business action on climate change

where next after emissions trading?

Institute for European Environmental Policy

“green alliance…

Business Action on Climate Change: Where next after emissions trading?

by Catherine Bowyer, Claire Monkhouse, Ian Skinner and Rebecca Willis

Published by Green Alliance, February 2005, £20

Artwork and printing by Calverts – www.calverts.coop

Printed on Revive matt – 75 per cent post-consumer waste.

ISBN 0 9543813 8 6

Green Alliance
40 Buckingham Palace Road, London SW1W 0RE
tel: 020 7233 7433 fax: 020 7233 9033
email: ga@green-alliance.org.uk
website: www.green-alliance.org.uk

Green Alliance is a registered charity number 1045395
Company Limited by guarantee, registered number 30

about the organisations

Green Alliance

Green Alliance is one of the UK's foremost environmental groups. An independent charity, its mission is to promote sustainable development by ensuring that the environment is at the heart of decision-making. It works with senior people in government, parliament, business and the environmental movement to encourage new ideas, dialogue and constructive solutions.

Institute for European Environmental Policy (IEEP)

The IEEP is a leading centre for the analysis and development of environmental and related policies in Europe. An independent, not for profit organisation, the Institute has offices in London and Brussels. IEEP brings a non-partisan analytical perspective to policy questions, engaging in both pressing short-term questions and long-term strategic studies. We focus primarily on European Union environmental and sustainable development policies, and relevant aspects of other policies such as agriculture, transport, rural and regional development and fisheries. We are also actively engaged in the development of policy at a national level in Europe. The Institute seeks both to raise awareness of the policies that shape the European environment and to advance policy-making along sustainable paths.

acknowledgements

Our thanks go to our project partners, the Carbon Trust, Scottish Power and WWF-UK for their support of the project. We are grateful to all the interviewees and seminar participants who helped to shape the report. Particular thanks to our steering group for their valuable input and insights: Angela Love, Russell Marsh, Guy Thompson, Robin Bidwell, Bryony Worthington, Nicola Saltman, James Wilde, Michael Rea and Michael Grubb.

The recommendations presented in this report are put forward by Green Alliance and IEEP, and do not necessarily represent the position of project partners or steering group members.

CARBON TRUST
Making business sense of climate change

ScottishPower

WWF

contents

executive summary

The UK has a clear commitment to tackling climate change – yet government estimates suggest that we are not currently on track to meet targets for carbon dioxide reduction – particularly the pledge to reduce carbon dioxide emissions by 20 per cent below 1990 levels by 2010.

This report focuses on the business sector, evaluating the policies in place to help business take action on climate change. It looks in particular at the implications of the EU's Emissions Trading Scheme (EU ETS), which began on 1 January 2005 and creates an EU-wide market for carbon. This report reviews the incentives in place to encourage business action on climate change, and makes recommendations for strengthening and simplifying the policy framework. It considers the following policies: the EU ETS, the Climate Change Levy (CCL), the Climate Change Agreements (CCAs), the Carbon Trust, the UK Emissions Trading Scheme and the Renewables Obligation. Descriptions of each of these policies are set out in the introduction.

Methodology

The report is based on research conducted in the second half of 2004, while the arrangements for the EU ETS were being finalised. The research consisted of an initial literature review; a series of semi-structured interviews with 25 key stakeholders representing government, industry, NGOs and independent experts; and finally a stakeholder seminar, held in November 2004, at which draft findings and recommendations were presented and discussed.

The report contains three sets of research findings and recommendations, as follows.

The Climate Change Programme (CCP) Review

Our research showed a clear need to review domestic climate change policy, irrespective of the EU ETS, because the UK is not on track to meet its targets. Participants felt that the government was providing clear signals about the importance of climate change and the need to take action, but that there was no clear link between this overall message and individual policies. Many criticised the complexity and lack of coherence of the package of measures in place. Based on these findings, the following recommendations are put forward:

> "our research showed a clear need to review domestic climate change policy, irrespective of the EU ETS, because the UK is not on track to meet its targets"

- **Set out a clear path to meeting targets.** The aim of the CCP Review should be to establish a longer-term, defined pathway that sets out objectives, dates, actions and reviews, to make it clear how objectives will be achieved.
- **Recognise the limitations of carbon pricing.** The EU ETS is unlikely to result in a significant price for carbon in the short term. Even if this does occur over the longer term, there will still be a need for a package of measures. A price for carbon is necessary but not sufficient. It will

not automatically encourage the development of innovative technological solutions. Other policy measures also provide vital awareness-raising benefits, which might be lost if the price of carbon is just subsumed into the general price of energy. Finally, emissions trading cannot incorporate all businesses, particularly small business, so other measures will be needed to incentivise this group.

- Plan ahead for Phase II of the EU ETS. The Review should map out the process of preparing for the next phase of the EU ETS, to overcome the weaknesses of Phase I.
- Address gaps in climate policy. Policy needs to be developed to incentivise the commercial sector and SMEs, as well as the transport and domestic sectors.
- Address competitiveness concerns. Few participants saw the EU ETS or UK policy measures as a threat to competitiveness. However, these concerns continue to be expressed, and there is a need for further research to consider whether well-designed environmental regulation can aid competitiveness.
- Raise awareness. The Government, NGOs, the media and business need to help raise awareness of climate change both amongst the public and the business community.

EU Emissions Trading

Our research shows strong support for the principle of EU emissions trading. However, concerns were expressed about the way the scheme is being implemented, both at an EU level and in the UK. The scheme will only achieve its aims if emission allocations are limited, and this may not happen, as member states have been given considerable leeway in allocating allowances. There was significant criticism of the way the UK developed its National Allocation Plan (NAP), particularly the October 2004 decision to increase the number of allowances issued. Given these difficulties, we make the following recommendations for the second phase of the EU ETS:

> “ there was significant criticism of the way the UK developed its National Allocation Plan, particularly the decision to increase the number of allowances issued ”

- The Commission should conduct a thorough review of Phase I. It should build the lessons learned into Phase II, particularly looking at the use of emissions projections as the basis of NAPs.
- The UK’s approach should be considered in the context of the CCP Review. There should be a particular focus on the way in which the National Allocation Plan is drawn up.
- Develop NAPs early. The UK should use its 2005 Presidency of the European Council to push for early development of NAPs for Phase II.
- Strengthen the NAP process. The Commission and all member states should take a stronger line to ensure that there is not the same degree of over-allocation of permits in Phase II.
- Harmonise implementation. Greater harmonisation across member states could help prevent over-allocation. An EU-wide cap is desirable but unlikely. Member states could, however, co-ordinate development of their NAPs.

The domestic policy framework

It is clear from our research that the EU ETS should not prompt major revisions of policy in the short-term. It is not clear yet how effective the scheme will be, or whether a significant price for carbon will emerge. The major driver of change for the domestic policy framework should be a strengthening of policies to meet carbon targets. On the basis of the research findings, we put forward a package of measures that will complement the EU ETS, and help the UK achieve its domestic targets.

> “ it is not clear whether a significant price for carbon will emerge ”

We recommend the following policy measures, to strengthen and simplify domestic policy:

The Climate Change Levy, Climate Change Agreements and the Carbon Trust

The Climate Change Agreements (CCAs) were considered to be an effective measure, though uncertainties were expressed over whether they were ambitious enough, and if it was realistic for SMEs to participate. However, the CCL was considered to be less effective as an incentive to reduce energy use, and so there is a need to further incentivise sectors outside the CCA system. The work of the Carbon Trust was supported, though there were concerns that many businesses are not aware of its schemes and do not make use of the opportunities offered. The following recommendations are therefore put forward:

- **Maintain the CCL as an energy tax, with the aim of promoting energy efficiency to all businesses.** Increase the CCL, whilst recycling the revenues, to stimulate action on energy efficiency in line with the UK's targets. The CCL would therefore remain as a downstream measure to stimulate energy efficiency in those sectors not in the EU ETS, thereby complementing the trading scheme. The CCL should also be increased, with revenues recycled, to a level that stimulates further energy efficiency measures.
- **Maintain the Climate Change Agreements, but open the process of target-setting to public scrutiny.** The EU ETS was developed through an open process of target-setting, which proves that this is feasible.
- **Incentivise CCL-payers to invest in energy efficiency, by offering temporary or partial reductions in the CCL, linked to participation in Carbon Trust schemes.** This would encourage all businesses to consider energy efficiency improvements. The system would need to be administratively simple, so that SMEs could access it.

The UK Emissions Trading Scheme (UK ETS)

This was not considered to be an effective policy instrument in its current state. Most thought that it had not resulted in emissions reductions beyond what would have been achieved without the scheme. However it was seen as useful in preparing businesses for trading and establishing a UK infrastructure for trading. Most felt that the UK ETS had served its purpose, but there was support for the idea of changing the scheme to incentivise energy efficiency in non-energy-intensive sectors. Therefore we recommend the following:

- **The UK Emissions Trading Scheme should not continue in its current form.** The scope for restructuring the Scheme into an instrument that incentivises action in other sectors not covered by the EU ETS, such as the commercial building sector, should be explored.

The Renewables Obligation

This was considered to be one of the most effective UK instruments, with success in stimulating investment in renewable energy. However, its scope is seen as narrow, only benefiting certain technologies. It was noted that there is a lack of policy instruments to encourage the development of technologies that are less able to compete commercially. We therefore recommend:

- The Renewables Obligation should be maintained. There is a need to simplify procedures to help small-scale generators to participate.
- The Climate Change Programme Review, and forthcoming review of the Renewables Obligation, should look at ways of encouraging renewables technologies that do not currently benefit from the Renewables Obligation.

Green Alliance
40 Buckingham Palace Road, London SW1W 0RE
tel: 020 7233 7433 fax: 020 7233 9033
email: ga@green-alliance.org.uk
website: www.green-alliance.org.uk