

Economic instruments to improve household efficiency consultation

Summary of responses

EXECUTIVE SUMMARY

The Treasury would like to thank everyone who responded to this consultation.

This report summarises the main points made by respondents.

All responses were generally positive, supporting government action in this area, and recognising the potential benefits that economic instruments could deliver.

Respondents' suggestions were aimed at providing incentives in two broad ways – incentives for specific products and incentives aimed at improving the home as a whole.

To provide an incentive for investment in particular products, many responses focussed on the possibility of varying VAT rates to encourage the purchase of energy efficient products. Other suggestions included specific products taxes (e.g. a tax on light bulbs) and grants to promote energy efficient products.

To provide incentives to improve the energy efficiency of the home more generally through investment in energy efficiency measures respondents suggested a range of potential measures including: providing incentives through stamp duty; personal tax allowances; council tax reductions (often relating any incentive to the SAP rating of the property).

There were also some more radical suggestions such as introducing a Domestic Climate Change Levy and adjusting the Winter Fuel Payments to include energy efficiency incentives.

Respondents also noted that other (non fiscal) measures are also necessary if energy efficiency in the domestic sector is to be effectively addressed. Suggestions included education and awareness programmes.

BACKGROUND

Budget 2002 announced that the Government would consider ways in which economic instruments might be used to improve household efficiency. A consultation document, "Economic Instruments To Improve Household Efficiency" was published in July 2002. The deadline for responses was 8 October 2002.

The purpose of this consultation exercise was to seek views on ways in which economic instruments could be used to overcome market failures, which prevent

improvements in household energy efficiency. These responses will also help to inform the Government's policy development in this area, alongside the process of consultation leading up to the Energy White Paper.

RESPONSES

117 responses were received to the consultation.

81 responses expressed support for the "Clean Dozen" – a list of economic instruments and other measures suggested by a broad coalition of organisations. This can be found in Annex C

A list of respondents can be found at Annex B

OVERVIEW OF RESPONSES

Responses highlighted that the current unit price of energy failed to take account of associated long-term environmental costs. As a result, households fail to recognise the importance of energy efficiency in households.

The importance of providing households with the necessary information regarding household energy efficiency was noted in many responses. Respondents felt that raising awareness of the availability, and the economic and environmental benefits of energy efficiency measures and products is essential if energy efficiency in households is to increase.

Respondents also noted that the private rented sector is a difficult sector in which to tackle energy efficiency. Energy wastage in this sector is a major problem. Landlords need to be provided with incentives to encourage them to invest in improving the energy efficiency of the private rented housing stock.

Responses identified the lack of skilled labour as being a barrier to improving domestic energy efficiency. Many suggested that the Government should create incentives to promote training.

POINTS RAISED BY RESPONDENTS

Respondents were invited to submit proposals for economic instruments to improve household energy efficiency by answering a list of questions. Not all respondents answered all questions and not all respondents followed the format of the consultation document. A full list of questions asked is at Annex A

- 1. Do you agree that the market failures set out above are barriers to improvements in domestic energy efficiency? Are there any other market failures that you believe constrain investment in this area?*

All of the respondents who answered this question agreed with the market failures outlined in the consultation document. Other comments included:

- Consumers fail to behave rationally. Decisions are not prioritised on the basis of long term financial return;
- Capital market constraints - the inability of buyers to borrow money to finance energy efficiency improvements;
- There is an absence of clear energy efficiency targets. Targets are essential for energy efficiency improvements to be realised;
- Savings made are not sufficient to claim the attention of householders nor to justify the inconvenience of having the work carried out.

2. *Which of these barriers do you consider are not fully addressed by existing Government support for domestic energy?*

Generally, respondents believed that existing Government support was not sufficient to achieve Government aims. On the whole it was felt that support for domestic energy efficiency has to date been limited, and that carefully targeted intervention is essential. Typical comments included:

- Adequate information is not available. Need independent advice from neutral sources;
- The Government needs to define energy targets;
- Domestic fuel prices fail to reflect external costs;
- The creation of incentives for homeowners to invest in energy efficiency measures needs to be addressed;
- There needs to be a clearer elucidation of the financial benefits. Households are unaware of the financial savings available.

3. *Do you wish to comment on any of the examples of economic instruments given in Annex D?*

Examples of economic instruments to improve household energy efficiency in other countries were listed.

Only a small number of respondents answered this question – there was a mixture of responses. These included:

- The examples given in annex D favour the fuel rich;
- The examples listed generally seem quite complex;

- Tax incentives offered seem to be effective;
 - The incentives offered need to be combined with effective awareness campaigns if they are to be successful;
 - Capital grants or subsidies are the most attractive examples and appear to be effective in delivering benefits.
4. *Do you propose any specific economic instruments to improve domestic energy efficiency, consistent with the Government's commitment not to introduce new taxes on domestic energy? If so, please indicate how each instrument would help to overcome the market failures above.*

VAT

Responses showed overall support for applying lower rates of VAT as a specific instrument to improve domestic energy efficiency. The concept of VAT reductions on both energy efficient appliances and insulation measures was popular. Alternatively, some respondents also supported increased VAT on inefficient products. However, European Union VAT directives limit the scope for using VAT reductions more widely. A number of respondents were aware of this. (The option of introducing 0% VAT rates for energy saving products and materials was also raised. This is not allowed under EU VAT law and is not currently open to negotiation.)

Suggestions included:

Lowering VAT on low energy lights, A and B rated condensing boilers, DIY energy efficient products such as loft insulation and A-rated household appliances.

For new residential build:

Removing the current zero VAT rate on the construction of new buildings and introducing a reduced VAT rate conditional upon achieving a sustainability rating – Government would need to determine what criteria are required from new build for it to be eligible for the reduced rate. It was suggested that the zero rate would however still apply to the construction of new building for charitable use and alterations to protected buildings. New residential build that does not achieve the sustainability ratings would be taxed at 17.5%.

Other widely supported measures included:

- Stamp Duty – Many respondents felt that the existing mechanism could be adjusted. Targeting homeowners when they are moving house would be an effective way to improve domestic efficiency, as it was widely felt that this is a time when householders are likely to consider carrying out home improvements.

One proposal was that any energy efficiency work carried out could be offset against stamp duty. One option was that work would need to be carried out prior to the date on which stamp duty is payable. However, given that stamp duty is payable when a transaction occurs, it would be unlikely that a purchaser would undertake work before this point. A variant of this measure would be to allow rebates of stamp duty on improvements carried out in a set period, although technically this would be a spending measure rather than a tax one.

Some respondents also suggested that the rate of stamp duty on properties is varied depending upon the energy efficiency rating (measured by the Government's Standard Assessment Procedure (SAP) rating) of the dwelling. This would require all property transactions to be accompanied with a SAP rating, as envisaged by the draft EU Energy and Buildings Directive.

Additional revenue generated on energy inefficient homes could be used to for grant schemes aimed at the fuel poor or to provide assistance for properties in designated deprived areas.

Most respondents did realise that a suitable level of monitoring would be an essential factor in the design of this measure.

- *Personal Tax Allowances* – A number of respondents believed that this instrument could be used to stimulate energy efficiency. It would be used to convey to householders the balance of taxation, supporting environmentally good behaviour. Comments included:

Relief should be provided via personal income tax depending on the amount of efficiency improvements undertaken.

Tax credits could be used to stimulate installation of energy efficiency products. However it would only be an incentive for those who fill out a tax return. It could be used as part of a package of measures.

Improvement of home energy efficiency is measured by the SAP system and a 'before and after' SAP certificate could be a requirement where higher expenditure is involved.

- *Differential rates of Council Tax* – Many respondents believed this would be an effective measure to improve domestic energy efficiency.

All householders pay council tax. Lowering council tax as a reward for energy efficiency improvements or giving a rebate could be a popular incentive. This would need to be linked to an 'energy audit' to ensure fairness, and the cost of this would need to be included in the rebate.

A council tax reduction could be given on the basis of:

- an improvement to the house, which could be specified measures or an increase in the SAP rating;

- the energy efficiency of a house as measured by an energy rating. A property that is inefficient could be rated a band higher than a similar property that is energy efficient. This would require all homes to have an energy rating.
- A change to Energy Efficiency Commitment – this existing measure is approved of by a majority of respondents. Generally respondents felt that the EEC could be extended so that additional benefits can be achieved through the programme and Government targets can be met. Comments included:
 - expansion of the EEC should come with reforms to encourage greater commercial incentives;
 - provision needs to be made for those on low incomes;
 - the Government could provide targeted information to householders who receive benefits.
 - the EEC is a major source of incentives, which has positive benefits on the environment but needs to be broadened to be more effective.

Other suggested measures included:

- Grants – Some respondents felt that providing grants would be an effective measure. Some suggestions included:

Grants to be provided for domestic measures of insulation and heating controls, targeted at all domestic consumers. This could be funded from general taxation.

Grants could be made available for energy efficiency improvements linked to council tax banding. The grants may be partially funded from increased council tax revenues from inefficient homes. This would be an effective way of recycling the funds for property improvements.

Lack of skilled labour was also an issue. Some respondents felt that providing grants to companies would be an effective measure in tackling the training of workers. This would provide an incentive for companies to introduce training schemes. Another suggested method of promoting training was to give tax incentives for businesses to engage in training.

- Capital Allowances – Suggestions given by some respondents included:

Apply enhanced capital allowances to companies leasing energy efficiency products. This measure is already available in the Affordable Warmth Programme but should be extended to the wider domestic market.

Landlords should be able to claim tax allowance against rent income for energy efficiency work undertaken, including for energy efficiency measures which are currently ineligible for allowances as they count as ‘improvement’ measures.

Capital allowances for expenditure on the conversion of premises into ‘sustainable’ dwellings for the rental market, thereby promoting the improvement of the existing housing stock.

- *Product Charges* – A few respondents also supported this measure. Suggestions included:

A ‘product charge’ on energy intensive appliances or devices such as those that are added to a property which increase energy use (e.g. air conditioning);

A tax/charge on inefficient tungsten light bulbs;

A tax or charge on household appliances with an EU efficiency label of D or below.

- *Mortgage rates* – A very small number of respondents felt that encouraging mortgage lenders to offer favourable mortgage rates to homeowners who install energy efficiency in their home would be worthwhile. However, there were no suggestions as to how this might be achieved.
- *Domestic Climate Change Levy* – A small minority of respondents suggested that extending the CCL to the domestic sector would help consumers to realise the importance of improved energy efficiency by recognising the wider costs of energy use. However, it was noted that the levy should not have an adverse impact on the ‘fuel poor’ and that this could be avoided through other compensatory measures.
- *Winter Fuel Payments* – A few respondents felt that the current payments could be adjusted to encourage pensioners to make their homes more energy efficient.

5. *How would the proposed economic instrument relate to existing policy measures? Are there any synergies or overlaps? Would the instrument be consistent with the aims of existing measures or would they involve potential conflicts? If there are conflicts, how might these be addressed?*

Not all respondents answered this question. Those respondents that did failed to answer all aspects of the question.

Responses tended to highlight that some of the economic instruments suggested were simply extensions, consistent with existing Government policy measures. Generally respondents felt that:

- The EEC is a success and should be built upon. Many of the suggested measures would permit the current EEC to broaden and be able to achieve more within its existing budget (through reduced prices of energy efficient products). There was also support for the EEC to be extended.
- The suggested VAT changes would be an extension of the existing reduced rates of VAT. Currently, a reduced rate of VAT is charged on a range of energy efficient products installed as part of grant schemes or by professional installers. This would ensure consistency in approach towards VAT rates for energy efficient products;
- In general, the measures suggested will not conflict with the Government's existing policies;
- Grant schemes already exist in the UK and are shown to be successful.

6. *Where the proposal is to encourage the take-up of particular appliances or equipment, what is the wider environmental impact of the product in question? Are there other environmental issues around the production or use of the product?*

There was only a small response to this question. Comments included:

- Any new instrument should not support the uptake of a product that has a net negative environmental impact.
- Any environmental effects relating to the use of household appliances should be better understood and managed by the development of more effective labelling and waste disposal requirements.
- The impact on the appliance industry must be noted as many appliances are imported.
- Adequate supply of certain products could be an issue if incentives/disincentives were introduced (e.g. CFL light bulbs).

7. *What would be the likely impact of the proposed instrument in changing behaviour? Would it act as a reward or a penalty and what are the merits of this approach?*

Generally, respondents who answered this question felt that the proposed measures would act as rewards, increasing activity related to household efficiency. Those measures that would act as a penalty included increased stamp duty and product charges on inefficient goods. It was also noted that if introduced as a package, these measures might be more effective (stick and carrot approach).

Few respondents commented on behavioural changes. It was noted that any charges on inefficient goods, targeted at the supplier, would encourage the production of more efficient products, and thus diminish the market for inefficient goods.

8. *What would be the likely costs – whether financial, social or environmental – to (a) business and (b) consumers?*

A number of respondents suggested that the Treasury would be able to more accurately determine the costs involved. It was noted, however, that the financial cost to the Government would be considerable if proposed measures such as providing grants were used.

It was generally suggested by most respondents that consumers and businesses would benefit from fiscal incentives to improve energy efficiency. However, any increases in grants or similar schemes may result in increases in taxation.

9. *What would be the distributional impact of the proposed instrument? Would there be an effect on prices of products, dwellings or fuel?*

Comments from some respondents who did answer this question included:

- The adoption of more innovative technological approaches would suggest a fall in the prices of products.
- House prices may increase. Capital spent will add to the tangible assets of the dwelling. Lower running costs would make the property more attractive.
- Reduced demand for fuel, given supply, would suggest a fall in price.
- Fuel taxation – the price of domestic fuel would increase. Other taxation elements would need to be reduced in order to compensate.

10. *Are there any other features of the proposed instrument that should be taken into account - e.g. administrative costs, EU state aid issues, consistency with other legislation?*

A majority of the respondents realised that any changes to VAT would need to be compliant with VAT directives.

Other comments included:

To ensure strategic approaches, costs should be built in for planning, development, scheme management and administration. Funding should also take account of the costs involved in evaluating any proposed instrument.

Any changes in measures such as stamp duty relief would involve additional administration with Inland Revenue.

Energy efficiency is linked with local authorities through the Home Energy Conservation Act (HECA) requirements.

Conclusion

The Government is grateful to all who responded to this consultation. A range of economic instruments has been proposed to tackle the market failures that have been identified. The Government will consider these proposals as part of the Pre-Budget Report and Budget process. It will also take account of the role which further improvements in domestic energy efficiency can play as it develops the forthcoming Energy White Paper.

ANNEX A

Questions for respondents

1. Do you agree that the market failures set out above are barriers to improvements in domestic energy efficiency? Are there any other market failures that you believe constrain investment in this area?
2. Which of these barriers do you consider are not fully addressed by existing Government support for domestic energy?
3. Do you wish to comment on any of the examples of economic instruments given in Annex D? Examples of economic instruments to improve household energy efficiency in other countries were listed.
4. Do you propose any specific economic instruments to improve domestic energy efficiency, consistent with the Government's commitment not to introduce new taxes on domestic energy? If so, please indicate how each instrument would help to overcome the market failures above.
5. How would the proposed economic instrument relate to existing policy measures? Are there any synergies or overlaps? Would the instrument be consistent with the aims of existing measures or would they involve potential conflicts? If there are conflicts, how might these be addressed?
6. Where the proposal is to encourage the take-up of particular appliances or equipment, what is the wider environmental impact of the product in question? Are there other environmental issues around the production or use of the product?
7. What would be the likely impact of the proposed instrument in changing behaviour? Would it act as a reward or a penalty and what are the merits of this approach?
8. What would be the likely costs – whether financial, social or environmental – to (a) business and (b) consumers?
9. What would be the distributional impact of the proposed instrument? Would there be an effect on prices of products, dwellings or fuel?
10. Are there any other features of the proposed instrument that should be taken into account - e.g. administrative costs, EU state aid issues, consistency with other legislation?

ANNEX B

List of respondents

David Amess MP
Association for the Conservation of Energy
Association for Environment Conscious Buildings
B&Q
John Battle MP
BEAMA energy Limited
Bedfordshire and Hertfordshire Energy Efficiency Advice Centre
Bedfordshire County Council
Harold Best MP
Tim Boswell MP
Peter Bottomley MP
Tom Brake MP
British Energy Efficiency Federation
British Rigid Urethane Foam Manufacturers' Association
Building Research Establishment Limited
Dr Vincent Cable MP
Patsy Calton MP
Central Heating Information Council
Centre for Sustainable Energy
Centrica plc
Jake Chapman
Sir Sydney Chapman MP
Chartered institute of Housing
Chartered Institution of Building Services Engineers (CIBSE)
Michael Clapham MP
Frank Cook MP
Council for Energy Efficiency Development
Creative Environmental Networks
Croydon Borough Council
Paul Daisley MP
Paul Davidson
Janet Dean MP
Derby City Council
Brian H Donohoe MP
Sue Doughty MP
Downland Housing Group Limited
Julia Drown MP
Eaga Partnership Limited
East Hertfordshire District Council
East Staffordshire Borough Council
Electricity Association
Energy Action Scotland
Energy Conservation and Solar Centre (ECSC)
Energy Efficiency Partnership
Energy Saving Trust
EURISOL (UK Mineral Wool Association)
Lord Ezra

Don Foster MP
Max Fordham
Friends of the Earth
GM Energy Limited
Dr Ian Gibson MP
Gloucester City Council
Greater Manchester South EEAC
Mark Green - East Hampshire District Council
Green Heat Limited
Greenwich Borough Council
Guildford Borough Council
Paul Holmes MP
Home Energy Conservation Act (HECA) Forum
Home Energy Conservation Act (HECA) Partnership
Innogy plc
Institution of Civil Engineers
Lighting Industry Federation Limited
Lynne Jones MP
Kent Energy Efficiency Partnership
Kingspan Insulation Limited
Kirklees Metropolitan Council
Archy Kirkwood MP
Lattice Group
Mark Lazarowicz MP
Lincoln City Council
Lincolnshire Energy Efficiency Advice Centre
London Borough of Lewisham
John Mann – Councillor – Wellingborough Council
Mansfield District Council
Paul Marsden MP
Denise Marsdon
Midlands Energy Saving
Chris Mole MP
National Association of Estate Agents
National Energy Action
National Energy Foundation
National Energy Services Limited
National Federation of Women's Institutes
Dr Doug Naysmith MP
Newark and Sherwood Energy Agency
North Wales HECA Forum
Northampton Borough Council
Nottingham City Council
Nottinghamshire County Council
Ofgem
PRP Architects
Pilkington Energy Efficiency Trust
Ray Sayers Insulation and Preservation
Riverside Housing
Rother District Council

Royal Borough of Windsor and Maidenhead
Save Cash and Reduce Fuel
Jonathan Sayeed MP
Sciotech
Scott Energy
Scottish and Southern Energy plc
Scottish Power plc
Alan Simpson MP
Seeboard Energy Limited
Sefton MBC
Debra Shipley MP
Society of British Gas Industries
South Ayrshire Council
South Lakeland District Council
South West Scotland Energy Efficiency Advice Centre
Southampton City Council
Andrew Stunell MP
Colin Surtherland
Matthew Taylor MP
Simon Thomas MP
Sylvania UK Technical Projects
Lesley Thornton – Councillor – Wigston Borough Council
Torren Energy
Paul Truswell MP
TXU
UK Public Health Association
Warden HA Limited
Brian White MP
Wiltshire County Council
World Wildlife Fund
Wycombe District Council

ANNEX C

THE CLEAN DOZEN

Suggested policy initiative	Applying to	Why (i.e. in addition to <i>general</i> CO2/fuel poverty reasons)
1. Set an overall policy objective to achieve a national 20% target for energy <i>efficiency</i> improvement by 2010 (based on current levels), as recommended in the PIU Energy Review. This is virtually the same as the EST target of 12.5% energy <i>saving</i> by 2010 (cf. energy <i>efficiency</i> improvement).		This will affect the extent of the measures – and will ensure that the Treasury adopts the maximum number of new policies. In other words, without a target the Treasury need do very little. Both ACE and the British Energy Efficiency Federation have stressed that, without a firm target, there can be no market certainty and therefore no long-term supply-side investment in energy efficient plant, products and personnel.
2. Cut VAT to 5% on: (a) the supply and installation under Government grant schemes of energy saving materials in homes; (b) the supply and installation of energy saving materials used in non-grant schemes when householders employ contractors.	<u>All insulation materials, including low emissivity glass.</u> Energy efficient central heating and hot water systems (including micro CHP and solar thermal); low emissivity glass.	These products are currently discriminated against as other energy saving materials installed under grant schemes are charged at 5% VAT. These products are discriminated against at present. Other energy saving materials installed by contractors are charged at 5% VAT.
3. Cut VAT to 5% on DIY energy saving materials, bought by a householder to install him/herself.	All	We will argue that EU law <i>does</i> allow this reduced rate of VAT, despite earlier claims to the contrary.
4. Cut VAT to 0% on energy saving materials. The Treasury to report annually to Parliament on what actions at EU level to achieve this.	All	This is currently not allowed under EU law – but the Government has said that it backs a change in EU law. This will keep the issue high on the Government's agenda.
5. Grant subsidy to householders installing certain innovative products. NB. The term 'householder' is used throughout this chart to cover all tenures: owner occupiers, private tenants and social housing	Micro CHP; heat pumps	To encourage new technology. There is a strong precedent with current 50% grants for photovoltaic installations. The PIU Energy Review said that micro CHP is the most efficient means of carbon abatement, so we need to encourage this new technology for this reason. As boiler installation only generally happen every 15 years or so, it is vital that people install the most efficient technology <i>at the right time</i> . With other products, timing is not so critical – e.g. whether loft insulation is fitted now or next year, there is little extra inconvenience or cost.
6. Enhance and extend existing capital allowances to allow companies' (e.g. RSLs, Energy Service Providers) investments in <i>all</i> domestic energy saving equipment to be written off against tax in a single year.	All energy saving materials – with >100% allowances on innovative market-leading products such as micro-CHP, heat pumps etc.	This would act as a spur to take-up, and the Treasury would lose no money. Simple extension of existing schemes. Easily tailored to give a boost to innovative products. Capital allowances are currently available for the Affordable Warmth Programme and for non-domestic Energy Service Providers, so that this is only extending a precedent already set.
<u>7.</u> Introduce a stamp duty rebate on house purchase if energy efficiency improvements are made within 6 months.	All	People are most likely to act at the time of purchase, so we need to create an incentive at the 'softest' time. See evidence re take-up in "Evaluating the effectiveness of the Home Energy Report", Rosie Parnell, Sheffield University, September 2001.
8. Introduce a 'domestic business tax allowance' (i.e. a tax allowance against profits/surplus for landlords – private and RSLs – on the cost of energy saving	All	The absence of such a measure means there is no incentive for landlords to install energy saving materials. This is a genuine business expense for them – especially if it becomes compulsory as a result

materials)		<p>of HMO licensing.</p> <p>Landlords can already claim tax allowances when <i>replacing</i> household materials (<i>not</i> just energy-saving materials). The installation of materials that improve the property is <i>not</i> tax allowable (this is defined as '<i>betterment</i>'). However, the definition of '<i>replacement</i>' has recently been revised, so that double-glazing can now be classed as '<i>replacement</i>' and <i>is</i> therefore tax allowable. This gives us the precedent for extending the definition of '<i>replacement</i>' to include the installation of all energy saving materials.</p>
9. Personal tax allowance (i.e. allow expenditure on energy saving materials to be set against income tax)	All	This will encourage personal expenditure by those who can afford it, i.e. the fuel rich, and so will have the greatest effect on CO2 emissions.
10. Offer Treasury funding (to councils) for council tax reduction (over 3-5 years) for householders for approved SAP increases. To include immediate rebate for cost of verification survey.	All	There is enthusiasm among local authorities e.g. the Nottinghamshire/Derbyshire Energy Partnership.
<p>11. Treasury funding for local authority energy manager, or HECA* Officer (at an appropriate level of seniority)</p> <p>[* Home Energy Conservation Act]</p>		This would enable local authorities to give greater priority to energy conservation work; it would ratchet in more money and help local markets. HECA professionals are very keen. DETR recommended this in 1999; both the LGA and DEFRA recommended it in 2001.
<p>12. Tax incentives to help energy efficiency companies expand:</p> <p>(a) tax allowance for companies training installers;</p> <p>(b) grant payable to trainees (along the lines of current grants to trainee teachers);</p> <p>(c) tax incentives for investors in energy efficiency companies, perhaps similar to the Enterprise Investment Scheme.</p>		<p>Shortages of staff and lack of capacity in the energy efficiency industry could hamper delivery of Government programmes.</p> <p>Both (a) and (b) could be targeted to help alleviate shortages in key workers (e.g. currently gas fitters).</p> <p>(c) would help companies raise the necessary capital to expand and develop new innovative products (e.g. micro CHP).</p>