

Economic instruments to improve household energy efficiency: consultation document on specific measures

Summary of responses

December 2003



HM TREASURY



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EXECUTIVE SUMMARY

1.1 The Government would like to thank all those who responded to the second consultation on the use of economic instruments to improve household energy efficiency. The Government is also grateful for the many contributions made during seminars and workshops in September and October on the subject of household energy efficiency.

1.2 This report summarises the main points made by respondents. The consultation concentrated on the most viable options emerging after the first consultation. It also considered the potential product groups where economic instruments could be used to encourage market transformation. In doing so the consultation asked for a range of information and therefore responses have been grouped under the general themes of the consultation. These are:

- # market failures;
- # products suitable for economic instruments;
- # impact of economic instruments on the market;
- # criteria for assessing application of economic instruments;
- # distributional impact of economic instruments;
- # measures for the rented sector;
- # other measures;
- # economic instruments and other government interventions.

1.3 The consultation responses were broadly supportive of the principal measures proposed by the Government, and there was also significant support for other measures. In general, improving the housing stock was considered very important in meeting the Government's targets for the domestic sector in the context of its greenhouse gas targets and aspirations.

1.4 Respondents were also keen to emphasise the importance of a package of measures. A single measure was rarely seen to be enough to achieve the required shifts in consumer behaviour, and in particular a range of interventions was seen as important to support the Government's strategy on fuel poverty.

1.5 The consultation responses will be taken into account in the development of Government policy in this area. The proposed next steps on the use of economic instruments are noted in the *Pre-Budget Report 2003*.¹

¹ *Pre-Budget Report 2003*, HM Treasury, December 2003; www.hm-treasury.gov.uk.

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BACKGROUND

1.6 This consultation built on a previous consultation, *Economic instruments to improve household energy efficiency*, issued in July 2002.²

1.7 This earlier consultation aimed to inform policy development, alongside wider discussions which fed into the Energy White Paper, *Our Energy Future - creating a low carbon economy*, launched by the Department of Trade and Industry in February 2003.³

1.8 *Budget 2003* announced a further consultation on specific measures, taking as its starting point the most promising proposals from the first consultation.⁴

OVERVIEW OF CONSULTATION

1.9 The consultation was launched on 1 August 2003, and closed on 24 October. We received 126 responses, from individuals and a range of organisations, a number of which cited wider support from other individuals and organisations which did not respond directly to the consultation. A full list of respondents is contained in Annex A.

1.10 There was broad agreement on the market failures identified in the consultation document. There was also general recognition of the need to work within the context of the targets and aspirations of the Energy White Paper, and the importance of securing improvements to household energy efficiency as part of those commitments.

1.11 The responses were generally supportive of the key measures which the consultation highlighted:

- ⌘ a reduced rate of VAT to 5% for the supply and installation of energy efficient products or materials in non-grant schemes when householders employ contractors (supported by 120 respondents);
- ⌘ a reduced rate of VAT to 5% on DIY energy saving materials (supported by 33 respondents);
- ⌘ a reduced rate of VAT to 5% for energy efficient equipment (supported by 27 respondents);
- ⌘ capital allowances and enhanced capital allowances for companies to write off investments in energy saving equipment to lease to social landlords and households (supported by 67 respondents);
- ⌘ a domestic business tax allowance for landlords to claim against their profit/surplus on the cost of installing energy saving materials (supported by 72 respondents).

² *Economic instruments to improve household energy efficiency: Consultation Document*, HM Treasury/DEFRA, July 2003; www.hm-treasury.gov.uk.

³ *Our Energy Future - creating a low carbon economy*, DTI, February 2003; www.dti.gov.uk.

⁴ *Budget 2003*, HM Treasury, April 2003; www.hm-treasury.gov.uk; *Economic instruments to improve household energy efficiency consultation: summary of responses*, HM Treasury/DEFRA, November 2002; www.hm-treasury.gov.uk.

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1.12 In addition, there was some support for a tax incentive for relevant training, stamp duty incentives for home energy efficiency improvements and product charges for energy-inefficient appliances.

MARKET FAILURES

1.13 The consultation identified six main areas of market failure in the context of domestic energy efficiency: information deficiencies; incorrect price signals; limited access to capital; contractual problems; skills shortfalls, and uncertainty.

1.14 Respondents strongly agreed that these were the most important failures of the market. Particular emphasis was placed on the following:

- # skills shortages;

- # incorrect price signals;

- # information failures, in particular the need for greater awareness of the total life span running cost of a product.

PRODUCTS SUITABLE FOR ECONOMIC INSTRUMENTS

1.15 The consultation proposed four main groups of products to which economic instruments could be applied: boilers and micro-CHP; lights; insulation, and appliances.

1.16 There was substantial agreement with the identification of this group of products. A large proportion of respondents supported a general VAT reduction for contractor-installed energy efficient products or materials. Boilers were specifically mentioned by 16 respondents, and micro-CHP by 23. A few respondents supported a reduction in VAT on cavity wall insulation. Other products mentioned included double glazing, solar panels, photovoltaics, wood stoves and ground source pumps.

1.17 A reduction of VAT on DIY energy-saving materials was supported by 33 respondents. Although concerns were expressed by some about the disadvantages of DIY as opposed to contractor installation of insulation, it was pointed out by others that the lower cost of DIY installation would make it affordable for households with lower incomes.

1.18 VAT reductions for energy efficient equipment were supported by 27 respondents, 15 of which specifically mentioned compact fluorescent lamps (CFLs).

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IMPACT OF ECONOMIC INSTRUMENTS

1.19 The consultation asked about the impact of the use of economic instruments:

- # would price reductions be passed on to consumers?
- # would price reductions affect consumer demand?
- # should economic instruments be used both to raise some prices and lower others?
- # what would be the impact on producers and government?

1.20 Most respondents were clear that price reductions would be passed on, and that they would in turn influence consumers' decisions. The need for economic instruments to be used in conjunction with other measures was also noted by a number of respondents. They felt that a reduction of VAT on its own was a relatively weak incentive, and that information deficiencies should be addressed before price differentials are considered. Others felt that product charges could prompt repair rather than replacement of products, and that the best way to remove inefficient products from the market was to encourage manufacturers not to produce them in the first place.

1.21 When asked about the likely response by consumers to the use of economic instruments, the majority of respondents felt that consumers would alter their purchasing behaviour in response to these signals. Some respondents pointed to specific evidence of the impact of price changes on consumer demand, in particular when acting in concert with other promotions.

1.22 The consultation asked whether the use of economic instruments would pose unmanageable burdens on government or industry. Respondents to this question generally felt that the burdens would be manageable, and would be outweighed by the support for environmentally-friendly technologies that would follow from the use of economic instruments.

CRITERIA FOR ASSESSING APPLICATION OF ECONOMIC INSTRUMENTS

1.23 There was a variety of responses to the question about the efficacy of the existing EU energy labelling scheme. Most respondents felt that the existing labelling scheme was not sufficient, largely because it did not apply to all products. A variety of alternatives were suggested for areas where the EU scheme did not operate, including the SEDBUK system for domestic boilers, and the Energy Saving Trust's energy rating system. Some respondents felt that this was an area where the UK could take a lead in Europe, by developing a broader system which could assist the use of economic instruments to promote energy efficiency.

DISTRIBUTIONAL IMPACT OF ECONOMIC INSTRUMENTS

1.24 The consultation noted the Government's concern about the impact of the use of economic instruments on its commitments regarding fuel poverty, and in particular measures which could increase the price of energy-using products.

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1.25 Respondents felt that in the longer term, fuel poverty is best tackled by some of the policy initiatives discussed in the document, particularly encouraging the use of energy efficient products, and the installation of energy-saving measures in homes.

1.26 While the majority felt that the effect of the proposed measures on the fuel poor should be neutral, others suggested further interventions to alleviate fuel poverty. Chief amongst them was the use of the Energy Efficiency Commitment (EEC), and others also suggested the Warm Front scheme.

MEASURES FOR THE RENTED SECTOR

1.27 The need for particular interventions in the private rented sector was echoed by many respondents, although some felt that the problems in this sector were no worse than in housing in general, and therefore did not deserve special attention.

1.28 Respondents felt that there was no incentive for private sector landlords to install energy saving materials or energy efficient products. There was no tax incentive for them to do so, and rents rarely reflected the cost or benefit of the installation of insulation or central heating.

1.29 There was general support for the idea of a domestic business tax allowance, which would give landlords a greater incentive to improve the energy efficiency of their properties. Many respondents favoured some form of regulation, or penalty system, to encourage improvements, and others supported an extension of existing grant schemes to assist the private rented sector.

OTHER MEASURES

1.30 The consultation suggested the possibility of introducing capital allowances and enhanced capital allowances for companies to write off investments in energy saving equipment to lease to social landlords and households. This measure was supported by 67 respondents.

1.31 Respondents also suggested other uses of the tax system to promote energy efficiency. The most popular was a rebate on stamp duty for homeowners who make energy efficiency improvements to homes within six months of purchase. Half of the respondents favoured this measure. Other respondents favoured rebates of corporation tax or council tax as an incentive, or tax penalties for owners of energy inefficient buildings.

ECONOMIC INSTRUMENTS AND OTHER GOVERNMENT INTERVENTIONS

1.32 The consultation noted a range of current Government policies designed to improve household energy efficiency, including EEC, Warm Front, the Community Energy Programme, and building regulations. It asked respondents to consider the effectiveness of economic instruments compared with these existing activities.

1.33 Most respondents felt that building regulations on their own were insufficient to make a significant contribution to greenhouse gas emissions from the domestic sector. Similarly, product standards were not considered to be viable as an alternative to economic instruments.

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1.34 Most respondents, indeed, favoured the use of a variety of policy interventions to improve domestic energy efficiency, and felt that an important aim of government policy should be to promote innovative means of space heating and lighting.

CONCLUSION

1.35 The Government is committed to its Energy White Paper targets, and to developing the use of economic instruments in keeping with the principles set out in *Tax and the Environment: Using Economic Instruments* (November 2002).⁵

1.36 The responses to this consultation have been used to inform policy development in this area, and the Government's initial proposals are contained in the environment chapter of the *Pre-Budget Report 2003*.⁶

⁵ *Tax and the Environment: Using Economic Instruments*, HM Treasury, November 2002; www.hm-treasury.gov.uk.

⁶ *Pre-Budget Report 2003*, HM Treasury, December 2003; www.hm-treasury.gov.uk.

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ANNEX A

1.37 This list contains the names of those who responded to this consultation. In addition, a further 7 people contacted their constituency MP to support an Early Day Motion on the consultation. These views have been taken into account, but their names are not reproduced here.

Advisory Committee on Consumer Products and the Environment
Aldwyck Housing Association Ltd
David Amess MP
Anglian Group plc
Association for the Conservation of Energy
B&Q plc
Baxi Group Ltd
British Rigid Urethane Foam Manufacturers Association Ltd
Building Research Establishment Ltd
Carrick District Council
Martin Caton MP
Cavity Insulation Guarantee Agency
Centrica plc
Colin Challen MP
Chartered Institution of Building Services Engineers
David Chaytor MP
David Chidgey MP
Harry Cohen MP
Combined Heat and Power Association
Construction Products Association
Frank Cook MP
Ian Davidson MP
Derby City Council
Devon County Council
Disenco Ltd
Sue Doughty MP
Julia Drown MP
Eaga Partnership Ltd
East Ayrshire Council
East Devon District Council
East Renfrewshire Council
EDF Energy plc
Energetix microPower Ltd
Energy Consultancy
Energy Saving Trust
Environmental Industries Commission
Eurisol UK Ltd
Lord Ezra
Friends of the Earth - England, Wales and Northern Ireland
Friends of the Earth - South Bedfordshire
Fuel Poverty Action Group
Gateshead Council
Glasgow City Council
Glass and Glazing Federation
Green Alliance

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Win Griffiths MP/AS
Guildford Borough Council
John Horam MP
Alan Howarth MP
Eric Illsley MP
Insulated Render & Cladding Association Ltd
Dr Lynn Jones MP
Kent Energy Centre
Kingspan Insulation Ltd
Mark Lazarowicz MP
Lewisham Council
Lighting Industry Federation Ltd
Elfyn Llwyd MP
Andrew Lockley
London Borough of Hammersmith and Fulham
Alice Mahon MP
Maldon District Council
John McWilliam MP
Microgen Energy Ltd
MicroPower Ltd
Austin Mitchell MP
National Association of Estate Agents
National Consumer Council
National Energy Association
National Federation of Residential Landlords
National Insulation Association
National Right to Fuel Campaign
Northampton Borough Council
Northwest Development Agency
Ofgem
Oil Firing Technical Association
Diana Organ MP
Dr Gill Owen
Oxford City Council
Peripheral Imaging Solutions Inc.
Peterborough City Council
Anthony Powell
Powergen UK plc
Powys County Council
Adam Price AS/MP
PRP Architects
Rother District Council
Royal Institution of Chartered Surveyors
Royal Society for the Protection of Birds
Rushcliffe Borough Council
Bob Russell MP
RWE Innogy plc
Sciotech Projects Ltd
Scott Energy
Scottish and Southern Energy plc
Scottish Borders Council
Scottish Power plc

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Alan Simpson MP
Society of British Gas Industries
Solid Fuel Association
Strathclyde and Central Energy Efficiency Advice Centre
Sustainable Energy Partnership
Swale Borough Council
Tamworth Borough Council
Matthew Taylor MP
Dr Jenny Tonge MP
Transco plc
UK Business Council for Sustainable Energy
Vaillant Hepworth Group
Viterra Energy Services Ltd
Wakefield Metropolitan District Council
Joan Walley MP
Whisper Tech Ltd
WhitbyBird Ltd
Betty Williams AS/MP
Pete Wishart MP
Worcester Heat Systems Ltd
World Wildlife Fund UK
Wycombe District Council

