Global Counsel

Social tariffs: a progressive solution to the UK's energy affordability crisis?

Blog post by Jasbir Basi, 11 April 2023

With wholesale gas prices falling, the retail energy market has shown signs of opening up. Last month Ovo launched the first tariff deal where customers can pay £225 less than the Government's Energy Price Guarantee.

However, energy affordability is an issue that isn't going to go away. The latest Ofgem data shows that around 12 million households across the UK are now spending more than 10% of their income on energy bills. Whilst the government was right to introduce the EPG to mitigate the impact of the spike in prices, it could only be a short-term measure. Longer term it is clear we need policies focussed on helping the most vulnerable to make their homes more energy efficient and help for some with their bills on a scale greater than previous interventions. Absent action on a suitable scale, many households will face significant hardship, energy suppliers will be at risk from non-payment of bills and it will be impossible to win public consent for lifting the price cap with its distortions of the market and support for the additional investments needed to complete decarbonisation of the power and heat sectors.

How did we get here? What are the right long-term policies required?

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The UK has been heavily exposed to the recent energy price shock. The previous Liz Truss Administration intervened, capping price increases for domestic customers felt under the Ofgem energy price cap to £2,500 a year until April 2024.

Winter has since passed without the significant disruption to UK energy supplies previously feared. Falling wholesale gas prices, while still above pre-crisis levels, have meant that the cost of Government business energy support has fallen, roughly £69bn according to the National Audit Office, halving the Government's initial forecast of £139bn. This prompted the Chancellor to propose raising the energy price guarantee scheme by £500 a year to £3,000 until April 2024. However, a consequence of this was the cost of the Government's cap was projected to rise approximately three months earlier than falling wholesale prices feed into consumer bills via Ofgem's price cap (Figure 1).

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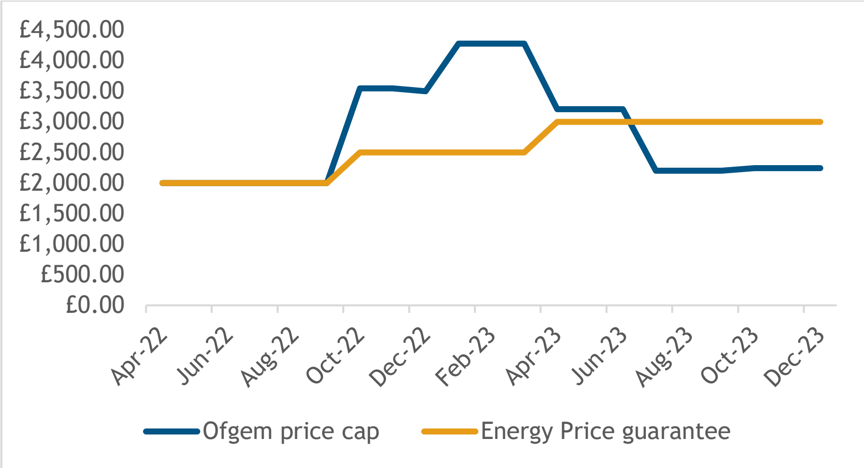
The Energy Price Guarantee is rising before wholesale prices feed through
Typical annual GB energy bill under the EPG and Ofgem price cap



Sources: Global Counsel estimates based on Ofgem and Cornwall Insights data

What's next?

The Chancellor confirmed in the Budget that the Energy Price Guarantee would be maintained at £2,500 for another three months. From Global Counsel polling and focus groups conducted in late February, it is clear that the approach of the price cap plus some targeted support is widely supported by consumers – but considered the bare minimum. Our poll found that 84% of the UK public supported extending the Energy Price Guarantee beyond March 2023, with 75% of the UK public supporting some form of 'social tariff' to provide discounted energy bills for those on the lowest incomes.

There is now a moment of change. The Government confirmed last month it intends to consult this summer on options for the future of consumer protection post-April 2024 and on the future of the price cap on default tariffs. The Chancellor has talked of wanting a "social tariff approach" to support those on the lowest incomes. Labour has proposed keeping the Energy Price Guarantee at £2,500 and has so far been silent on a social tariff.

The review of the price cap and potentially lifting it significantly strengthens the arguments in favour of a social tariff. Whether it is replacing the "protection" of a price cap in favour of a social tariff for the most vulnerable, or its use as an insurance policy to mitigate potential impacts on bills of extra investment as we decarbonise.

But what does this mean in practice? A social tariff can be defined as a discounted, targeted tariff aimed to protect the most vulnerable to ensure they live comfortably in warm homes. One example is the Warm Homes discount, a £150 energy bill discount offered by all licensed suppliers with more than 50,000 customers.

No easy choices

So, how would a social tariff work? There are broadly four options. A fixed-value bill discount, such as the current Warm Homes Discount; a unit rate discount, where each unit of energy used is cheaper; a rising block tariff, where you charge less for the first units consumed and charge more as consumption increases and a real bill cap, where an absolute limit is put on an amount a household would pay for energy. What are the key issues in design and implementation?

What are the options and issues? The first question is who is eligible? The benefits system provides one tool for targeted support. However, as a recent Citizen Advice Bureau/Social Market Foundation study showed, this would reach just half of those spending 10% or more on energy bills. Another issue is enabling policymakers to obtain a holistic view of social tariff eligibility. The Department for Energy Security & Net Zero will need to collate finely tuned data from a range of sources, such as from HMRC on taxpayer incomes and social security, energy suppliers on household energy consumption and from DHSC on health conditions. Focus groups conducted by Global Counsel suggest that targeting support only at the lowest-income households risks a public backlash in absence of wider support for all households.

The second question is who pays? The Citizen Advice Bureau/Social Market Foundation study has shown that assuming average energy bills of £2,500 per annum, the costs to the exchequer of a tiered fixed payment or tiered unit discounted rate are likely to be the region of £5.6-5.9bn. Given this is a figure multiples of the current warm homes discount, anticipating taxpayers alone will foot the bill is a big ask in the current fiscally constrained environment. In Global Counsel focus groups, there was a strong public aversion to taxpayers footing the whole bill and a belief this should be paid for by energy companies (participants showed zero awareness that the “supply” part of the energy chain isn’t profitable). One possible option could be funding a social tariff or part of it through a regulatory mandate. The Government could frame this as a contribution from energy companies, but in practice, the tab is picked up by bill payers such as energy policy and social costs were prior to the current energy crisis.

The third question is implementation. There are both legislative and non-legislative pathways to deliver a well-designed and targeted social tariff. Whether it is new primary legislation from the Government, such as an amendment to the Energy Bill going through the Lords or a separate private member’s Bill, or implementation by Ofgem.

18 months into the current energy crisis and ahead of a potential election, energy affordability is a pressing issue. Addressing it on a durable basis will require the introduction of a social tariff. Energy suppliers and data providers have a key role to play in helping a current or future government develop and implement with urgency, a well-designed social tariff policy.