

Climate Action Committee
Wednesday 14th November 2018

Opening Statement by Mr Robert Watt
Secretary General, Department of Public Expenditure & Reform

I would like to thank the Chair and the Committee for the opportunity to meet with you today.

As this committee is well aware, as a country we have a fundamental challenge with climate change. I would like to set out why I think this is, what I think can be done about it and the specific actions the Department of Public Expenditure & Reform is taking.

What is the challenge?

The climate is a public good. We all benefit from amenities such as clean air and clean water but the effect of a benign climate is harder to perceive. The story of modern humanity has been our ability to conquer the elements but it's hard for us to conceive of a world radically altered by rising temperatures. This perception gap collides with our well known bias towards the immediate – in general, we're bad at sacrificing now to benefit later.

This effect is compounded when it comes to climate change because we have never before had to deal with a situation where the consequences of a problem are so far removed from the actions we must take to deal with it. The price that will be paid for the emissions we release into the atmosphere today won't be paid by those of us in this room but it will be paid for by our children and their children.

Naturally, Government Departments focus on the interests of the general public and society. But the determination of the public interest is filtered through the views expressed by their stakeholders and ultimately the political system. And because of our biases societies underestimate the impact of our current behaviour on the climate, and we continue doing business as we always have.

This status quo bias is, to a certain extent I believe, reflected in our approach. The climate actions and policies that we have pursued to date have evolved to be compatible with existing policy priorities rather than specifically targeted at delivering the kind of change we need at the scale we need. In other words, we have pushed open doors in respect of policy options which have been easy and uncontentious. The evidence suggests that reductions in emissions on the scale required will involve winners and losses and have distributional consequences for society.

What can be done?

What I have described is a well-recognised problem. The adverse effects of emissions fall on society collectively rather than on those individually responsible for their emission. They are external to the market or externalities. There is not enough incentive for individuals, whether businesses or consumers, to reduce emissions. As a result, the market fails by over-producing greenhouse gas emissions, to the detriment of society as a whole.

The best way of addressing externalities is to place a price on them. The European-wide Emissions Trading Scheme is an attempt to do this for greenhouse gas emissions in certain sectors, such as electricity generation.

Because every installation has to pay a price for every tonne of greenhouse gas emissions it releases, it bears a direct cost for its emissions and is incentivised to find new and creative ways of reducing them. Even with the flaws of the ETS, the impact of pricing carbon in power generation has seen emissions from that sector consistently decline across Europe.

With an effective mechanism in place for the ETS, the primary focus of Government policy to reduce greenhouse gas emissions is to tackle emissions in the non-ETS sectors where the liability for not complying with climate targets falls to the State.

Do we have enough least cost abatement options in the policy system? I think that the biases I have outlined translate into a very basic principal-agent problem. Responsibility for dealing with climate change primarily rests with the Minister for Climate Action, but responsibility for policies to reduce non-ETS emissions fall across several Government Departments.

Like other countries, we have structures in place across Government to try to overcome this problem. But I think we should consider whether these structures are likely to be sufficient or if they need to be complemented by more stringent central mandates. Or perhaps, even replaced by mechanisms such as making individual Departments or Ministers more directly responsible for specific emission reductions targets in their sectors.

Irrespective of these structures however, we need new climate policies and measures and we need methodologies to assess options across sectors. There is no easy way of deciding whether we should prioritise actions in any one

sector. That is why, in my view, the first questions that we should ask of any climate proposal is how does this initiative help us meet our climate and energy targets and at what cost does it do so. In other words, we need to know the marginal cost of abatement for potential options.

Once we know where the most economic opportunities for carbon reduction lie then we can consider the policy trade-offs.

Carbon pricing – either through the ETS or taxation – allows market discovery. This mechanism allows market agents to establish least cost opportunities and provides them with the incentives to take appropriate action. These market mechanisms may need to be supported by expenditure measures to encourage for example, early adopters. It may also be underpinned by regulations that can provide investment certainty to private consumers and businesses.

A tangible example in this area is Government policy on electric vehicles. There are very generous supports available for electric vehicles at the moment, both expenditure and taxation. As the technology advances and the cost of an electric vehicle becomes competitive with that of a fossil fuel vehicle, it will no longer be appropriate to reward early adopters. Instead the role of Government will be to ensure that the regulatory environment supports EVs drivers, ensuring that there is a sufficient supply of charging points available for example and there is competition in the supply of electricity through these charging.

In the interim, until there is a critical mass sufficient that the market can provide this EV infrastructure, its development will be funded by Government.

In terms of investments funded by the taxpayers, decision-makers need to reflect a realistic estimated shadow price of carbon to ensure that decisions reflect the future costs of emissions and, of course, the benefits of abatement. I will return to this in a moment.

Actions DPER is taking

The Department of Public Expenditure and Reform is contributing to this policy work with the levers at our disposal.

The mission of the Department is to serve the public interest by supporting the delivery of well-managed, well-targeted and sustainable public spending. In my view, when it comes to climate change, this means public spending that supports the achievement of Ireland's low carbon transition in the most cost effective manner. It means targeted expenditure while allowing market mechanisms to deliver carbon reductions in the most efficient manner.

In terms of project appraisal we have published some very significant proposed reforms to the Public Spending Code. In a major departure, we will now require all Government investment projects to price any future greenhouse gas emissions at the estimated cost that Irish society will have to bear in reaching our climate targets. In effective terms, this triples the cost of greenhouse gas emissions that applies today, with the price reaching €32 a tonne by 2020, €100 a tonne by 2030 and €265 a tonne by 2050.

This will reduce the economic viability of projects that produce emissions and critically place a high value on projects that cut emissions.

We are also lowering the discount rate that applies to Government investment appraisal from 5% to 4% and for longer term projects, this discount rate will decline over time. These reforms mean that investment decisions must fully reflect the climate consequences.

Finally, the Irish Government Economic Evaluation Service, IGEES, was created to enhance the role of economics and value for money analysis in public policy making. IGEES has already conducted reviews of areas of climate related expenditure and will continue to systematically analyse the performance of programmes to gather evidence to support better informed decisions.

Summary

In summary, in terms of what we are doing I would highlight the following issues:

- *Supporting policies to price carbon*

Incentives matter and the best way of encouraging behavioural change is to place a price on the behaviour that we want to change and encourage people towards the alternatives. Applying a trivial charge per plastic bag for example lowered plastic bag use by 95%.

On a larger scale, in the UK as recently as 2012, 40% of their electricity came from coal. This year, up to until the middle of the year at least, just 6% of their electricity came from coal.

Pricing carbon works and it should be the primary tool in our arsenal to combat climate change.

- *Having a shadow price of carbon for Government decision-makers which properly reflects the cost of emissions*

Just as prices matter to the individual, so too they matter for Government. We are now pricing the carbon emissions of any new Government investment at the price it will cost us to eliminate those emissions at a later date. This raises the bar and will help to avoid investments which may lock us in to high carbon patterns of living.

- *Developing least cost options by estimating the marginal abatement cost of different policy options*

Making effective climate policies will involve hard choices and trade-offs. To enable these choices to be made, we must provide Government with the evidence that allows them to compare and contrast potential climate measures from across a wide variety of sectors. This means examining the progress each measure will make towards our targets and the potential cost associated with them.

This is by no means the only analysis that must take place but if we can prioritise those measures which make the most sense economically we will ensure that as a country we can achieve our climate ambitions at the lowest possible cost.

We are working with other Government Departments to ensure that when Government is considering climate policy that it has this necessary information to make decisions.

- *Examining structures to ensure that we address the principal agent problem*

The Department is working through the existing climate structures established at Government level to ensure the best possible climate policies. We need to ensure that we have the necessary structures to drive this change across Government, reflecting the scale and urgency of this challenge.

- *Leadership*

As well as these supporting roles, the Department of Public Expenditure and Reform will lead in certain areas of climate policy. The Office of Government Procurement are actively working with the Department of Communications, Climate Action and Environment to update our procurement guidelines to ensure that we can source goods, services or works with a reduced environmental impact.

In addition, Project 2040 made a commitment that every single building in the public building stock will achieve an energy efficiency rating of at least a B by 2030.

To achieve this commitment, the OPW are working with DCCAE and SEAI on a pilot scheme. In 2017 12 buildings underwent a significant energy

efficiency upgrade, this figure increased to 50 this year, with a further 40 buildings planned for 2019. The evidence from this pilot will allow us to develop a programme sufficient to reach the ambition articulated in Project 2040.

This will be financed primarily by the Exchequer but staff in the Department are also working to investigate the use of structural funds or other innovative financing solutions that could maximise the reach and impact of the State's investment in the energy efficiency of the public building stock.

Conclusion

Ireland can't solve climate change alone - but we must show that as a developed country we are capable of making the adjustment required.

Overcoming the biases that I have talked about earlier will require commitment. The kind of commitment that only a cross-party committee like this can deliver.

That is why, I don't think this committee should underplay the challenges we face. Addressing our emissions will mean short term pain for individuals and groups but it will benefit all of us in the long term. I worry that if we promise people this will be cheap and easy we won't build the kind of support that will be necessary when it comes time to take tough decisions. We need to be upfront and honest. To achieve the decarbonisation that the International Panel on Climate Change thinks is necessary, will require changes to society on a scale not seen since the industrial revolution.

I look forward to the discussion today and ultimately the committee's recommendations.

Thank you.