Designing a durable energy bill policy: modelling the options

TWO MINUTE SUMMARY

December 2022

Citizens Advice, the Social Market Foundation, and Public First are working together on long-term policy responses to the high household energy bills, which may be commonplace for the rest of this decade. We'll make our proposals for reform in the spring. As we develop our ideas, we've published an interim report based on economic modelling, data analysis, polling and focus groups. This is a summary. Let us know what you think on energy-bills@smf.co.uk.

Full details of our project, including data tables and other documents can be found at https://www.smf.co.uk/future-of-energy-bills/

KEY POINTS

- **Energy bills will continue to have a significant impact on household finances in future.** With average bills at £3,000, we calculate that 12m households would spend over 10% of their income after housing costs on energy.
- **Current policies don't reach all those in need.** From April, additional support will go to people getting benefits and pensions. But of those 12m households in need, a quarter do not receive any social security.
- **Long-term policies to help with bills should be targeted on households in need.** But current systems can't identify all of those people, meaning some people in need miss out on help, and some public money goes to people in less need.
- **The state needs better mechanisms for identifying people in need of help and getting it to them.** That could be only for energy, or it could cover other sectors. But it needs to be independent, evidence-based and long-term.
- **Voters are increasingly prepared to accept higher taxation to fund bill support.** In July, 52% of people we polled said they supported bill support policies "even if this means taxes rise as a result". In October, this had risen to 64%.

Bill support – options for policy

Fixed payment discount, where eligible households get a cash discount regardless of usage

Popular (51% support) and effective way to get help to households in need. Risks of "cliff edge" can be softened with a tiered structure, with bigger payments for the poorest.

We assume typical bills of £3,000 and model a tiered fixed payment policy: £900 for benefits claimant households, £600 for non-benefits households with incomes under £25,000. This would cost a total of £6.7bn and reach 8.3m households.

63% of recipients would be in the lowest three income deciles. Over half (58%) of the policy costs would be focused on benefiting the bottom three income deciles while 7% of policy costs would benefit the top three income deciles.

Unit rate discount, where households get a discount on each unit of energy used

Net support of 66%. Most help goes to the poorest. Risks include reducing incentives to use less energy, and cliff-edges.

We assume typical bills of £3,000 and model a tiered unit discounts 30% for those on the lowest incomes, 20% for the higher tier. This would benefit 8.3mn households at a cost of £6.7bn.

63% of policy 'winner' households are in the bottom three income deciles. 52% of overall policy costs would go to help the bottom three income deciles.

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9% of policy costs would go to the top three income deciles.

Rising block tariff, where per-unit prices for energy rise incrementally

Modest public backing: net support was 32%. Often backed on environmental grounds, since higher prices for higher use might encourage demand reduction. But some high energy users have very low incomes, for reasons of ill health or poor housing.

We assume typical bills of £3,000 and model a policy where a household's first £500 of spending buys energy at market prices; the next £500 buys units at a 22% premium.

Our analysis suggests that 26% of households in the poorest decile could lose under a rising block tariff, while 62% of the richest would gain.

Even with a £2bn mitigation payment for high-need household, our rising block tariff model still leaves around a fifth of the most vulnerable households worse off. The modified policy benefits 17.5m people, but leaves 9.7m worse off, at a cost to taxpayers of £2.3bn.

Real bill cap, where bills cannot exceed a certain level regardless of usage

Weak public support. Net support of just 19%. Risks giving biggest benefits to wealthiest and encouraging wasteful energy consumption.

We assume typical bills of £3,000 and model a tiered real cap – £2,400 for most households, and £2,100 for benefits-recipient households. This benefits 9.5m households at a cost of £14.8bn.

The overall cost of this policy would be £14.8bn, spent to benefit 9.5 million households. This is more than double the cost of a unit rate discount policy and a fixed payment policy, despite only benefiting 1.2 million more households. The number of households helped by a real cap is limited by the fact significant numbers of households have usage that puts their bills below the cap level.

Distributionally, the benefits of even a tiered real cap policy skew further towards higher income groups than other interventions modelled for this report. More than half of the very poorest households would not benefit.

Energy efficiency – options for policy

Energy efficiency can reduce bills but policy must be much more ambitious . We find that nearly 11 million homes rated EPC D or below in England would not be considered fuel poor and therefore ineligible for support.

On a "whole house" basis, upgrading all 14.1 million UK homes rated EPC D or below to EPC C would cost in the region of £119bn and deliver total annual energy bill savings of £10.2bn, meaning savings equal costs after 12 years.

Targeted support for energy efficiency would require broader eligibility criteria than price support. Help with efficiency should be given to people outside the group of people on means-tested benefits or the lowest incomes.

The relationship between efficiency and income is not straightforward. There are about just as many homes rated EPC D and below in the poorest decile (1.5 million) as there are in the richest (1.4 million).

Modelling

An efficiency policy that prioritised *fuel poverty* would – working on a "whole house" basis – seek to upgrade 3.2 million homes. The cost would be around £27bn, delivering annual savings of £3bn, for a payback period of 12 years. An efficiency policy that prioritised *demand reduction* would – working on a "whole house" basis – seek to upgrade 3.1 million homes. The cost would be around £46bn, delivering annual savings of £5.6bn, for a payback period of 8 years.

Polling

A surprising 54% of homeowners do not believe they need (more) insulation. This is made up of 41% who think they have already had all the insulation measures they need and 12% who have not had insulation fitted but still don't think they need it. Raising awareness around energy efficiency seems an obvious and important way to increase uptake.

In principle, the public are very supportive of the idea that there should be a government energy efficiency scheme. Across all adults 77% they were supportive compared to just 5% who were opposed.

Public opinion is divided on how any government support on efficiency should be allocated. 40% of respondents preferred such help to be targeted, while 54% preferred universal availability.

There are significant limits on how much householders are prepared to pay for energy efficiency work. We found 14% of homeowners would not be willing to contribute at all and a further 23% would not contribute more than £250. Only 10% of homeowners said they would be willing to contribute £3,000 or more. In our poll, affordability was the most cited barrier to getting insulation fitted.

Voters would prefer any government energy efficiency scheme be paid for via taxation rather than through energy bills (40% vs 11%). But are relatively high proportion (29%) said they had no preference.