

Fixing the roof while the sun shines: Improving energy bill support for the coming winter

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With high energy prices remaining this winter there is still a strong case for providing energy bill support. This briefing looks at the potential for reforming the Warm Homes Discount to provide more targeted and generous support to help struggling households afford energy bills.

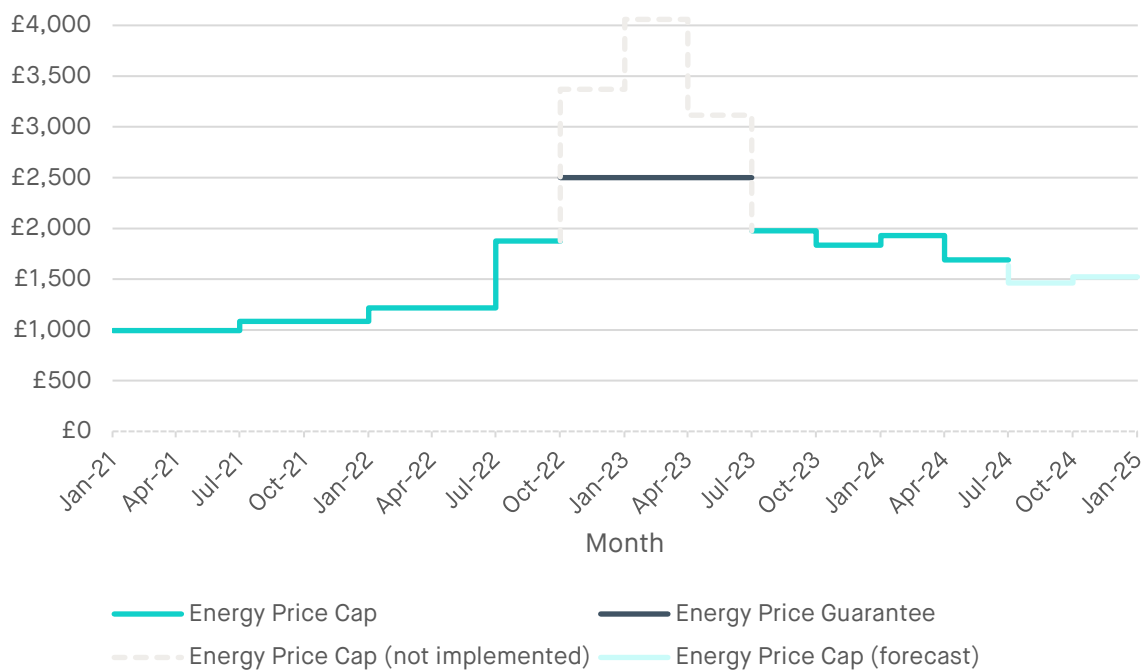
KEY POINTS

- Current schemes such as the Warm Homes Discount (WHD) and Winter Fuel Payments (WFP) are insufficiently generous to meet the scale of difficulty households could experience and are poorly targeted.
- An expanded WHD with tiered bands which gives more support to households who are spending more on energy would better target support at households that need it.
- While a tiered WHD is not an 'ideal' scenario for energy support, it would be an improvement on the status quo. It could plausibly be put in place this winter given its reliance on existing WHD architecture.
- An expanded WHD scheme could be at least partly funded by phasing out WFP, which are inefficiently targeted at many households that do not need support.

The situation this winter

With the energy price cap set to fall by 15% from April¹ – translating to savings of around £300 a year for a typical household² – it is tempting to think that Britain has got through the energy crisis intact. After all, this reduction would bring the price cap down to its lowest level since spring 2022, meaning lower bills for households. Yet despite this welcome news, the price cap by the end of this year is still forecast to be well above where it was at the end of 2021, shortly before Russia’s invasion of Ukraine.³ These developments are depicted graphically below.

Figure 1: The evolution of the energy price cap



Source: Ofgem, Cornwall Insight, House of Commons Library. Price cap for direct debit customers.

While the situation on energy prices has undoubtedly improved, as Figure 1 shows, we are clearly not yet back to pre-crisis levels. Even if the worst of the energy price spike may now be behind us, this winter also looks set to be extremely difficult, with the energy price cap still almost 40% higher than it was in the first half of 2022. According to Citizens Advice, over five million people are now living in households with an energy debt⁴, which on aggregate has reached record levels.⁵ Meanwhile nearly 3.2 million households remain in fuel poverty, and the depth of this fuel poverty – the reduction in bills that a fuel poor household needs to not be classed as fuel poor – is increasing.⁶ Estimates suggest that 6.5 million households across the UK are currently paying over 10% of their income on energy bills.⁷ Indeed, many are deliberately cutting back their energy usage to cope, with around half of British adults saying in one recent survey that they had turned their heating off even though it was cold inside the house.⁸

Why we need to reform energy support

Against this backdrop, support for energy bills will continue to be an important lifeline for many households this winter. To ensure households don't go without the essential utility this year, we need to carefully consider how to improve the design of energy bill support schemes to make them more targeted and effective.

The two major support schemes in place for energy bills are the Warm Homes Discount (WHD) and Winter Fuel Payments (WFP). An overview of the main design features of each scheme is presented in Table 1 below.

Table 1: Comparison of WHD and WFP

	Warm Homes Discount	Winter Fuel Payments
Coverage (no. households)	2.5 million	8.3 million
Eligibility criteria	<p>Core Group 1: Receives the Guarantee Element of Pension Credit</p> <p>Core Group 2: Receives certain means-tested benefitsⁱ and assessed to have high energy costsⁱⁱ</p>	At least one person in household aged 65 or over
Discount given	Flat £150 rebate	Between £100 and £300 a year depending on recipients' age and circumstances
Annual aggregate cost	£374 million	Approx. £2 billion
Funding mechanism	Cross-subsidy on energy bills	General taxation

Source: SMF analysis

Any reforms seeking to improve these two current schemes for energy support should seek to address two key drawbacks in their current design: a lack of generosity and a relatively crude approach to targeting support based on need.

ⁱ These include Housing Benefit, income-related Employment and Support Allowance (ESA), income-based Jobseeker's Allowance (JSA), Income Support, the 'Savings Credit' part of Pension Credit and Universal Credit, as well as tax credits below an income threshold.

ⁱⁱ A property's energy cost is modelled using VOA data. This uses a property's age, type and floor area to give an estimate for energy costs.

Generosity

Over time, the level of support offered through the WHD has fallen behind both energy costs and wider inflation. In 2014, the discount was worth £140 and represented 12.5% of the average bill, but was only increased to £150 in 2022 and now makes up just under 8% of the average bill. If the level of support had risen in line with inflation it would now be worth £185. If it had risen with the higher rate of rising energy costs it would now be worth £240.⁹ This current level of support is failing to support the most in-need households to afford essential household energy use.

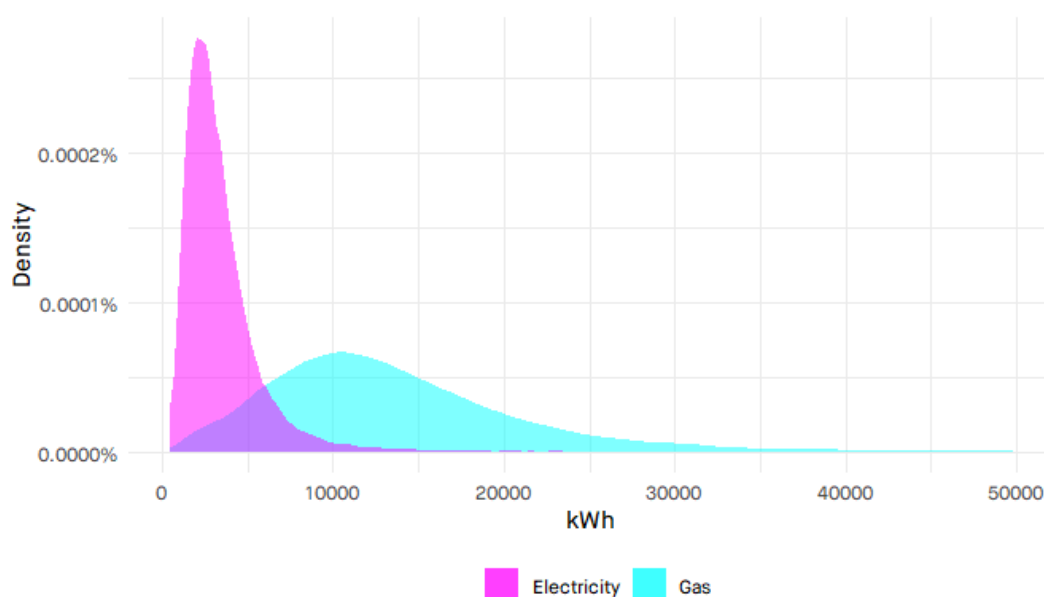
Similarly, according to Citizens Advice, had the core support given under the WFP scheme kept pace with inflation it would now be worth £350.¹⁰

Admittedly, the failure of the WHD and WFP to keep pace with inflation and developments in energy prices has been partly offset in the past year by the cost of living payments. The three schemes – low income, disability and pensioner cost of living payments – offered those in receipt of certain benefits a number of tax-free payments in instalments. While these schemes have undoubtedly blunted the impact of the last winter, this ad-hoc, one-off approach to designing schemes is not a satisfactory approach to addressing energy costs in the long term.

Targeting need

The eligibility criteria employed by the WHD, while administratively simple, means some households most in need of support fail to receive it. This is because eligibility is based on either being in receipt of pension credit or being in receipt of means-tested benefits and being assessed to have high energy costs as modelled through VOA data on the age, size and type of the property in which people live, with those whose heating costs are modelled to be above a ‘high cost’ threshold being eligible for support. This means that a household in receipt of benefits whose property’s heating costs are modelled to be just under the ‘high cost’ threshold will be ineligible for the WHD. This creates a ‘cliff-edge’, where such a household may struggle to afford their energy needs but will go without support due to their property being slightly below this threshold.

Considering how widely energy usage varies between households, as shown below in Figure 2 which displays a density distribution of household-level usage of electricity and gas, only having one band also means the WHD targets need only approximately: a £150 flat-rate rebate can mean very different things to two different households depending on how much energy they are having to use.

Figure 2: Distribution of household usage in kWh of gas and electricity

Source: SMF analysis of National Energy Efficiency Dataset

The targeting of the WFP is even worse. The WFP makes no adjustments for energy need; eligibility is decided simply by at least one person in the household being above 65. This means that, inevitably, some public money is poorly targeted given that around 45% of pensioner households are in the top half of the income distribution.¹¹ Even a House of Commons Energy and Climate Change Committee report conceded that: “As a means of tackling fuel poverty, the case for Winter Fuel Payments is weak... it would be more intellectually honest to... concede that it is a general income supplement.”¹²

There is room to improve on the current situation. While the WHD broadly targets those on low income and with high energy needs, it does so through proxy measures and does not take account of differing levels of need between households. The WFP does not target income or need and functions as a universalist scheme rather than one aimed at support for energy bills.

Options for improving energy support this winter

Previous SMF reports have set out an ideal long-term scenario for targeting energy support. This could be achieved by moving to a ‘formula-based lump sum payment’ for energy bills, which would involve a maximum lump sum payment to help with energy bills that is modified according to income and energy usage.¹³ Alternatively, support could come in the form of a social tariff for energy with eligibility determined by a ‘bills to income ratio’ that would deliver a proportional discount on energy bills for households spending over a certain proportion of their income on energy and other essentials.¹⁴ Either of these strategies would make sure that support for energy bills takes into account both energy usage and household circumstances in a much more comprehensive way than either the WHD or WFP do at present.

However, both of these initiatives would require a significantly upgraded targeting system able to make use of HMRC data on incomes, DWP data and supplier data on energy consumption in order to build a fine-grained picture of energy need. This is an ambitious step up from current data sharing practices and, given the extensive setup that would be needed, is highly unlikely to be in place before this winter.

A tiered WHD

This begs the question of how energy bill support can be improved for this coming winter. Given the short time to implement changes, this will need to be achieved through existing schemes. One approach, as Citizens Advice have suggested in recent work, is to set up a banded WHD, which would expand eligibility to more households and set up multiple thresholds for households' predicted energy needs, with those above the 'high cost' threshold get a higher payment, and decreasing levels of support for those who live in properties modelled to be in lower energy cost thresholds. This WHD would also have expanded funding.

This represents an improvement over the status quo in two key respects. Firstly, expanding the funding of the WHD tackles the lack of generosity of the scheme discussed above. Secondly, having bands for the WHD improves targeting because it makes the scheme more reflective of different levels of energy need and softens the cliff-edges present in the scheme. Doing this allows for more generous support to be targeted at those most in need.

Using existing WHD architecture means that it is possible to put support in place for this winter. But four main questions remain for the design options for a modified, banded WHD: how could it be funded? How many households should it reach? How should they be split into bands? And how much of a discount should be given?

Funding

The Government could implement a tiered WHD in a revenue-neutral way, keeping the overall level of support the same. This would improve the targeting of the WHD and remove the cliff-edge situation faced by households in properties just below the 'high cost' threshold. However, it would do nothing to address the inadequacy of support given to struggling households. Increasing the overall generosity of the scheme to ensure households can afford their energy needs will require an increase in the overall level of funding the scheme has available.

The WHD is currently funded by cross-subsidy on energy bills which currently adds around £19 to all bills¹⁵, so one way to increase the overall package of support would be to increase the level of cross subsidy better-off billpayers contribute to those eligible for the WHD. However, where possible, cost of living support for essential goods and services should be funded through general taxation as this ensures that the burden on households is progressive. Simply raising the bills of all billpayers would constitute a regressive measure.

It is also clear that there is ample opportunity to better direct state funding for energy bills support towards a better targeted and more effective system of support. As we have seen, the WFP is a poorly targeted and incredibly costly form of energy bills support, costing taxpayers around £2 billion annually and, in many cases, providing support to households that do not need it. We believe that there is a strong case for phasing out the Winter Fuel Payments and redirecting the money spent on this scheme to fund a more generous WHD with multiple thresholds tiered according to modelled energy use.

Estimating the eligibility pool

According to the Family Resources Survey (FRS), there are approximately 6.2 million households in receipt of at least one of Universal Credit, Tax Credits, Pension Credit, Housing Benefit, ESA, JSA or Income Support. Adding Personal Independence Payment (PIP), Disability Living Allowance (DLA) and Attendance Allowance, which in 2022 were removed as a qualifying benefit for the WHD amid criticism that this would disproportionately punish disabled claimants¹⁶, brings this total up to 7.81 million. It is worth noting here that the FRS may under-report benefits receipt slightly due to respondent error¹⁷, but we chose to use the FRS because it enables us to estimate the number of households that could be eligible for the WHD.

Benefit caseload statistics from the DWP, while less prone to under-reporting, typically estimate benefit receipt on the basis of *benefit units*, which are not the same thing as *households*: for example, a couple living with their young children and an elderly parent would be one household but two benefit units. Indeed, the FRS suggests there are around 35.2 million benefit units in the UK, but only 28.3 million households. Since the WHD is intended to reduce energy bills, it makes sense to target the scheme at the household level since energy bills are based on a property's usage.

Discounts and bands

To provide a basis for deciding how much of a discount the WHD should give, it is helpful to examine what energy costs for eligible households might look like this winter. The Living Costs and Food Survey (LCFS) provides information on what households spend on a range of goods and services, including energy.

In order to estimate what households who would be eligible for the WHD (households claiming at least one of Universal Credit, Tax Credits, Pension Credit, Housing Benefit, ESA, JSA, Income Support as well as PIP, DLA or Attendance Allowance) could be spending on energy later this year, we took data from the 2021 edition of the LCFS. Since energy prices are very different today compared to what they were in 2021, we uprated households' reported energy spending through multiplying it by the ratio of the total price cap forecast for Q4 this year (£1,521)¹⁸ and the price cap that was in place when the household responded to the survey.ⁱⁱⁱ

ⁱⁱⁱ For example, if a household responded to the LCFS in Q1 of 2021, we divided the forecast price cap for Q4 2024 (£1,521) by the price cap in place for Q1 2021 (£993), meaning we uprated energy spending by a coefficient of 1.53.

To see the distribution of these potential energy costs for this group, we then split this estimated energy spending into deciles. Table 2 below shows the median estimated energy spend for each of these deciles.

Table 2: Potential spending on gas and electricity for WHD-eligible households.

Estimated spending in deciles	Median value
1	£441
2	£825
3	£1081
4	£1276
5	£1441
6	£1650
7	£1865
8	£2176
9	£2660
10	£3668

Source: SMF analysis of LCFS

While this exercise can only provide a rough estimate of potential energy spending among WHD-eligible households, it nevertheless paints a picture of how much the WHD would need to be to deliver meaningful savings for the households with the very highest energy spending.

Example policy: WHD with five bands

What could a tiered WHD look like in practice? Given a starting eligibility pool of 7.81 million households, a WHD that targeted the top half of this pool in terms of predicted energy spending would reach around 3.9 million households, significantly widening access to the WHD from the current 2.5 million households and ensuring more people get support.

These bands could be designed to correspond to the top five deciles of expected energy spending outlined in Table 2. If this tiered WHD aimed to be worth around 15% of energy spending for the median household in each of these bands – which would represent a genuine expansion of support since the WHD used to cover 12.5% of the average bill at its most generous – the discount for each band and associated fiscal costs are outlined in Table 3 below:

Table 3: Example five-band WHD targeting a 15% reduction in energy bills for eligible households.

WHD Band (Highest to Lowest)	WHD amount	Estimated cost (millions)
1	£550	£429.7
2	£400	£312.5
3	£325	£253.9
4	£280	£218.7
5	£250	£195.3
Total cost		£1,410.1

Source: SMF analysis of FRS and LCFS

Expanding the WHD in this way would cost around £1.41 billion. This would provide WHD support to more households and mean that WHD better accounts for different levels of household energy need/spending, resulting in a significant improvement in support this winter.

In terms of costs, this is a significant expansion of the WHD. But this cost could plausibly be met at least in part by a reduction or phase-out of the WFP. Considering that if WFP were completely phased out up to £2 billion could be freed up for other types of energy bill support, the £1.41 billion cost of an upgraded WHD also leaves room for additional support aimed at older households who are eligible, for example a ‘pensioner uplift’ to the WHD that adds a fixed amount to the discount for eligible households with people aged over 65. Doing so could ensure that older people, who are more vulnerable to the impacts of fuel poverty, do not lose out too much from a move to a reformed WHD and also address political concerns around winding down the WFP scheme.

ENDNOTES

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- ² Lawson, Alex. “Energy Bills in Great Britain Forecast to Fall by 16% in April.” The Guardian, January 22, 2024, sec. Money. <https://www.theguardian.com/money/2024/jan/22/energy-bills-great-britain-fall-price-cap-cornwall-insight>.
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- ⁵ “Energy Regulator Sets out Proposals to Help Ensure Customers at Risk of Getting into Debt Are Better Supported | Ofgem,” December 15, 2023. <https://www.ofgem.gov.uk/publications/energy-regulator-sets-out-proposals-help-ensure-customers-risk-getting-debt-are-better-supported>.
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- ⁸ Ibid.
- ⁹ “Shock Proof: Breaking the Cycle of Winter Energy Crises.”
- ¹⁰ Ibid.
- ¹¹ “Back on Target Resolution Foundation,” May 27, 2022. <https://www.resolutionfoundation.org/publications/back-on-target/>.
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- ¹³ Social Market Foundation. “Fairer, Warmer, Cheaper: New Energy Bill Support Policies to Support British Households in an Age of High Prices.” Accessed March 18, 2024. <https://www.smf.co.uk/publications/fairer-warmer-cheaper/>.
- ¹⁴ Social Market Foundation. “Bare Necessities: Towards an Improved Framework for Social Tariffs in the UK.” Accessed March 18, 2024. <https://www.smf.co.uk/publications/bare-necessities-social-tariffs/>.
- ¹⁵ “Shock Proof: Breaking the Cycle of Winter Energy Crises.”
- ¹⁶ “Disabled Claimants Set to Lose Warm Home Discounts | Disability Rights UK.” Accessed March 18, 2024. <https://www.disabilityrightsuk.org/news/2022/march/disabled-claimants-set-lose-warm-home-discounts>.
- ¹⁷ GOV.UK. “State Benefits on the Family Resources Survey (WP115).” Accessed March 18, 2024. <https://www.gov.uk/government/publications/state-benefits-on-the-family-resources-survey-wp115>.
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