House of Commons

Environmental Audit Committee

PRE-BUDGET REPORT 2001: A NEW AGENDA? Government Response to the Committee's Second Report of Session 2001–02

Second Special Report of Session 2001–02

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ENVIRONMENTAL AUDIT COMMITTEE

Remit
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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Publications
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/commons/selcom/eahome.htm.

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SECOND SPECIAL REPORT

The Environmental Audit Committee has agreed to the following Special Report:

PRE-BUDGET REPORT 2001: A NEW AGENDA? GOVERNMENT RESPONSE TO THE COMMITTEE'S SECOND REPORT OF SESSION 2001–02

1. The Environmental Audit Committee reported to the House on the Pre-budget Report 2001: a new agenda?, published on 12 February 2002 as HC 363.

2. The Government's response to the Committee's Report was received on 27 May 2002 in the form of a memorandum to the Committee. It is reproduced as an Appendix to this Special Report.

APPENDIX

GOVERNMENT RESPONSE TO THE ENVIRONMENTAL AUDIT COMMITTEE'S SECOND REPORT: PRE-BUDGET 2001

Overview of the Pre-Budget Report

1. We conclude that few of the environmental measures contained in Pre-Budget Report 2001 are significantly new. While we fully accept the importance of incremental developments in some areas, we are disappointed that the Government has not begun this Parliament with a more imaginative and creative approach to the environmental agenda to match the commitment made in 1997.

The Government remains committed to using economic instruments to make environmental progress. The Statement on Intent on environmental tax, which was published in 1997, has served the Government well and the principles were reiterated in Pre-Budget Report 2001 and Budget 2002. The Government continues to build upon the significant progress already made since 1997. For example, Budget 2002 announced a strategic review of agriculture and associated environmental issues as well as announcing measures to incentivise the use and development of sulphur free fuels, and the introduction of a further incentive to purchase low carbon vehicles through a new lower rate of vehicle excise duty.

As the EAC has recognized, there are long lead times involved in developing new initiatives such as the CCL, aggregates levy and emissions trading scheme. These are significant measures and it is simply not possible to have a further stream of new measures at the same time that these are just being introduced and bedding down.

Specific environmental taxes

2. We are concerned about the extent to which confusion and inefficiency can result from the growing complexity of policy instruments in the energy sector. The Government might therefore wish to explore the scope for rationalising these instruments over time.

Policy instruments aimed at the energy sector reflect the objectives which the Government has in this area, such as improving energy efficiency, increasing use of renewables and gaining a head-start in emissions trading, while maintaining an exemption from tax for the domestic sector and a level playing field between fuels.

The Government will keep policies in this area under review as it develops its Energy White Paper in follow-up to the PIU energy review.

3. We are concerned at the potential overlap between schemes for Enhanced Capital Allowances, and recommend that the Treasury should rationalise them to avoid confusion and unnecessary complexity.

The Government has, and will continue to, keep all taxation policies under review. The Government notes the Committee's concerns and will continue to ensure that information regarding these schemes is easily accessible. In particular, the Government hopes that the Committee will welcome the fact that additional energy-saving technologies to benefit from ECAs will be introduced as part of the existing scheme rather than a new scheme.

4. We note that no reasons have ever been given by the Government for its decision to shelve the introduction of a pesticides tax and adopt instead industry proposals for a package of self-regulatory measures. As part of its evaluation of progress in this area for Budget 2002, the Government should set out why it considers a 'partnership' approach with industry is a more suitable policy instrument than a tax.

The Government commissioned independent consultants to examine the merits of voluntary measures to reduce the environmental impact of pesticides.[1] This report indicated a voluntary approach might be a more effective way of delivering improvements than a tax. The Government has therefore decided to proceed with a partnership approach with industry, but—as indicated in Budget 2002—it maintains the option of a tax should the voluntary package of measures not deliver the expected environmental benefits.

5. We recommend that the Government publish both progress reports on the voluntary pesticides partnership approach as soon as possible in order to inform public debate on this issue.

The independent steering group overseeing the voluntary package reports to the Minister for the Environment. The steering group intends to publish a comprehensive report on the first year of the voluntary package shortly.

6. We recommend that the Government carries out its own study to quantify the cost externalities associated with the use of pesticides and fertilisers. In addition, it should clarify where it stands on the 'polluter pays' principle in relation to pesticides and fertilisers.

The Government acknowledges that there are significant externalities associated with pesticide use, and that there is a case for Government intervention. This is why the Government has agreed with the industry that a voluntary package of measures should be introduced to reduce the environmental impact of pesticides, while maintaining the option of a pesticides tax should this package fail to deliver.

In addition, Budget 2002 recognised that agriculture is associated with a wider range of environmental issues, including nutrient pollution. The Chancellor therefore announced that the Government would review the role that economic instruments, such as taxes, could play in addressing these issues and how to help provide a level playing field for less environmentally harmful forms of farming.

7. The Treasury must take advantage of the widespread consensus among both industry and environmental groups that the rate of landfill tax should be radically increased, and the Government should not wait until 2004 to do so. To maintain appropriate differentials and prevent incineration becoming an easy option, the Treasury should explore the scope for introducing an incinerator tax.

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[1] *The consultant's report—"The Potential Cost and Effectiveness of Voluntary Measures in Reducing the Environmental Impact of Pesticides", by EFTEC for DEFRA—has now been published on the DEFRA website.*

8. When setting a much higher rate for the landfill tax, the Treasury must also review the fiscal treatment of inert waste, and the extent to which it acts as a perverse incentive to landfill rather than re-use secondary material.

The Government is committed to the challenging targets set out in Waste Strategy 2000 for recycling and reducing the amount of waste sent to landfill and is using a range of instruments to achieve more sustainable waste management. These include economic instruments, such as the landfill tax, as well as public spending and statutory recycling targets for local authorities. The landfill tax escalator of £1 per tonne a year until 2004 reinforces the environmental effect of the tax and enables waste producers and managers to plan ahead.

However, the Government announced in Budget 2002 that it anticipates that the rate of the landfill tax will need to be increased significantly in the medium-term as part of the mix of future policy measures. The inert rate of landfill tax has had a significant impact: the quantity of inactive waste going to landfill has fallen by 57% since the introduction of the landfill tax. The Government will consider the landfill tax, including the case for a tax on incineration, in the light of the Performance and Innovation Unit's report on waste, due to be published in Summer 2002.

9. We recommend that the Treasury, as a matter of some urgency, carry out research on the impact of removing the perverse fiscal incentive to build on greenfield sites.

The Government continues to keep the VAT treatment of housing under review but has no plans at present to make such a radical change to the VAT base.

10. The Government will need to offer greater financial incentives to business than those provided by enhanced capital allowances, if it is to promote effectively greater investment in environmentally friendly technologies.

Enhanced capital allowances (ECAs) are only one element of the Government's approach to encouraging environmental improvements by business. Environmental taxes, regulations and tradable permit schemes all encourage business to invest in environmentally friendly technologies.

11. We urge the Government to reconsider the focus of the R&D tax credit scheme for larger companies and orientate it more specifically on environmental objectives.

The Government does not believe that the R&D tax credit should be restricted to activities with environmental objectives, although it is possible that some R&D with environmental benefits may be supported by the tax credit.

In many cases the environmental impact of research and development (R&D) will be far from clear. It would be extremely difficult to incorporate environmental objectives into the R&D tax credit; it would require companies to judge the environmental impact of their R&D in making their corporation tax self-assessment; and tax inspectors to review these judgements. This is impractical—it would encourage intractable disputes and would threaten to undermine the ability of the tax credit to deliver economic benefits.

The role of the Treasury

12. We regret the fact that the Treasury has retreated from a strategic commitment to environmental tax reform, by diluting the language used in the original Statement of Intent. Together with other factors discussed below, it suggests that the Treasury's approach is indeed ad hoc.

The Government has not "retreated" from its commitment to using environmental tax, as set out in the Statement of Intent. There has been no change in emphasis.

13. We consider that the extent of Treasury research undertaken to support the Statement of Intent on Environmental Taxation—both directly and in coordination with other departments—is inadequate; and that the Treasury is failing to provide adequate leadership and coordination across central Government.

The Government has undertaken (and continues to undertake) extensive research to support environmental taxation. Research on environmental issues is usually led by the Department with lead policy responsibility for related objectives, such as DEFRA or DTLR. Budget 2002 referred specifically to areas such as waste, agriculture and persistent pollutants where research is under way.

14. As the Government has consistently refused to countenance the option of a Green Tax Commission, the Treasury should involve stakeholders in systematically identifying possible areas where environmental tax proposals could be developed. To provide public accountability for such an approach and a strategy to support the Statement of Intent, it should publish a short annual report setting out the key issues arising from stakeholder dialogues, the outcomes of research undertaken, and its proposals for the future.

The Government has, and continues to have, regular meetings with a wide range of stakeholders in discussing environmental taxation policy. Budget 2002 confirmed that "the Government will continue to develop its strategy towards environmental taxation in discussion with other stakeholders".

It is unrealistic to expect the Government always to publish proposals for future taxes until it is ready to do so, especially where such proposals may affect the market positions of the sectors concerned.

15. If the Government is to regain the initiative on environmental tax reform, it will need to make a convincing case for the benefits of such a strategy. Increased environmental awareness and understanding among the public will be crucial.

16. As we have pointed out before, leadership is crucial, and we believe that there is much more the Treasury and the Chancellor could do to promote this agenda.

The Government has made the case for action in this area in every Budget and Pre-Budget Report since 1997. Budget 2002 states that the Government is committed to "improving the quality of life for everyone and to do this the Government recognises that it is essential that we improve and preserve our environment".

17. We are concerned at the extent to which table 7.2 (previously table 6.2) of the Pre-Budget Report 2001 still fails to capture comprehensively the impact even of environmental measures—let alone the 'mainstream' measures contained in earlier chapters. We recommend that the Treasury provides a detailed environmental appraisal as a supporting document for all future Pre-Budget Reports. This should set out in more detail the basis for the summary appraisal figures included in the main report, and the methodology and assumptions used to calculate them. It should also contain an analysis of any other measures (or combinations of measures) in the Pre-Budget Report which the Treasury believes may have significant environmental impact but which it has been unable to calculate.

18. We recommend that the Government should fulfill its commitment to incorporate systematic ex post appraisals within future Pre-Budget Reports. Data should be incorporated in summary form within the Pre-Budget Report, and supported by more detailed information in supporting the environmental appraisal document we have recommended above.

19. We find it difficult to understand how the Government can decide what is the most appropriate policy mechanism, if it is not able to assess the effect of different policy instruments. We urge the Government to clarify how it proposes to develop appraisal and monitoring systems on a more comprehensive basis.

The Government remains committed to evaluating and appraising the impact of environmental tax measures. The results are given in the appraisal tables of the Pre-Budget Report and Budget documents and these tables cover the environmental impacts of all tax policy changes that are considered to have a significant environmental impact or serve an environmental purpose.

Supporting documentation for the appraisal tables is referred to in the footnotes. The Committee has previously been provided with information on the methodology used to provide certain estimates. The Government would be happy to provide more specific information about the appraisal of individual policy measures to the Committee.

Spending Review 2002

20. We expect to receive copies of the sustainable development reports (SDR) submitted by departments as part of Spending Review 2002, so as to be able to audit them in line with our remit from the House.

SDRs are internal documents, which will be closely associated with departments' proposals to the Spending Review. If the Treasury announced its intention to let other bodies audit them, departments would limit their analysis to what they are prepared to make public. This would restrict the validity and worth of the reports by reducing them to a tick-boxing exercise.

21. If the Treasury continues to insist on keeping secret the sustainable development reports (SDR) submitted by departments, then it must—at the very least—agree to allow the National Audit Office to audit these reports and report the results to this Committee.

The outputs and outcomes of the review will be the subject of scrutiny by the NAO and other bodies, not the internal inputs to it. The decision to divulge the content of their SDR after the spending review to the EAC is at the discretion of each department. The NAO has a role to play in auditing policies, but their remit does not cover departmental policy plans. NAO and others can only audit the impact of policies after those policies have been implemented and therefore the NAO auditing the SDRs would be of little use.

22. If the Sustainable Development Unit is indeed a cross-governmental resource (as the Government have previously argued) then it should be involved in evaluating the sustainable development reports submitted by departments as part of their Spending Review bid. Otherwise, there is a clear need for a central Sustainable Development Unit to provide just such expertise.

The Sustainable Development Unit within DEFRA will not be involved in evaluating the Sustainable Development Reports; they have however played an important role throughout the review, offering expertise to departments preparing their reports.

The Sustainable Development Unit have provided assistance in the production and preparation of the reports but the evaluation of departmental proposals (including SDRs) is the responsibility of the Treasury.

23. We recommend that the Treasury should establish an internal unit which is adequately resourced and staffed so as to evaluate the sustainable development reports submitted by departments as part of Spending Review 2002. Such a unit could also encompass other responsibilities—in line with earlier recommendations in this report—such as the responsibility for environmental taxes, for developing resource productivity indicators, for monitoring the adequacy of environmental appraisal in new policy proposals, and for coordinating a more strategic approach to research and development in all these areas.

The Treasury has resources to deal with its policy responsibilities. Staff are distributed across a number of teams and carry out this work in relation to many different Government commitments, not just the spending review. The Treasury also has close working relations with other Government departments, such as DEFRA, DTLR and DTI, which have a greater capacity to undertake research and development in many of these areas.

24. We are deeply perturbed at the negative approach adopted in the environmental guidance for Spending Review 2002 to sustainable development targets. This conflicts directly with evidence given to us by the Secretary of State for Trade and Industry who told us that she expected to see a lot more targets relating to sustainable development as a result of this Spending Review.

This is not environmental guidance, it is sustainable development guidance. We have very good reasons for not requiring PSA targets on sustainable development. Public Service Agreements (PSAs) are designed to ensure that the Government delivers effective results and focuses effort clearly on its priorities for action. PSAs are a means of demonstrating measurable progress against specific detailed targets within the Government's priorities. Many detailed departmental PSA targets contribute directly to the achievement of sustainable development, as measured by the Governments' sustainable development headline indicators.

For example, the DEFRA PSA includes a target to "care for our living heritage and preserve natural diversity by reversing the long term decline in the number of farmland birds by 2020, as measured annually against underlying trends." This target is directly related to a UK SDS headline indicator. The Government believes that PSA targets have an important part to play in delivering the Government's quality of life and sustainable development objectives, by ensuring that progress is made across the social, economic and environmental dimensions. It does not believe, as the SR2002 sustainable development guidance points out, that sustainable development will be achieved merely by adding those words to departmental PSAs.

25. We strongly regret the refusal of the Treasury to provide us with the Spending Review main guidance. This contrasts markedly with its readiness to make public the environmental guidance, and vividly demonstrates that the Treasury will only share what it does not value or consider important. (Paragraph 57)

This is not simply environmental guidance, it is sustainable development guidance. The main guidance is an internal document to help officials produce advice to Ministers on their conduct for an internal decision-making process. It is not of interest to a wider audience: the outcomes of the Review will properly be the subject of scrutiny, not the inputs to it.

The Treasury published this guidance because it takes sustainable development seriously and this demonstrates its commitment to sustainable development. The Treasury's readiness to make this Guidance public is a mark of the increasing transparency with which HMT treats environmental policies.

Transparency of figures in Budgets and spending reviews

26. The difficulties we have had in tracing monies demonstrate in our view a desperate need for greater clarity in the presentation of figures. We therefore recommend that the Treasury develops and includes in future PBRs, Budgets, and Spending White Papers, a consistent and comprehensive table which sets out in an easily intelligible form funding sources for environmentally related policies, and the manner in which monies are recycled. (Paragraph 63)

Budget 2002, as with previous Budget and Pre-Budget documentation, contains tables setting out the spending implications of all policy decisions. These documents will continue to describe levels of funding for environmental policies and the Government does not see a need for a separate table.

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