July 12

the inside track #27

Highlighting CSR Issues of the moment

Incentives for emissions reduction – do they work?

In late June, as part of the Government's publicity for its participation in the Rio 20+ summit, Nick Clegg, the Deputy Prime Minister announced a requirement for listed companies to publish their carbon emissions.

This was the long awaited announcement of mandatory green house gas reporting, instigated as part of the Climate Change Act 2008.

He stated the move would "encourage companies to measure and ….improve their performance". Government officials have calculated the move would "save the equivalent of 4 million tonnes of CO2 by 2021".

The question, of course, is whether this action will encourage companies to reduce emissions?

Consider the impact of the Carbon Reduction Commitment Energy Efficiency Scheme (CRC). When launched in 2009, its stated aim was "to improve energy efficiency and reduce the amount of carbon dioxide emitted in the UK" – sounds familiar!

Much of this scheme has changed since inception, including a move from a revenue neutral recycling payment scheme to a tax revenue raising approach. However still in place are the deadline for purchase of CRC allowances (by July 31st this year) and the performance league table.

The first performance league table was published in September last year but, surprisingly, has had very little publicity.

Our own analysis of the league table produces some interesting insights.

1. Instead of the Government's anticipated 5,000 participants in the CRC; the table included only 2,104 organisations (private and public sectors, together with some from the voluntary sector). These organisations' emissions totalled over 61 million tonnes, which if purchased as allowances would have given HM Treasury 2011 tax revenues of £734 million.

2. When we ranked participants, based on total emissions (rather than the now derided 'early action metrics' measures), the Ministry of Defence with emissions of 1.75 million tonnes was the largest emitter. The next five largest included the four major supermarkets (Tesco, J Sainsbury, Wm Morrison and Asda), along with BT (whose network's energy consumption represents just under 1% of the UK's electricity consumption).

3. Within the top twenty organisations there were seven retailers, six utilities, two banks, two in leisure, and one in energy. In the public sector, as well as the Ministry of Defence, there was also the Ministry of Justice (responsible not only for all the country's courts, but also for providing accommodation on a 24/7 basis for the country's 85,000 prisoners).

These top twenty organisations represent 22% of total emissions from all 2,104 participants. The top 20% of organisations represented over 70% of all emissions, whilst the bottom 18 organisations each reported only 1 tonne of emissions – presumably after taking into account their existing participation in other carbon management schemes such as EU ETS or Climate Change Agreements.

As a tax raising scheme, the CRC is inefficient with 70% of the revenue coming from just over 40% of participants. A more cost effective revenue approach would be a simple surcharge on business energy bills that would be collected by the energy suppliers, and forwarded to HM Treasury, just as with VAT.

What was particularly interesting was that public sector organisations (including NHS, Universities, Government departments, executive agencies, non-departmental public bodies and local authorities) represented about 30% of the participants and about 28% of the emissions. If CRC allowances had to be purchased last year, these public sector organisations would have paid nearly £210 million to the Treasury – a strange cyclical activity!

A key question in the context of Government initiatives is "has the CRC incentivised organisations to reduce energy consumption – and as a consequence, reduce emissions?"

TVC comment overleaf >

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the virtuous circle comment: #27

Has CRC helped reduce emissions – and if so, how?

We will not know until the September 2012 performance league table is available, but there are indications (based on discussions with clients) that it has not had the influence that Government (and in particular its sponsor departments) expected.

One point to be considered is whether the CRC allowance cost is punitive i.e. does it potentially have an adverse or punishing effect on high energy use organisations that take no action to reduce usage. Based on gas and electricity charges a large voluntary sector client recently negotiated, the cost of the CRC allowance adds about 7% to the cost of these two fuels. Yet for many office based organisations, the cost of property energy is not a high overhead , so this uplift has limited impact when it comes to boards' priorities. Vehicle fuel can be a more significant overhead and fuel excise tax represents about a 100% uplift, which, if tax is a motivator, should represent a significant incentive to improve fuel efficiency.

The next performance league table is likely to reflect this winter's mild weather, affecting energy consumption (with one client, gas consumption dropped by 30%). In addition, the recession will lead to reduced electricity consumption; either through lower production workloads or property closures and consolidation to save overhead costs. As a consequence, the next league table is unlikely to have the reputation influence the government may have anticipated – and may indicate lower emissions/taxes than 2011.

So if the CRC does not provide the lever that government seeks, would mandatory reporting for listed companies have any greater impact?

In operational level client dealings, the concept of emissions is often poorly understood. At board level, it may not appear high on the agenda The best way to get organisations – at all levels – to address the issue is to focus on energy efficiency – both for vehicle fleets and property portfolios.

With clients we advocate establishing internal performance league tables, where like for like enterprises can compare vehicle and property energy efficiency. It is only when organisations start looking at how they manage energy that they grasp the opportunity to save energy – and with that, emissions reduction.

The increasing cost of energy (which is lower currently because of the impact of a worldwide recession on energy usage, but once growth returns, forecasts are for increasing energy prices), together with the increasing incidence of carbon related taxes, makes a planned approach more important. The recent announcement of a carbon tax by the Australian government includes an allowance rate at £15 per tonne, which may be followed by other schemes, including CRC.

In the UK, combined with the current 7% CRC cost uplift, some commentators suggest the introduction of a carbon floor price for electricity generators will mean electricity price rises of about 15% next year and beyond. This is because the carbon floor price is designed to encourage low carbon investment in power generation, but financially could penalise more traditional, emission intensive forms.

Making emissions performance more public is one weapon in the government's arsenal to achieve its 2050 emissions targets, but in reality it is probably far weaker than the government surmises. Organisations act in response to commercial pressures. The likelihood is that government will either passively allow energy prices to rise or will introduce greater tax penalties, as a commercially incentive to reduce energy consumption.

Over the next year, organisations need to be more proactive in focusing on energy efficiency programmes to anticipate higher costs of energy – which in turn will have the desired effect of reducing emissions.

If you would like to know more about developing energy efficiency in your organisation, and would like an objective and impartial view, contact Tony Hoskins via thoskins@thevirtuouscircle.co.uk

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