of Session 2007–08, HC 149-I & -II.

2. The Government's Response to the Committee's Report was received on Tuesday 6 May 2008 in the form of a memorandum to the Committee. It is reproduced as an Appendix to this Special Report.

Appendix—Government response

1. The Treasury's argument that new or higher green taxes are unnecessary, because the Government is doing enough to protect the environment through other policies, is hardly convincing given the Government's lack of progress in reducing UK carbon emissions over the last decade. Even if it were the case that policy across Government was successfully delivering its environmental objectives in full, it would still not be an excuse for the Treasury's inaction. There is always a case for looking at the scope to increase green taxation, since the Government is always in need of tax revenue, and since, as the Treasury accepts, it is better to tax 'bads' than 'goods'. Taxes on high carbon activities such as driving and flying can be used to reduce their demand without destroying it, thus helping to achieve environmental objectives while still generating large and predictable tax streams—which could potentially be used to reduce other taxes. (Paragraph 8).

2. As for the Treasury's argument that the relative decline in green taxes is a sign of their success in deterring the activities on which they are levied, we would reply overall that it has rather more to do with the Treasury's own decisions to freeze most environmental taxes in most years from 2000 to 2006 inclusive. This is not the first year we have heard this argument from a Treasury minister; we are disappointed to hear it yet again, having repeatedly pointed out its obvious flaws (Paragraph 9).

3. We understand the Treasury's caution over hypothecating revenues from taxes to specific ends. However, it seems clear that an element of hypothecation could play a crucial role in gaining public acceptance of green taxes. It is perhaps unnecessary formally to ring-fence certain revenue streams for particular purposes, which could indeed reduce the flexibility the Treasury has to manage year-to-year public finances. What is more important is that the Treasury does a better job of publicly justifying green taxes by explaining their core environmental purpose, as well as linking them-however strictly-to increased spending on the environment and reductions in other taxes. We recommend that the Treasury consults on, publishes, and follows an explicit strategy to win public support for environmental taxation (Paragraph 12).

The Government welcomes the Committee's report on the 2007 Pre-Budget Report and Comprehensive Spending Review. The Committee continues to provide a useful focus on environmental issues.

The Government believes that the best measure of success of environmental policy is its outcome. In the case of climate change, this would mean looking at emissions reductions achieved through the Government's Climate Change Strategy, and performance against its Kyoto commitment. Policy instruments—whether tax; regulation or spending—are a means to an end. It would therefore be wrong to focus on a single instrument as a measure of the success of environment policy—environment taxes are just one of several possible levers at the Government's disposal. Stern suggests that each country should use the appropriate mix of taxes, trading, spending and regulation as befits its national circumstances.

The Government has a strategy for tackling climate change and the other environmental challenges we face that is consistent with Stern. This strategy is set out in Government publications and reiterated in PBR and Budget documents. As set out in the Treasury's 2002 publication, Tax and the Environment, the development of the Government's environment policy takes place within a principled framework. This framework sets out the criteria for deciding whether intervention through the tax system is the right action to take, with one of these criteria being the need to take account of the impact of action on wider social and economic objectives—including maintaining sound public finances. Another of the criteria is that, where tax is the best instrument to use, the Government will look to shift the burden of tax from 'goods' (e.g. employment) to 'bads' (e.g. pollution). This is in line with the Government's 1997 Statement of Intent on Environmental Taxation, where the Government committed publicly to exploring the scope of using the tax system for environmental purposes.

Within this framework, it is essential that the Government uses the most effective instrument to achieve its aims. For instance, regulation or voluntary agreements can be most effective where there are a limited number of polluters, or where, for example, market failures make product standards for energy or water efficiency the most cost-effective instrument of behavioural change. Spending measures may have a role to play where the polluter cannot afford to reduce pollution, or where equity or distributional issues make a tax or similar measure unacceptable. Fiscal measures can tackle external environmental costs—such as pollution—through reflecting such costs in prices and encouraging the behavioural changes needed to move to a more sustainable economy, but it is important that the bluntness of this instrument does not impact negatively on wider Government objectives, such as reducing fuel poverty.

Using this principled framework, the EU Emissions Trading Scheme (EU ETS) is the centrepiece of the UK's climate change strategy as it ensures that climate change is tackled effectively and at least cost. This is a key instrument for pricing carbon into decision-making. Alongside this, the Government has introduced an innovative range of other measures to tackle the environmental challenges we face, including fiscal measures such as: reducing emissions in the business sector through the introduction of the Climate Change Levy, associated Climate Change Agreements and enhanced capital allowances for energy-saving technologies; and incentivising higher energy efficiency in the household sector through the extension of the reduced VAT rate for professionally-installed energy-saving materials and microgeneration technologies. Budget 2008 announced further fiscal measures, including: significant reform of VED and taxation of business travel; the setting of future rates of fuel duty; increase in climate change levy rates for 2009; and funding for the Green Homes Service.

Where fiscal measures have been the right instrument for taking action, the Government has looked to shift the burden of tax from 'goods' to 'bads'. For instance, the Climate Change Levy package was introduced alongside a 0.3 percentage point reduction in employers' national insurance contributions (NICs). The combined CCL/NICs package has led to a net reduction in tax liability for business as a whole: The lower NICs rate saves about £950m per year for businesses in sectors paying CCL, while CCL costs these businesses about £600m per year. CCL is encouraging business to reduce energy costs. Cuts in NICs also accompanied the introduction of the Aggregates Levy and Landfill Tax. And the additional revenue raised from business by the increase in the Landfill Tax escalator, announced in Budget 2007, was recycled to business through the other corporation tax rate cut announced in the Budget'.

The Government seeks to use environmental taxes to shift the burden of tax from goods to bads. The Government shares the Committee's views that hypothecation of tax revenues to particular spending programmes can reduce flexibility and efficiency in the allocation of public spending, with spending on that programme determined by the revenues received rather than by a balanced assessment of relative priorities across public services. It is important that spending decisions are taken in the round as part of the spending review process. Indeed, hypothecation of environmental tax revenues to particular environmental spending programmes, rather than using the revenue to fund general spending, can reduce the scope for using environmental taxes to shift the burden of tax from goods to bads.

In terms of the effectiveness of the Government's environment policy, it is therefore important to look at the whole strategy rather than just environment taxes. The Government has made significant progress against its environmental objectives, and is one of the few countries on course to meet its Kyoto commitment on reducing emissions. Indeed, the Government's use of an innovative range of measures has meant that the Government has delivered these environmental benefits whilst supporting wider Government objectives too, such as strong economic growth and reducing fuel poverty.

4. In December 2006 the Treasury announced a doubling of all APD rates from February 2007, which in some parts of the media was reported as a bold move for the environment. In reality for the majority of flights it only restored the rate of aviation tax the Government inherited when it came into office. This represents a cut in real terms of 29%. (Paragraph 13).

5. We welcome the Treasury's announcement to reform Air Passenger Duty into a levy per flight rather than per passenger. We further welcome the Treasury's announcement of consultation on how this reform should be implemented, and how aviation tax might be better correlated to distance travelled. We recommend that airlines be mandated to calculate each passenger's share of the reformed 'per-flight' tax, and to make this figure highly visible (on adverts, websites, and tickets). We also recommend that the Treasury closely examine the merits and practicalities of better reflecting the emissions arising from longer intercontinental journeys by adding a third banding to Air Passenger Duty, to cover 'very long-haul' flights. Short-haul charges must reflect the disproportionate emissions resulting from take off and landing, and should be aimed to encourage 'modal shift' towards rail alternatives. Above all, it is vital that all rates of aviation tax are significantly increased, so as to stabilise demand and resulting emissions. (Paragraph 15).

The Chancellor announced at Pre-Budget Report 2007 that air passenger duty will be replaced by per plane duty on 1 November 2009. The new duty is intended to ensure the industry makes a greater contribution towards its environmental costs and to ensure that the aviation sector continues to contribute fairly and equitably towards the funding of public services. The Government aims to have a fairer duty more in line with the environmental impacts of flights, including the distance travelled, and which takes account of any social or economic impacts including market distortions. The Chancellor further announced at Budget 2008 that the new duty will raise a further 10% in its second full year of operation

HM Treasury is currently running a formal consultation on the new duty, which will finish on April 24th 2008. The consultation considers all aspects of the operation of the per plane duty including:

1. Basis of the duty—an aircraft measure;
2. Basis of the duty—a distance measure;
3. The treatment of general and business aviation;
4. Possible exemptions to the duty;
5. The administration of the duty; and
6. Impacts on freight and transit/transfer services.

The Government welcomes the points made by the Committee and will consider them as part of the consultation process.

6. In view of their potential size, we recommend that the Treasury publish an estimate of the costs to the Exchequer of reimbursing VAT expenses to aviation companies. This would be in the public interest, no matter the practical obstacles to changing aviation's VAT status, and might galvanise interest in how these obstacles might be overcome. (Paragraph 17).

Air passenger tickets for journeys within the UK or on a UK leg of an international flight are zero rated for VAT purposes, consistent with the treatment of other domestic passenger transport tickets. Airfreight is either outside the scope of VAT (if international) or standard rated (if domestic or intra-EU) according to the normal VAT place of supply rules. In all instances above, the input VAT (the tax payable on costs) incurred by an airline company in the course of supplying these services can be reclaimed if the company is registered for VAT in the UK.

Changing the VAT treatment of these services so that input VAT could not be reclaimed would require unanimous agreement by all EU member states. In addition there is likely to be a significant behavioural change as aviation companies seek to purchase their inputs in countries in which no VAT is payable on their expenses, reducing their UK tax bill and the effectiveness of such a measure.

In view of these significant obstacles the Treasury has made no detailed assessment of the revenue which would accrue from applying VAT on airline tickets. Prime Minister Brown

considered this measure in his Budget 2007 speech as Chancellor. He noted that because of the legal difficulties, it would apply only to domestic flights, business would be able to claim back VAT, and even by 2020 would save just 50,000 tonnes of carbon—less savings in one year than achieved by the climate change levy in just one week. The Chancellor rejected this proposal for a package of more environmentally efficient measures, which will save 6 million tonnes of carbon.

If the Treasury were to impose VAT on airline tickets, a great proportion would be reclaimed back from business travel by VAT-registered businesses, according to the normal VAT rules. There would therefore be no overall net VAT gain on these particular flights, which account for a large share of air travel. The Treasury estimates that the removal of the current zero rate of VAT would bring in around £260 million on domestic flights and £150 million on international flights. This revenue would accrue from household expenditure on flights, and by those unable to recover input tax such as charities and those businesses in sectors with significant VAT-exempt activities.

7. We note that some motoring organisations have begun calling for the next planned increase in fuel duty to be scrapped, given the rise in petrol prices due to increases in the price of crude oil. We also note, however, that demand for road fuel is still strong in spite of these price rises. The forthcoming Budget is a test of the Treasury's environmental credibility: it must not defer its planned rises in fuel duty (Paragraph 19).

The Government remains committed to increasing fuel duty at least in line with inflation each year, in order to reduce emissions, focused on achieving our long-term CO_2 targets. To demonstrate long-term commitment to this policy—in the context of long-term environmental targets—Budget 2008 announced that fuel duty will increase by 1.84 pence per litre in April 2009, and by 0.5 pence per litre above indexation in April 2010.

To show that the Government is still able to respond to the short-term economic pressures, however, Budget also announces that the planned 2 pence per litre increase due on 1 April 2008, would be deferred to 1 October 2008. Fuel duty increases in October 2008, April 2009 and April 2010 will result in savings of around 0.5 million tonnes of carbon dioxide a year by 2010.

8. If the Government were only going to fund one Carbon Capture and Storage demonstration project, we believe it was right to restrict the scope of the competition to a post-combustion coal plant. We agree with the Government that this type of technology has the greatest global potential, given the possibility that it could be retrofitted to existing power plants. If widely adopted, it could dramatically reduce the emissions of countries such as China and India, while simultaneously providing significant economic opportunities to firms with experience of carrying it out (Paragraph 22).

9. Post-combustion technology appears to be further away than pre-combustion from being introduced by the market on its own. This means that funding a full-scale demonstration plant is a particularly appropriate and effective form of subsidy for post-combustion technology. We hope that this demonstration will be able to prove to

interested companies that post-combustion plants are physically viable, and teach valuable lessons about how to build and operate them efficiently (Paragraph 23).

10. While the CCS competition is very welcome, it is imperative that the Treasury provides considerably more assistance for CCS projects overall. No matter which type of technology is adopted, CCS plants will incur extra build, operational, and infrastructure costs over conventional power stations. Without clear and long-term financial security for CCS, the risk is power companies will not invest in CCS plants even once the demonstration project is operational—let alone bring forward the plans they have for pre-combustion plants today. In the longer term the EU ETS may be able to provide sufficient financial incentives. But in order for CCS to be deployed widely and swiftly in the UK, we recommend that the Government introduce some form of financial mechanism for incentivising CCS power plants over conventional power stations. The Treasury should examine options such as a feed-in tariff for CCS plants, or contracts, which guarantee funding for the difference in costs between CCS and conventional plants (Paragraph 28).

11. Overall, we are concerned that the Government is not showing sufficient urgency in its assistance to Carbon Capture and Storage industries. The Government must now be more decisive in its support for CCS, especially given that a number of existing power stations are coming to the end of their lives, and power companies are taking decisions imminently on a new generation of power plants to replace them. Where these can be built with pre-combustion CCS, they will immediately lower UK emissions. Where they are built as conventional gas and coal-fired power stations, the Government must mandate that they are built 'CCS-ready', with the expectation and the financial support in place to ensure they are retrofitted with post combustion technology as soon as possible (Paragraph 29).

Carbon Capture and storage (CCS) is a key global technology identified by the Stern Review. The Government is committed to developing and demonstrating CCS technology.

The competition to design and build the UK's first full-scale CCS demonstration is underway, and BERR expect to conduct an initial sift of bidders shortly. The project aims to be operational by 2014—this makes the UK a world leader in this important technology.

An important incentive for investment decisions in CCS is the carbon price. Carbon pricing through the EU Emissions Trading Scheme (EU ETS) ensures that energy generators face the cost of their emissions and helps to reduce emissions in the business and energy supply sectors in an effective and least-cost way. In the initial phases of the EU ETS, allowances were distributed for free, however in the longer term free distribution can reduce incentives for firms to reduce omissions. Auctioning of allowances is the most efficient way to avoid this. The UK is one of the Member States going furthest on auctioning in Phase II and the Budget 2008 announced that in Phase III the UK will auction 100 per cent of allowances to the large electricity producers' sector.

Alongside the UK competition, BERR will shortly announce a new call for expressions of interest under the Environmental Transformation Fund to support the development of component parts of CCS.

The Government is also developing the regulatory framework for CCS in the UK. The Energy Bill will enable carbon to be captured in the UK and stored in the North Sea. The Government will shortly be launching a consultation on CCS regulations as well as what it would mean for a new coal-fired power station to be 'capture ready', (i.e. to be in a position to retrofit CCS technology once it is proven at a commercial scale), and whether all new fossil fuel power stations should demonstrate that they are capture ready.

Climate change is a global problem, and especially technology solutions require multilateral collaboration. The UK is working with India on research on CCS, with China on the nZEC CCS demonstration project, with Norway and Denmark on he required infrastructure for CCS and with the G8 and the EU Commission on CCS strategy.

12. There appear to be serious flaws in the thinking behind the new Shadow Price of Carbon. We recommend that it be reformed, so that instead of assuming that global climate change goals will be met, it is based on the costs of climate change on a 'business as usual' trajectory of emissions. Furthermore, given the inherent difficulties in putting a price on climate change, the Government's first priority in deciding on the merits of potential policies and construction projects ought to be deciding how they affect UK carbon budgets, and only secondly on what the monetary value of resulting carbon emissions would be. We may choose to examine the Shadow Price of Carbon in more detail in a future inquiry, looking in particular at how it is being used in cost-benefit analyses and impact assessments throughout government. (Paragraph 38)

Defra released guidance and an explanatory background paper on the Shadow Price of Carbon (SPC) in December 2007. The SPC is the approach used by Government for incorporating the cost imposed by carbon dioxide (and non- CO_2 GHGs) into the appraisal of projects and policies. The current figure of £26.50 per tonne CO_2e is based on modelling from the Stern Review, reflecting estimates of the global climate change costs created by a tonne of carbon dioxide (or an equivalent volume of other GHGs).

The Stern Review shows that the social cost of carbon depends on the level of atmospheric concentrations (it is higher for higher levels of GHG concentrations), so the value we should use today depends upon the expected concentrations in the future. Clearly, we are taking action nationally, and internationally, to address climate change and therefore the business as usual figure is not the appropriate one to use. The new SPC is, rather, based upon Stern's suggested stabilisation range, and hence, as argued in the explanatory note, is the appropriate figure to adopt rather than using the business as usual social cost of carbon.

However, we do agree that there is a case for assessing other methods of valuing the SPC. That is why Defra made a commitment when publishing the revised guidance to conducting a review of the SPC in 2008. The scope of the review, which is currently being undertaken, is to consider the case for moving towards a shadow price that is based not, as at present, on damage costs but on the marginal abatement costs that would need to be incurred in order to reach the UK's climate change obligations. The potential benefit of this approach is that of increased 'target-consistency'—i.e. giving greater assurance that the value attached to greenhouse gas emissions is fully consistent with the domestic targets (notably carbon budgets) and international obligations that the UK has signed up to. Initial findings from the review are expected towards the end of 2008.

The Government is grateful for the Committee's interest in this issue. It would welcome any further input from the Committee into the review of the SPC.

13. We believe that the £170m new money over three years, announced in the PBR for low carbon investments in the UK, would have been a significant start several years ago. But the urgency of the need to cut emissions means that this should now be a much higher spending priority. In particular, we are disappointed that this sum appears to be considerably smaller than the amount of revenue the Government is projected to earn from auctioning carbon allowances under the EU Emissions Trading Scheme. We are also concerned that the domestic Environmental Transformation Fund is being spread too thin, and that a considerable proportion of the funding, while welcome, is not aimed at developing step-changes in new technology, which ought to be the focus of the Fund. We recommend that the Treasury revisit the settlement for the domestic ETF as soon as possible, especially once revenues from EU ETS auctions are more certain (Paragraph 43).

The domestic Environmental Transformation Fund (ETF) allocates over £400 million to ensure that technologies that are in the later stage of development can be brought to market and demonstrated. It is the Government's intention that the ETF is a genuinely transformational fund that works closely with the Energy Technologies Institute (ETI), research councils and other funding bodies, as well as internationally, to coordinate support across the technology chain. In the summer, the Government will publish a low-carbon technology strategy, which will detail how the coordination of existing and new schemes can maximise the UK's efforts in developing the right technologies to tackle global climate change.

The Carbon Capture and Storage demonstration project will also make a valuable contribution in the development of carbon abatement technologies.

Government's spending priorities are not, in general, determined by the way in which the money is raised. Hypothecating revenues to particular-spending programmes imparts inflexibility in spending decisions and can lead to a misallocation of resources, with reduced value for money for taxpayers. The Spending Review process ensures that resources are allocated efficiently to deliver Government objectives and ensures priorities receive the increased levels of funding, as set out in the CSR (Comprehensive Spending Review).

The CSR increases Defra's budget by 1.4 per cent in real terms, from £3,508m in 2007/08 to £3,960m. This increase allows the Government to allocate substantial resources to tackle climate change including the Environmental Transformation Fund, and increased resources for flood defences to help the UK adapt.

14. We welcome the announcement of £800 million new money over three years for environmental investments in the developing world. This was probably the most significant and impressive announcement in the PBR (Paragraph 45).

15. The Government should work with the World Bank to ensure appropriate governance standards are in place for their international ETF to deliver a suitable disbursement mechanism that places rigorous sustainability criteria at the heart of what the fund delivers. Furthermore, the Government should look again at whether

these funds should be dedicated solely to low carbon energy investments, with forestry protection and climate change adaptation being funded by separate instruments, less focused on profit-making opportunities (Paragraph 46).

The Government agrees with the Committee that sustainability will be a key factor in ensuring the success of the funds. The new funds/programmes that the international ETF will help capitalise, will adhere to the principles that multilateral development banks should provide financing for adaptation and mitigation programs that are country-driven and designed to support sustainable development. Decision-making on how the funding is spent will be primarily at country level, led by recipient countries governments and including the private sector, as well as civil society.

Good governance standards are a key priority as we take forward the design of the funds with the World Bank, other donors and recipient countries. The international window of the ETF will go into the Strategic Climate Fund, which will work alongside the Clean Technology Fund. Under the current design, the Strategic Climate Fund will disperse funds, to clean technology, climate resilience and preventing deforestation. How funding is spent on each area will then be based upon different criteria, reflecting the different nature of the three areas.

The Government agrees with the Committee that concessional funding is appropriate for energy investments. Concessional funding can also catalyze innovations in risk management mechanisms and instruments, including insurance and other modes of risk transfer. Therefore, UK funding for the program on adaptation, (Pilot Programme on Climate Resilience (PPCR)) will be part concessional loans, with a small grant element. The PPCR will provide grant assistance to help pilot countries to develop climate resistant plans and budgets, and significant resources (potentially a mix of grants and highly concessional loans) to help fund investments identified in the climate resilient development plans. During the design process we are talking to other donors about the possibility of grant financing for the funds/programmes. For example, we understand that grants would be the US preferred approach. We envisage co-mingled 'pots' of money for all of the funds/programmes, which would encompass a mixture of both loans and grants.

16. In his Pre-Budget address on 9 October 2007, the Chancellor told the House that, 'we are the only country to have met our Kyoto obligations. We have reduced our greenhouse gas emissions by almost a fifth since 1990', without making it clear that this incorporated the net purchase by the UK of some 33.8 million-carbon allowances in 2006. We recommend that it is always made clear, in Government statements and documents, where UK reported emissions figures incorporate the purchase of carbon credits; the risk otherwise is that politicians and the public will receive a falsely reassuring picture of progress in decarbonising the UK itself (Paragraph 50).

The impact on the global climate of greenhouse gas emissions does not depend on their geographical location. Following the conclusions of the Stern Review of the Economics of Climate Change, the Government sees emissions trading as one of the most powerful tools available to tackle climate change in a cost effective manner, and the development of a global carbon market as keeping emissions within limits whilst allowing reductions at least costs, harnessing private sector investment, and delivering the finance flows needed to support low carbon development elsewhere in the world.

However, the Government continues to recognise the importance of transparency in reporting on emissions reductions, showing both emissions reductions in the UK and emissions reductions abroad funded by the UK. The latter is important in providing a measure of the UK's overall contribution to reducing global emissions. Chart 6.2 of Budget 2008 follows the Committee's earlier recommendations on this subject.

17. The Government cannot afford simply to assume that purchasing carbon credits is leading to genuine emissions reductions elsewhere in the world. We recommend that the Government demonstrate a systematic approach to verifying, as rigorously as possible, that the net purchase of carbon credits by the UK is funding genuine emissions reductions. We further recommend that the new Committee on Climate Change evaluate each year the quality of the emissions credits set against the UK's carbon budget for that year: we believe it should state whether, in its opinion, these credits have genuinely reduced global emissions by an equivalent amount (Paragraph 52).

The Government agrees with the Committee that environmental integrity of emissions reductions is crucial. In Europe, the Government has supported action by the Commission to ensure a robust cap for Phase II of the EU ETS, and welcomed the proposals for Phase III, which introduce a central cap that will deliver real scarcity and a well functioning carbon market that drives real GHG reductions. The latter is in line with the EAC's previous recommendations on cap setting.

Internationally, the main source of carbon credits within the context of the Kyoto Protocol is the Clean Development Mechanism (CDM). It is important that the project mechanisms including the CDM, delivers real emission reductions. In this context the UK supports the continued improvement in the procedures for the setting of baselines, and for the establishment of additionally. The UK is a strong supporter of the Clean Development Mechanism and, whilst it relies on the international processes to ensure the integrity of emission reductions achieved, has worked consistently for and seen improvement in processes over the past couple of years of operation. The UK believes the mechanism is essentially transparent and robust, though it will continue to press for robust processes through the EU and the UN to ensure the environmental integrity of projects.

In order to secure appropriate advice and scrutiny, the Climate Change Bill makes provision for the Committee on Climate Change to advise on the extent to which carbon budgets should be met through the use of carbon units such as credits from other schemes, and for parliamentary scrutiny of regulations under the Bill's provisions on carbon units. The Government does not therefore consider it necessary to give the Committee the specific task of considering the quality of carbon units credited to the net UK carbon account. However, the Government will seek to ensure that international processes and systems including emissions trading continue to provide genuine emissions reductions.

18. In bringing the previous Public Service Agreement on climate change to an end, the Treasury did not publish an assessment of Departments' performance against it, along with any actions for improvement. This is despite the fact that the previous target to reduce UK CO_2 by 20% by 2010 looks set to be missed by a wide margin. This suggests either that there is a weakness in the design and operation of the PSA system, or that

the Treasury is less interested in driving progress on reducing carbon emissions than other objectives (Paragraph 54).

As part of its transparent new PSA framework, the Government has set a new PSA to "Lead the global effort to avoid dangerous climate change", and the goals in SR04 PSA 2 are now subsumed into that. The PSA includes indicators intended to track progress on UK emissions and the greenhouse gas intensity of the UK economy. The Government will continue to provide regular public reporting on progress against the new PSAs. In addition to the public reporting on PSA progress, the Prime Minister's Delivery Unit is working closely with each PSA Delivery Board and department officials to regularly monitor and support progress of the PSAs. Throughout this process ministers will be held to account in stocktakes with the Prime Minister or Chancellor and in their regular PSA cabinet committees.

The first part of SR04 PSA 2 refers to the UK's international commitment under Kyoto, to reduce greenhouse gas emissions by 12.5% compared with 1990 levels for 2008–12, taking emissions trading into account. On this basis, UK greenhouse gas emissions were down by almost 21% in 2006, well in excess of 12.5%. The second part of the PSA refers to the domestic goal of moving towards a 20% reduction in CO_2 levels by 2010. In this case the task is proving more difficult. However, the latest verified figures indicate that the UK has made progress towards the goal and that considerable progress in cutting net CO_2 emissions has been made (CO_2 down by 12% between 1990 and 2006, and latest projections show reductions of around 16% expected by 2010). The projected fall would not be enough to achieve a reduction in carbon dioxide emissions of 20% by 2010, a goal which was always designed to be stretching but now looks increasingly difficult to achieve. The Government will continue to report progress on its climate change goals, including the domestic 20% goal, for example in Defra's Statistical Releases on the subject.

19. The new PSA on climate change is too diffuse, with no clear departmental targets for reducing emissions, and less emphasis overall on reducing emissions from the UK. We recommend that, in consultation with the Committee on Climate Change, the Government considers setting emissions reduction targets for specific sectors of the economy, with relevant Departments being made accountable for achieving them (Paragraph 55).

The Government does not consider it appropriate to set fixed targets for individual sectors. The Government's aim is to reduce emissions where it is most cost-effective to do so and setting targets for specific sectors would reduce flexibility as to where action should be taken. In addition, there may be some policies, such as trading schemes, which cover multiple sectors, making sector-specific targets difficult to define. In order to provide transparency the Climate Change Bill requires the Committee on Climate Change to provide advice on the respective contributions towards meeting the carbon budget by the sectors of the economy covered by trading schemes and those not covered, and the sectors of the economy in which there are particular opportunities for contributions to be made towards meeting the carbon budget for the period. In addition, the Government's report on proposals and policies for meeting each carbon budget will have to explain how the policies and proposals affect different sectors of the economy, thereby making clear how individual sectors may be expected to help deliver the targets and budgets in the Bill.

20. We recommend that, in preparing now for the next Spending Review, the Treasury work to develop PSAs that will mainstream environmental objectives throughout the entire range of departmental activity. Environmental objectives must not be confined simply to a couple of explicitly environmental PSAs. In particular, we recommend that, rather than focusing purely on labour productivity, work starts now on developing ways of incorporating targets for improving the efficiency with which natural resources are used in the UK economy. (Paragraph 58)

In keeping with the UK Government's sustainable development strategy, Securing the future, the Government agrees with the Committee that environmental objectives should be considered across the full range of activity. It is for this reason that, in the 2007 Comprehensive Spending Review, PSA 20 on housing supply includes an indicator on the efficiency rating of new homes, and PSA 22 on the Olympic and Paralympic Games will measure delivery of the Olympic Delivery Authority's sustainability strategy. Through their departmental strategic objectives (DSOs), HM Treasury, the Department for Transport, the Foreign and Commonwealth Office, the Department for International Development and the Department for Business, Enterprise and Regulatory Reform are all recognising the centrality of environmental protection and enhancement to their activity.

In the CSR 07 period, Defra's departmental strategic objectives include "sustainable patterns of consumption and production". Under this objective, the Department will monitor carbon emissions, water use and waste disposed of to landfill compared to value added in various sectors of the economy. The Government remains committed to decoupling economic growth from environmental impacts. However, it is not clear that a measure of resource productivity is more appropriate than the current approach of focusing on environmental outcomes, since different resources will have very different impacts for a given unit of volume or weight at the various stages of their life-cycle.

21. The next Pre-Budget Report will be published within a new policy landscape, following the scheduled passing of Bills on climate change, energy, and planning, as well as the EU carbon reduction and renewable energy targets for 2020. Pre-Budget Report 2008 must establish a coherent set of measures to help deliver the UK's 2020 domestic and European targets on emissions and renewable energy, and show explicitly what their planned contribution to this delivery will be. (Paragraph 62)

The next budget cycle will take place within a new policy landscape. The Climate Change Bill will commit the Government to living within fixed and binding carbon budgets, providing a strong clear focus to government decision-making and setting out for industry and individuals a pathway for the next fifteen years. Recognising the important economic and fiscal implications of the decisions that will be required, Budget 2008 announced the Government's intention to set the levels of the carbon budgets and plans to meet them alongside Budget 2009.