

Memorandum of Evidence

House of Commons Environmental Audit Committee Inquiry

The Structure and Operation of Government and the Challenges of Climate Change

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1. The problem

Though there has been no lack of ambition in respect of climate change policy in Britain, the record so far has been very poor. The emission reductions that have taken place have largely been the result of other policies and changes in the structure of the economy—such as the closure of the most of the coal industry in the 1990s and the de-industrialisation which has taken place since the very sharp recession of the early 1980s. Without energy-intensive industries, without coal mining and with the dash-for-gas in electricity generation, emissions inevitably fell of their own accord. Indeed, some of these emissions are now imported back from overseas energy-intensive producers, and in the meantime here in Britain aviation and road transport have—in part, explicitly driven by policy—increased.

Since 1997, CO₂ emissions have risen by around 5% and the 20% CO₂ emissions target by 2010, set in 1997, has effectively been abandoned. Renewables have not expanded as

planned, and the costs of the Renewables Obligation (RO) have made it one of the most expensive renewables programmes in the developed world. Repeatedly, energy efficiency aspirations and targets since the 1980s have been missed.

The causes of these policy failures are multiple, but one less emphasised reason is the chaotic institutional structures that have emerged in a piecemeal fashion in the last two decades. Little or no thought has been given to the overlapping duties of the various regulators, agencies and other public bodies. These agencies and public bodies are themselves given responsibility for a host of measures and initiatives, again with little thought as to their overlap. Into this chaotic situation, the government proposes to add a further overarching body in the Committee on Climate Change, proposed in the Draft Climate Change Bill, without much consideration as to its relationship to the other bodies and measures and initiatives.

This memorandum addresses the reasons why institutional architecture matters and makes a number of recommendations in respect of the proposed Committee on Climate Change, not only for the body itself, but also for the others in a crowded institutional space.

2. The importance of institutional architecture in climate change policy

A series of ambitious national and international targets have been proposed or set for the reduction of CO₂. These are: short term (20% by 2010); medium term (26–32% by 2020); and long term (60% by 2050)—all excluding aviation and shipping. It is proposed in the Draft Climate Change Bill to give oversight of these targets to a new Committee on Climate Change, and to translate these targets into rolling five-year carbon budgets.

Delivery of policy objectives is always imperfect: institutions develop their own interests, and they tend to try to maximise their budgets and influence as part of the process of furthering the careers of those who work in them. Where institutions overlap in their duties and responsibilities, these interests come into conflict, and inevitably elements of

institutional competition arise. In the case of climate change—where every aspect of governmental policy is affected, and hence most if not all public agencies, regulators and other public bodies have a role to play—institutional competition is likely to be endemic. Two conclusions follow: **institutions should be designed to take account of these inevitable failures within each body; and competition between institutions should be minimised by careful specification of the objectives**, setting of the hierarchical structure between public bodies, and by providing clear processes for reconciliation when conflicts arise. In other words, institutions need careful design and they need to be ‘joined-up’.

Overlapping responsibilities are endemic in the climate change, energy and transport fields, and, crudely, an arithmetic increase in the number of bodies leads to a geometric loss of focus and efficiency. There is therefore a good case for having as few bodies as possible within any one policy domain.

It has been fashionable—and consistent with the British administrative approach—to set broad public interest objectives for public bodies, and then leave the key individuals and their boards to internalise the trade-offs. The result is one which maximises flexibility and minimises the scope for judicial review, but in practice the wide discretion granted allows for considerable divergence from the overall objectives in pursuit of the institutions’ own interests. The classic case is in utility regulation, where the broad object of the consumer interest leaves open trade-offs in respect of the environment, short-term bills, investment and social issues. As a general rule, **precision in the specification of objectives is most likely to minimise the scope for pursuing institutional self-interest.**

Where there is more than one objective—for example, climate change *and* security of supply in energy—there is a good case for internalising the trade-off between the objectives, and as recommended below, an Energy Agency covering both climate change and security of supply may be more effective than setting up institutions for each objective separately and then leaving them to battle it out subsequently. In the energy field, this is a very real danger. In aviation, the various objectives of economic efficiency,

safety and coordination have been successfully incorporated into the CAA, and in rail, the ORR now also incorporates safety and economic efficiency. The implication is that **there is a strong case for single sectoral bodies**. Climate change can either be incorporated in each, or dealt with by an overarching body such as the proposed Committee on Climate Change.

3. Minimising capture and the impact of lobbying

Climate change policies have large economic rents attached. Emissions permits are valuable commodities, the RO has yielded significant profits to wind developers and there are numerous grants and subsidies. It is inevitable that the corporate sector will seek to capture these rents, and to use their influence to lobby public bodies. A core requirement in **institutional and policy design is to try to minimise this capture process**.

The degree of success for lobbyists depends upon their ability to exploit the asymmetries of information between themselves and the public bodies, and to affect the interests of politicians, regulators and administrators. In the former case, expertise by public bodies is an essential protection against lobbyists, and this is best achieved by the concentration of expertise. In the latter case, rules for governing the choice and subsequent employment of public officials matters greatly – and in particular the avoidance of “revolving doors” where politicians, regulators and administrators join the companies after public service. In environmental regulation, this is unfortunately the norm.

Minimising the number of public bodies also helps to reduce the avenues for lobbyists, but perhaps the greatest impediment to capture is the use of market-based instruments. Whereas conventional command-and-control regulation lends itself to the case-by-case applications, and hence maximises the use of information by lobbyists and vested instruments, market based instruments are much harder to manipulate.

4. The inefficiencies of the current structure—an example

The complexity of the existing institutional structure and the prevalence of capture have, not surprisingly, reduced the effectiveness and increased the costs of delivering on climate change objectives.

An example illustrates this point: renewables and the role of Ofgem. Ofgem has a primary general duty to consider the interests of customers, and in this role it has pursued the twin-track approach of maximising competition where possible and regulating monopoly. The government has a clear renewables target, but the delivery of this target is not a primary duty of Ofgem. Yet, the two are clearly closely entwined: delivering the renewables target requires network investments in distribution to facilitate embedded generation. Ofgem repeatedly declined from setting the capital expenditure allowances in periodic reviews with the renewables target as a prime objective—for the very good reason that its primary concerns were to minimise bills for customers. As Ofgem has repeatedly pointed out, carbon emissions are not its core responsibility.

The government's response has been to tag on—as a *secondary* duty—a requirement to have regard to sustainable development to the various regulatory bodies, and to issue *guidance* in the interpretation of the overlapping duties of the economic regulators. There is, however, no clear read-across from this new secondary duty to decisions: it is up to the boards of these regulators to decide how to weigh the various duties—always, of course, giving priority to primary over secondary duties. Not surprisingly, the result has not been to put the environment ‘at the heart of regulation’, and there is little or no prospect of judicial review.

Secondary duties and guidance have clearly failed to bring the economic regulators into line with overall governmental policy.

5. The case for an Energy Agency

In energy, Ofgem, the Environment Agency, the Energy Saving Trust and the Carbon Trust all overlap. They all compete for budgets and they all separately interact with government. In the case of the Environment Agency and Ofgem, it is noticeable how little impact (or even input) the Environment Agency has on periodic reviews of operating and capital expenditure for the electricity and gas networks. In the case of the Energy Saving Trust and the Carbon Trust, both have an interest in energy efficiency, as indeed in its secondary duties does Ofgem. All of them do their own separate analysis of energy markets, duplicating each other's research—and that of the DTI and Defra as well. All have their own offices too, and an administration to support them.

These bodies have disparate responsibilities in respect of the multiple initiatives and strategies. The list just in the 2007 White Paper, *'Meeting the Energy Challenge: A White Paper on Energy'* is a long one, and includes: the EU Emissions Trading Scheme; the UK Emissions Trading Scheme; the Carbon Reduction Commitment; the Energy Performance Certificate; the RO and its bands; the Carbon Emission Reduction Target (CERT); the Carbon Capture and Storage initiative; the Biomass Strategy; the Renewables Transport Fuel Obligation; the Low Carbon Transport Innovation Strategy; the Environmental Transformation Fund; the Energy Technologies Institute; the Climate Change Levy; the Climate Change Agreements; the Coal Forum; the National Policy Statements; Warm Front; UK Fuel Poverty Strategy; and the Sector Skills Councils.

The multiple bodies and overlapping initiatives, strategies and policies not only increase direct costs, but also impose higher costs on the private sector, creating multiple interfaces.

There is a clear case for merging Ofgem, the Energy Saving Trust, the Carbon Trust; some of the DTI functions (currently undertaken by the JESS Committee); and some of the DEFRA functions in respect of energy efficiency programmes and the Climate Change Agreements into a single Energy Agency and, in the process,

bringing the various objectives together into a single set. An Energy Agency would: maximise expertise; internalise the overlaps; reduce administrative costs and head offices; provide a single interface for business; eliminate the competition between regulatory bodies; and internalise the multiple objectives.

6. The Committee on Climate Change

Into this multiple context, the government now proposes to add a further body—the Committee on Climate Change—without considering the impact and interfaces with all these other existing bodies.

The Committee on Climate Change is designed without a clear independence from government and its remit is largely an advisory and reporting one. It therefore has few, if any, powers in respect of the other bodies described above. Yet the overlap is potentially very great: the new Committee will be involved in the setting of the five-year rolling carbon budgets, whereas the out-turns will depend in considerable measure on the decisions made by the other bodies, none of which will have a duty to help achieve them. It will have a role in respect of the emissions trading schemes—something the Environment Agency currently plays a part in.

The Committee on Climate Change does not have any policy instruments at its disposal. It is therefore quite unlike the Monetary Policy Committee, and indeed is more akin to the Sustainable Energy Policy Advisory Board (SEPAB), with the major significant difference in the requirement to publicly report to Parliament. It is far from clear whether the appointments to the Committee will be made independent of government. Therefore, unlike the numerous other bodies its powers are very limited.

The government therefore faces a choice: to recognise that it is primarily an advisory body, and therefore rely on the other bodies for policy delivery; or to give the Committee powers over instruments to deliver policy objectives.

7. Recommendations for a better way forward.

It is recommended that:

- (i) the government recognises the costs and inefficiencies of the multiple overlapping institutions in the energy, transport and water sectors;
- (ii) the government gives urgent consideration to the setting up of a single Energy Agency, incorporating existing bodies;
- (iii) the Climate Committee should be given a clear and precise set of duties, and its relation to the energy, water and transport regulatory offices and agencies should be formally defined;
- (iv) the energy, water and transport regulatory and other agencies should be given a primary duty to have regard to the government's climate change targets and to consult with the new Carbon Committee in all aspects of their activities which relate to carbon emissions;
- (v) the Committee on Climate Change should be made independent of government.
- (vi) The Environment Agencies responsibilities for air pollution (including the EU ETS) should be reconsidered in the light of the responsibilities and duties of the Committee on Climate Change, and the recommendation to create an Energy Agency

References

DTI (2007), 'Meeting the Energy Challenge: A White Paper on Energy, May, CM 7124, London: The Stationery Office.

HM Government (2007), 'Draft Climate Change Bill', March 13th, CM 7040, London: The Stationery Office.