

Current and proposed policies

The typology used to describe policies in each area divides them between current and previously proposed policies and policies aimed at increasing efficiency and policies aimed at curbing use of resources.

Energy

Current policies to increase efficiency

The government already has a number of policies in place to improve household energy efficiency. These include:

- The **Energy Efficiency Commitment**, which requires energy suppliers to meet targets for carbon savings by subsidising energy efficiency measures for some of their customers.
- **Warm Front**, funded by Defra, which pays for insulation measures for vulnerable households.
- **VAT reductions** – 5% VAT rates for DIY energy saving materials; energy efficient equipment; most microgeneration technologies; and the supply and installation of energy efficient products or materials in non-grant schemes when households employ contractors. (However, the government said that it would need to negotiate with its European partners to extend the reduced rate of VAT on energy saving materials and energy efficient equipment.)
- **Capital allowances** and **enhanced capital allowances** for companies to write off investments in energy saving equipment to lease to households;
- A **landlord's energy saving allowance**, which provides individual private landlords with relief on capital expenditure on insulation (HM Treasury 2004a).

Current policies to curb use

There are no current policies to directly curb use of household energy. The experience of the last Conservative government's introduction of VAT on domestic fuel has made the present government extremely averse to such measures. The effect of the EU Emissions Trading Scheme, the Renewables Obligation and the Energy Efficiency Commitment is in each case to increase the price consumers pay utilities for energy. By doing so, they will somewhat decrease demand. That is not the primary purpose however – these legal requirements exist primarily to directly reduce emissions, rather than to curb use. Additionally, these measures have been designed in such a way as to be invisible to the consumer, so that they are not aware they are paying higher bills as a consequence.

Proposed policies to increase efficiency

In 2002-3 HM Treasury and Defra consulted on fiscal incentives for household energy efficiency. (HM Treasury 2003) A number of the measures above were introduced following this consultation – including further VAT reductions and incentives for landlords. However, a number of other proposals, which have widespread support, were not taken up by government. These include:

Products

Inefficiency charges / product charges

Many organisations, including the Association for the Conservation of Energy and the Energy Saving Trust, put forward proposals for product charges to be levied on inefficient appliances. The government expressed concern after the initial round of consultation that product charges would be regressive, and referred to the Fuel Poverty Advisory Group (FPAG) for advice. The FPAG replied that some low income customers would pay more for inefficient appliances which bear the

tax, but this will be a small effect, as some will switch to more efficient appliances, and as the relationship between price of white goods and their energy efficiency is surprisingly weak i.e. the least efficient appliances are not necessarily the cheapest – especially but not only because of offers under the Energy Efficiency Commitment. (FPAG 2003). Another concern would be that inefficiency charges may increase the demand for second-hand appliances, which tend to be less efficient. The FPAG pointed out that many of the sellers are socially-owned enterprises, but that does not take away from the fact that the products they resell are energy inefficient and very expensive to run for the low income households that buy them. They also pointed out that the Social Fund forces benefit claimants to buy inefficient second-hand appliances, working entirely contrary to Government policies on fuel poverty and carbon emissions (there is clearly a strong case for changing Social Fund rules). The FPAG suggested that charges should apply to B and C-rated dishwashers and freezers and light bulbs. The Government did not mention the FPAG submission in their summary of the second round of consultation and continued to reject inefficiency charges. An advantage of product charges over VAT reduction is that it does not require EU approval.

Lower VAT on efficient products

Although a lower rate of VAT has been introduced on the installation of a limited range of construction products that contribute towards making buildings more energy efficient, to date the range of products has been restricted to those whose sole purpose is reducing energy use. However, greater reductions in energy could be achieved by extending the lower VAT rate to a wider range of energy products. The Government's own Sustainable Buildings Task Group (SBTG) made this recommendation last year, although they recognised that the introduction of differential VAT rates is governed by the European Union sixth VAT Directive which presently does not allow for differential rates for energy or water saving products (which are not professionally installed) or appliances. They recommended that the government continues to negotiate in the EU to establish amendments to the VAT directive that allows lower VAT rates to be applicable to a wider range of environmentally efficient products (Sustainable Buildings Task Group 2004).

New buildings and refurbishment

Variable VAT rates for new buildings and refurbishment

WWF has suggested the idea of varying the rate of VAT on new buildings and refurbishment. At present, new buildings have a VAT rate of zero and refurbishment has a VAT rate of 17.5%. The Royal Commission on Environmental Pollution is presently looking at the potential impact of a VAT rate of 8% by default on new homes and refurbishment, and 5% on new homes that met the Code for Sustainable Buildings or refurbished to meet that standard. The Treasury is not keen about the idea as because of EU law it would mean giving up a zero VAT rate for ever and would require EU approval. They regard the possibility of varying the proposed Planning Gain Supplement (see below) as preferable.

Planning Gain Supplement and Stamp Duty incentives for new buildings

The Barker Review (Barker 2004) put forward the idea of planning gain supplements, which would capture a share of windfall development gains. The Energy Saving Trust (2005) has proposed reducing Planning Gain Supplement equivalent to 50% of the additional cost of building to the standard (6-8% greater than the cost of meeting Building Regulations) and additionally offering purchasers of these homes a Stamp Duty exemption. This would incentivise developers, though there is a question about whether a rebate equivalent to 1% of purchase price would be sufficient incentive for purchasers compared to the higher costs of meeting the Code for Sustainable Buildings.

Existing buildings

Tax incentive for training installers

The Energy Saving Trust put forward a proposal for a tax incentive to encourage existing installers of energy efficiency measures to help with training of new installers. Improving home energy efficiency substantially will require increasing capacity in the insulation and heating installation industries. Both already suffer from skill and labour shortages. There are a very substantial number of sole traders who are often not prepared to take on apprentices as it reduces their own productivity while training an apprentice. The ability to offset training time and costs against their tax bill would be a useful incentive to overcome this problem. For larger companies, a rebate against corporation tax could be sufficient. The government did not take up this proposal, but gave no reason why not.

Stamp Duty incentives

The proposal for a Stamp Duty incentive for householders who undertake energy efficiency measures recommended in the Home Condition Report to be introduced in 2007 has a lot of support. The Association for the Conservation of Energy (ACE) sponsored a private member's bill in the last session of Parliament legislating such a scheme, that fell when the General Election was called.

Analysis by the Policy Studies Institute (PSI) suggests that this would be a workable option, but focus groups conducted by the Energy Saving Trust (2005) showed, surprisingly, that many people who had bought homes were not very aware of Stamp Duty and so the prospect of an incentive based on it was not much of an incentive. By contrast, everyone was aware of Council Tax, and reducing it was regarded as a real incentive. A priori analysis had suggested that Stamp Duty would be a better incentive because people would be more likely to undertake the upheaval of energy efficiency measures when they are moving in as that is when they are more likely to do work on their home. The research found that instead people regarded moving as stressful enough without undertaking additional work that was not perceived as essential at that time. They would instead prefer to do such work when they are settled.

EST estimated that annually up to 26% of households buying a property with unfilled cavity walls, or 5% of those moving home (67,850) each year could be encouraged to take advantage of an incentive linked to Stamp Duty, saving 12,000tC per year, and over the lifetime of the measures saving 0.4MtC.

A proposal by the Sustainable Buildings Task Group suggested that new homes built in accordance with the Code for Sustainable Buildings could be subject to a reduced rate of Stamp Duty (Sustainable Buildings Task Group 2004). The SBTG also recommended that the government consider amending the Stamp Duty regime to allow a rebate for householders.

Council Tax incentive

An alternative to Stamp Duty incentives would be Council Tax reductions for efficient households. Analysis by PSI suggests that this would be a workable option and EST research suggests that it would be a more effective incentive.

Further support for a Council Tax incentive comes from pilot projects in some local authorities. In November 2004, British Gas, in conjunction with Braintree District Council, launched a scheme providing rebates on Council Tax to residents installing cavity wall insulation. Householders taking advantage of a £175 insulation package (a home energy audit, cavity wall insulation and energy efficient light bulbs) receive a one-off £100 reduction in their Council Tax bill. The discount is funded jointly by the Council and British Gas. The scheme is targeted at the 'able-to-pay' owner-occupier sector. Eligible residents are contacted by the Council. Respondents are

passed to British Gas-appointed insulation contractors, who arrange surveys, provide quotes and where appropriate sign householders up to the scheme. The list of completed installations is then passed to the Council's Finance Department, who amend the Council Tax demands. Six hundred householders contacted the scheme in its first six months and 250 cavity walls were installed. South Cambridgeshire District Council launched a similar scheme with British Gas in April 2005.

In order to roll out the Braintree scheme across the UK, it would be necessary to provide central government funding for the initiative. Braintree has been able to fund its contribution out of surpluses generated from other activity it has undertaken for energy suppliers under the Energy Efficiency Commitment. However, this is not a reliable source of funding for other Local Authorities, nor would it provide adequate resources. EST has estimated, based on the Braintree experience, that about 8% of eligible households would take up such a scheme each year. Nationally, it would cost about £110 million per annum, saving around 290,000 tonnes of carbon (9.8 million tonnes of carbon over the lifetime of the measures). This money would have to come from central resources until after 2010, when there will be the opportunity to fund it in a revenue-neutral fashion under Council Tax reform.

Proposed policies to curb use

A carbon tax on domestic energy

This could provide an incentive to decrease use, but it would increase fuel poverty. Possible compensation mechanisms would not be able to prevent a significant number of low-income losers because of the large variation in the efficiency of the fabric of the housing stock.

Discussion

It would be worthwhile to introduce at least one economic instrument to tackle each area: products, new buildings and existing buildings.

Products: Product charges offer a lot more opportunity to create noticeable incentives than lower rates of VAT do, because a lower rate of VAT only reduces the price by 10%, whereas a product charge can increase it by much more than that – and without the need to get EU approval for each change. There would be potential to create a set of wasteful products that attracted inefficiency charges. Incandescent light bulbs and B- and C-rated dishwashers and freezers are the most obvious candidates. In order for the taxes to be effective, they should be clearly labelled on products that are subject to them.

New buildings: There is a choice between varying the VAT rate or using planning gain supplement (PGS) and stamp duty. There would be much more government resistance to varying the VAT rate, but using PGS would be quite complicated as the Treasury would have to compensate local authorities for insisting on the Code for Sustainable Buildings as otherwise they would have a perverse incentive to force the developer *not* to use the Code as it would lower the PGS the local authority receives. PGS has been widely welcomed, but the Barker Review in general is extremely controversial, having been strongly criticised by environmental organisations and the House of Commons Environmental Audit Committee. Barker's plans to create hundreds of thousands of extra households and dwellings beyond natural household growth in order to attempt to reduce house prices will have serious negative impacts on the use of land, energy and water, and on waste production.

Existing buildings: Council Tax is not going to be reformed until at least 2010. The introduction of the Home Condition Report in 2007 gives an earlier opportunity for the introduction of a Stamp Duty incentive. However, a Council Tax incentive is likely to have much more impact and EST thinks that having both measures in parallel would be administratively complex.

A training tax incentive for installers is a worthwhile measure to increase skills and capacity in the industry.

Water

Current policies

There is currently little fiscal incentive in place to encourage water efficiency, except limited water metering (see discussion below). In terms of household budgets switching to a metered supply, i.e. having a meter installed, typically results in lower charges for a household's water use. However, deciding whether this is the case is difficult and people are suspicious of meters as rates can increase in the future. Households that will gain even if their water consumption remains the same switch and those that would lose do not. The households that switch do not feel so incentivised to save water because they will gain even if their water consumption does not fall.

Proposed policies

Water metering

Both Green Alliance (2005) and the Institute for Public Policy Research (2005) have advocated increased water metering. The government supports voluntary water metering, but has not been prepared to make it compulsory. Current legislation allows water companies to introduce compulsory metering if they have 'water scarcity status'. Folkestone and Dover Water recently applied to the Secretary of State for this status. A decision is expected by the end of the year.

The Policy Studies Institute (Dresner and Ekins 2004a) showed that it is possible to design tariffs that would not suffer from the objection most often raised in the past to water metering - that it would necessarily penalise larger and poorer households.

Reduced VAT for water efficient products

Green Alliance (2005) has proposed that reduced VAT should be provided for water efficient products, alternative water supply products and their installation. Reducing VAT on water efficient products would provide a financial incentive for consumers when replacing products. It would also provide builders with an incentive to use water efficient products in the original design. The government would have to convince the EU that VAT reductions on water efficient products are within the competitiveness agreement. Reduced VAT on repair and maintenance would also have an impact water efficiency in the existing housing stock.

Planning Gain Supplement and Stamp Duty incentives for new buildings

Reductions in Planning Gain Supplement and/or Stamp Duty for new homes that met the Code for Sustainable Buildings, as discussed in the Energy section above, could be another fiscal incentive to promote water efficiency. Green Alliance has advocated that the Code for Sustainable Buildings be underpinned by regulation to increase its credibility and that Building Regulations should include water efficiency.

A Water Saving Trust

Green Alliance also supported the creating of a Water Saving Trust, to deliver water efficiency programmes and champion the issue – mirroring the work of the Energy Saving Trust.

A Water Efficiency Commitment

IPPR has advocated a Water Efficiency Commitment for water companies, working in a similar way to the Energy Efficiency Commitment, by placing a requirement on water companies to increase the efficiency of their customers' homes.

Waste

Policy on municipal waste is stated in the Waste Strategy 2000 for England and Wales (Department of the Environment, Transport and the Regions 2000), with subsequent separate strategies produced in Wales and Scotland. Municipal waste production continued to grow until 2003/4, when there was for the first time a small reduction in waste production was recently announced that the interim recycling target of 17% was achieved in 2003/4, although the target for 2005/6 is significantly higher at 25%.

Current policies

The main fiscal incentive for reducing household waste is the landfill tax. The Strategy Unit's (2002) report on waste called for the landfill tax to be increased to £35 a tonne in the medium term, and the Treasury subsequently announced that it would be increased by at least £3 a tonne each year from 2005/6 to reach £35 per tonne.

The Landfill Allowance Trading Scheme (LATS) started in April 2005. Local authorities across England have been set limits on the amount of biodegradable municipal waste they can dispose of in landfill sites. These 'landfill allowances' are tradable. Authorities can buy more allowances if they expect to landfill more than is permitted by the number of allowances they hold. Authorities with low landfill rates can sell their surplus allowances. This creates a further incentive to reduce waste to landfill. Disposal authorities that exceed the limit set by the allowances they hold will be fined £150 for every tonne they are over the limit and the limits will get progressively tighter.

The cost of the landfill, the tax on it, and LATS are borne by the local authority and passed on indirectly to households through Council Tax. However, this is not in relation to amount of waste produced, which creates little incentive for householders to take action.

Proposed policies

Variable charging for domestic waste

The Strategy Unit (2002) report on waste called for early legislative changes to allow local authorities to implement incentive and charging schemes for municipal waste collection, not least to provide an incentive for householders either to reduce their waste or to cooperate with recycling schemes. At present, local authorities cannot charge for the amount of waste produced. Charging according to the amount of waste produced is common in other developed countries. The subsequent Local Government Act allowed local authorities to give council tax discounts, but did not allow for direct or variable charging. The government expressed concern about the danger of fly-tipping, ensuring that low-income families are not penalised and the cost or complexity of administration (Defra 2003). Of course, by refusing to legislate to allow local authorities to experiment, the government made it impossible to test the effects. Experience in other countries has been that variable charging does not lead to an increase in fly-tipping and that the costs of administration are outweighed by the reduction in waste produced and needing to be managed (Eunomia Research and Consulting 2001, Eunomia Research and Consulting 2003). Research by the Policy Studies Institute (Dresner and Ekins 2004b) indicates that at the very least it is possible to design compensation schemes to ensure that low-income families are not penalised.

Defra have made funds (£5-6 million) available to local authorities wishing to run pilot household incentive schemes. These pilots are meant to start in October 2005 be concluded by Spring 2006. These schemes will not be allowed to charge according to waste produced but can use other incentives. Benefits can be financial, for example, discounts or council tax rebates; prize draws for participating in recycling); cash back incentives for real nappy use); "cash for trash" schemes);

cash discounts (eg subsidised compost bins). Alternatively community rewards are suggested such as trees planted per tonne of recyclate collected; charitable donations such as reward or donation to schools per tonne of recyclate collected).

Graduated waste tax/Incineration tax

As the Landfill Tax increases, the case for a graduated waste tax strengthens, i.e. a tax that is graduated according to the desirability of different waste management options. This is needed to ensure that incineration or other measures lower in the waste hierarchy are not prioritised over increasing recycling or waste reduction by local authorities. The Strategy Unit called for the case for an incineration tax to be kept under review. The government commissioned a review of the environmental and health impacts of all waste disposal and waste management options and stated that it would consider the case for the tax in the light of the review and in consultation with stakeholders (Defra 2003). In the 2004 Pre-Budget Report, the Treasury announced that there would not be an incineration tax as the government's priority was to reduce landfill because of the Landfill Directive and that incineration has a part to play in meeting this commitment, in particular by dealing with the residual waste left after recycling and reuse (HM Treasury 2004b).

VAT reductions and product charges

The Strategy Unit also recommended that the government consider applying economic instruments such as product charges and incentives such as VAT reductions for recycled products. The government said it would consider the idea, but this has not led to any change of policy.

Conclusion

It is clear from this survey that economic incentives for energy efficiency are much better developed than incentives for either water or waste. There is a case for looking at how the various existing and proposed measures could be linked together to provide a package of incentives for sustainable communities, allowing greater synergies and interplay between the different areas. Areas which could be developed further in this way include:

VAT reductions for efficient products: These could apply to energy, water and waste. The Treasury is open to this idea, but it is limited by the VAT Directive and the need for European agreement.

Product charges: Again, these could apply across the three categories. However, there seems to be little enthusiasm for product charges from the Treasury. Concerns about distributional effects may remain, despite evidence to the contrary, in energy at least, from the Fuel Poverty Advisory Group.

Planning gain supplement and/or stamp duty incentives for new homes to meet the Code for Sustainable Building: Measures for new homes, as recommended by the Sustainable Buildings Task Group, have been discussed more recently, and seem to be a promising area. Government has not expressed support or opposition for such measures.

Council tax and/or stamp duty incentives for existing homes to be made more efficient: Council tax incentives do not require Treasury approval, but there are financial implications. The idea could be applied to water efficiency improvements (e.g. replacing toilets and shower heads) as well as energy efficiency improvements.

Metering or variable charging of presently unmeasured activities: Metering and variable charging are fiscal incentives, but they are not the direct responsibility of the Treasury. The government has some social justice concerns about these, but research seems to indicate that they can be

addressed. There seems to be interest from government in water metering tariffs, but little enthusiasm currently for variable waste charging.

Training tax incentive for installers: This measure is rather different from the others, but it is very important because of the need for more trained installers and better skills in the energy conservation industry, and possibly in water conservation too. The Treasury did not take up this proposal in the consultation on fiscal incentives for energy efficiency, but there is a strong case for continuing to push this measure.

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