Five effective levers to bring energy bills down

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1. Putting an Arm around the North Sea — with a CFD

CFD's have been used very successfully to provide price certainty and reduce risk for new build green energy projects — that price certainty helps to reduce the profit margins required by operators, which in turn lowers the energy cost for consumers. We can provide the same price certainty, and get lower energy costs by using this existing mechanism for our North Sea industry. This will protect jobs and investments already made, not just from global pricing uncertainty — but from a potential cliff edge event whereby exceptionally low prices causing a walk away and premature end to operations. A CFD for the North Sea will enable us to maximise the resources that we have left in the North Sea and complete the green energy transition properly.

It will also lower our energy bills. Over the last five years, if we had applied a CFD strike price set at 10% above the published costs of production — we would have saved £10Bn each year from our cost of energy. Such a strike price fixes a 10% profit margin for the industry to ensure continued operation come what may. Retail energy suppliers are allowed a 2% profit margin. Government can choose where to set the margin, 10% is an illustration.

A CDF for the North Sea would also enable us to scrap the windfall tax, which was toxic on the doorstep in recent elections.

Finally this is an issue of fairness — CFDs are what we use to support green energy, providing the same thing to fossil energy could help end the toxic right wing narrative that claims net zero and green energy are the enemies of our fossil fuel industry. Jobs in the North Sea specifically. Who could argue with such a move?

2. Breaking the Link. Don't let gas set the price of our wind and sun

Since the energy crisis of 2022 we've been flagging this flaw at the heart of our energy system, which is that we allow the price of gas to set the price of all other energy — including from the wind and sun. Until we break this link we will not see our bills come down due to ever increasing amounts of green energy on the grid — the global price of gas will prevent that. And the right wing weaponises this already, record amounts of green on the grid - but energy bills are not lower.

In 2023 The Link added £43Bn to Britain's energy bills, £13Bn to households and £30Bn to business energy bills. It is by a long way the single biggest reason that we have, by a considerable margin, the highest energy bills in Europe.

This £43Bn added to our energy bills has a number of knock on impacts in our economy; it increases RPI, which is a major influence on BoE lending rates, which knocks on to mortgage rates, pay bargaining and our general cost of living.

We are aware that DESNZ believe we can simply wait it out, wait for there to be very little gas left on the grid to set the price — come 2030. There are a number of problems with that approach; firstly it's a long time to wait while high energy bills are seriously denting public sentiment towards this government, secondly by DESNZ's own predictions, come 2030 gas would still be setting the price 30% of the time (central forecast). It's also a bit late to leave things for the next election.

We are also aware of the view within DESNZ that by 2030 most of the power generated in our country will be on a CFD — and because the CFD mechanism recycles high energy prices (above the strike price) back to consumers - we would be protected.

The main problem with this approach is the three month delay in refunding consumers within the CFD mechanism — we would be taking cash from hard pushed consumers and giving it back three months later. Repeatedly. And the Energy Price Cap will still be set to a significant degree by the forward price of gas. So as a nation we will see our bills higher than they need to be, we will pay more than we need to and get that money back three months later - that's far from ideal, optically and in practice.

Another factor needs taking into account — higher energy bills feed the measure of inflation - unless the formulae for calculating that allows for the 'cash back' that comes three months later.

It is surely more simple and effective and immediate — to break this link now.

We have produced a road map for government to do this, aware that civil servants claim it is too difficult to do. If we start this year we can have it complete at the start of 2028.

3. Control the profits of the Distribution companies

These companies own the regional grids for gas and electricity, they are mostly foreign companies often based offshore.

Despite operating natural actual monopolies and despite being regulated by OFGEM — these companies make the biggest profit margins in our economy bar none — bigger even than the banks, bigger even than Venture Capital firms. With no risk to speak of.

Over the last few years their published accounts show typical profit margins of 40%.

At the same time OFGEM proposes to allow them another big increase in their bills, to fund investment in their own networks.

And at the same time they have paid massive dividends to their parent companies — often in tax havens, rather than invest in our networks. It's all very similar to the Thames Water debacle.

With proper control of these margins we could knock several hundred pounds a year off our energy bills and still have the network investment we need - the only thing we wouldn't have are record breaking profit margins and £billions leaving our economy in dividends.

These privatised networks are vital national infrastructure, they are regulated monopolies and they should work in our interest, first and foremost.

4. A Progressive approach to energy taxes

Electricity bills in our country contain a number of additional costs, stealth taxes is not an unfair way to describe them — even though they are designed to fund good things, green energy and energy efficiency. In combination these measures add £150 to a typical energy bill per year. They are applied as a flat rate per unit of consumption, as is VAT.

Removing them would deliver half of Labour's pre-election manifesto promise — but come at an enormous cost the the Treasury.

Instead we propose the creation of a progressive approach to energy pricing — essentially creating a tax free band of consumption at the very low end which correlates strongly with income and energy poverty and pushing the costs of that upwards into the larger consumption areas, where energy bills are not an affordability problem.

We have modelled several different scenarios, based around a tax free zone of 2MWh annual consumption (OFGEM states the annual average is just over 3MWh) — with differing approaches to applying that 'lost tax' in up the consumption scale. Our modelling shows that up to 80% of people could have lower energy bills this way

Under this system, annual energy bills for those on the lost incomes (and most likely to be in energy poverty) would be lower than OFGEMs energy price cap with the difference spread across the bills of those that consume the most. It would result in a modest and affordable increase for those on higher incomes, that consume the most, while significantly reducing the cost for those on the lowest incomes. It would be a progressive way to apply green levies and even VAT.

5. Removing VAT from energy bills

Energy bills are of course an essential, we have an energy price cap to protect people from energy bills being any higher than they absolutely need to be - but then we add VAT on top. That's a regressive form of tax. Millions of people struggle to pay their energy bills and face the choice of heating or eating in the winter, while millions more can easily afford this VAT. Meanwhile there is no VAT on flying, which is of course a luxury not an essential.

If government are minded to remove VAT from energy bills, rather than absorb the near £2bn annual cost of that — it could instead move that 5% rate to flying, placing it on something 50% of Briton's don't do. It would be a progressive move.

Currently the airline industry enjoys a near £20bn a year subsidy by means of being free from fuel duty and VAT. Some of that subsidy could be diverted towards energy bills and energy poverty where it will benefit far more people. 10% of Britons are taking 50% of all flights!

The role of Energy bills on the rate of Inflation and more

In 2023 Breaking the Link could have saved meant our nation’s energy bills were £43bn lower. An enormous sum of money.

£13bn of that could have been saved by households. We modelled the impact that would have had on inflation that year and found it would have reduced RPI by 1.35 percentage points — from 7.2% to 5.9%

It requires a more complex model to take into account the far larger sum that was added to business energy bills — if it were pro rata with the impact of domestic bills, then the headline rate of inflation in that year could have been almost halved — in total.

This is something Treasury could readily model.

Obviously inflation is a key factor in BoE rates, which effectively set mortgage rates, drives pay bargaining and the overall cost of living. Our modelling also shows 700k people would be lifted out of poverty in 2023 if we had ‘broken the link’

That is from just one, albeit the biggest, of our three suggested market reforms . The other two, a CFD for the North Sea proper control of network operator profits could have chipped in another £10bn and £5bn respectively in that year — driving inflation and all it’s knock on impacts - even lower

The benefits of lower inflation occur once, in the year of first implementation — but the benefits of these proposed reforms would endure beyond that due to the energy price stability they would create, keeping a lid on the energy component of RPI in future years.

In Summary

Above we set out in short, three policy proposals for reform of the energy market. Each is backed by it's own more comprehensive report. The cumulative impact of delivering all three could be the almost halving of our energy bills, which would take us from the most expensive in Europe to among the least - providing a major, enduring boost to our economy. We would also remove almost all of the volatility that we see in energy pricing — which requires OFGEM to reset the energy price cap every three months. None of this will come at a cost to government.

Our fourth proposal — to make taxes on our energy bills more progressive — likewise does not come at a cost to government but could reduce energy bills for the poorest among us by almost 20%.

These reductions are not confined to our energy bills. As above they have a profound impact on inflation, which knocks on to Bank of England lending rates, mortgages, pay bargaining, our overall cost of living and levels of poverty.