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Economic Bulletin

HELP FOR JAMS WITHOUT BREAKING THE BANK

Image Credit: iStock/Getty Images

- Infrastructure policies on housing, energy, water, broadband, railways, air travel, shale gas and ports could all help the just about managing in a tangible way.
- While expected Budget measures on social care and business rates will burden the Exchequer, the following policies won't affect Treasury revenues.
- The Housing White Paper is an encouraging step in promoting more supply. Pink zones – where planning procedures can be streamlined – should be taken forward.
- Policies must bear down on household bills. For example, freezing renewable energy subsidies could save households £173 a year by 2020-21.
- Structural separation of BT Openreach would reduce broadband bills, more open access on UK railways would push down rail fares, and scrapping air passenger duty would lead to lower air fares without impacting Treasury revenues.
- Shale gas development and free trade zones around UK Ports could incentivise economic growth in areas of low socio-economic standing.

INTRODUCTION

In the 2017 Budget, it is widely expected that measures will be taken to alleviate the underfunding of social care and the adverse impacts from business rate reform, which will require some fiscal loosening. The Chancellor, Philip Hammond, is now expected to undershoot his borrowing target for 2016-17, giving him some wiggle room. However, given that the UK's budget deficit is still expected to be over 3% of GDP in 2016-17, there is little further room for further fiscal loosening.

In her first speech as Prime Minister, Theresa May said that "If you're just about managing, I want to address you directly". This ambition is the right one. It is therefore imperative that the Government seeks to implement new policies that help with the cost of living for the Just About Managing (JAMs) without burdening the Exchequer in the immediate or long term. Policies promoting competition – among other things – in the areas of housing, energy, water, broadband, railways, air passenger duty, shale gas and free ports would potentially achieve this.

This bulletin offers nine policy recommendations split into 3 key sections: Section 1 looks at making housing more affordable, 2 looks at reducing the cost of household bills, and 3 focuses on promoting growth outside the south-east.

A forthcoming bulletin will look at tax and other supply side issues.

1. MAKING HOUSING MORE AFFORDABLE

Housing White Paper is encouraging – but more still to do

The cost of housing has become increasingly unaffordable for the 'Just About Managing' classes. Since 1997, England's median earnings to house price ratio has risen from 3.54 to 7.49, according to the Department for Communities and Local Government (DCLG). It is now estimated that just 20% of 25 year olds own their own home – which is down from 46% 20 years ago.

The dramatic increase in the proportional cost of housing has been even more pronounced in many London boroughs. In Hammersmith and Fulham, for example, the ratio has risen from 5.63 to 22.33 over the same period.

Unaffordable rents are also causing major issues, leading to a spiralling housing benefit bill. Since 2000-01 the housing bill has increased by 62%, according to the Department for Work and Pensions.

Fundamental to this problem is that the new supply of homes is failing to meet demand. Natural population increase, a falling average household size and high levels of net immigration mean that the UK requires up to 320,000 new homes annually. The Government's aim of reducing net immigration would certainly help in reducing demand for new homes, but there is a desperate need for a market-led approach to rapidly increase the supply of good quality housing – both for rental and for purchase.

Encouragingly, opinion polling suggests that NIMBYism is on the decline. Today, almost twice as many people in England back building new homes in their local area compared to 2010, the National Housing Federation has found. Support for new homes nearly doubled from 29% in 2010 to 57% in 2016, rising to almost 3 in 4 if the homes are affordable on average local incomes.

According to the latest British Social Attitudes survey:

- 69% of homeowners support new affordable homes in their local area.
- 70% of those aged 55+ support new affordable homes in their local area.
- 64% of Conservative voters, 72% of UKIP voters, 75% of Lib Dem voters and 83% of Labour voters support new affordable housing in their local area.

The Government's recent Housing White Paper is encouraging in many aspects. It builds on many of the ideas advocated by the Centre for Policy Studies, including a national standard by which councils can assess their future housing needs and promoting the idea of identifying "pink zones" (see Keith Boyfield and Daniel Greenberg) where planning procedures could be streamlined to speed up development. If enacted, these proposals will encourage a higher level and better quality of house building, offering a greater chance for the JAMs either to get onto the property ladder or to obtain high quality rental housing.

There are areas where the Housing White Paper falls short, however. The White Paper rules out a review of the greenbelt that could help free up land that is of low environmental quality – despite organisations including the London Forum, the DCLG Committee and London First calling for such a review. Quite understandably, however, this is politically difficult to achieve given the Conservative Party's manifesto commitments on the greenbelt.

PROPOSAL 1

The Government's White Paper on housing is encouraging in many aspects. It suggests some modest reductions to planning regulations and stipulates that councils must have an up to date local development plan. It is also welcome that the White Paper invites comments on the CPS' idea of "pink zones", and trust that this idea will makes its way into a subsequent Bill.

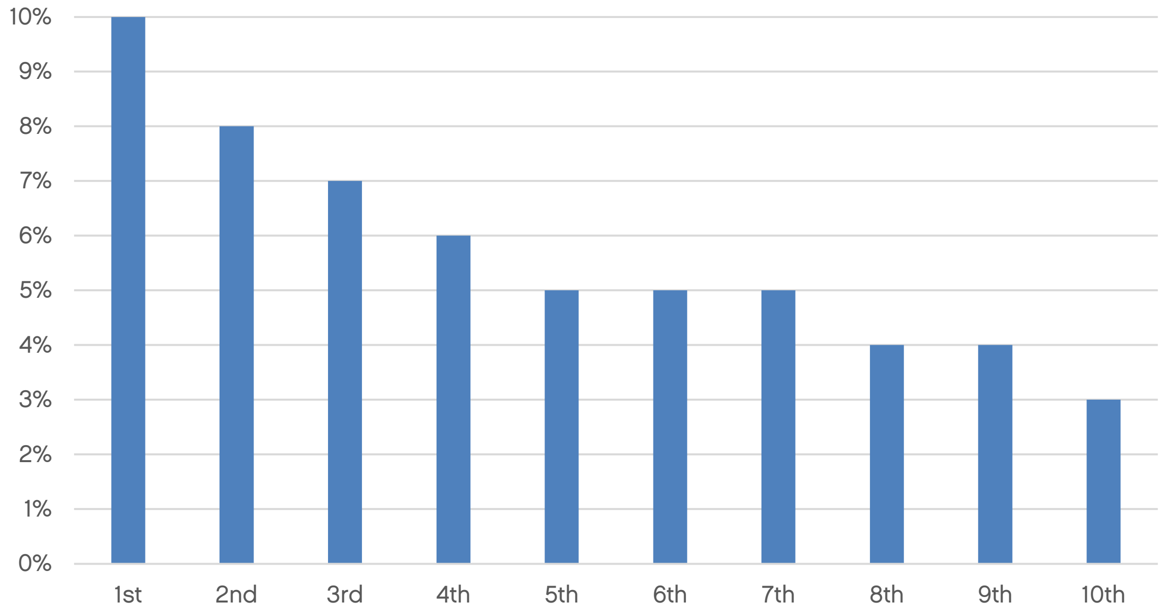
2. REDUCING HOUSEHOLD BILLS

Lower energy, water and broadband bills and cheaper rail fares

The poorest decile of households spends, on average, around 10% of their expenditure on energy compared to 5% for the middle deciles and just 3% for the top decile (see Figure 1). This means that any increase in energy bills acts as a regressive tax, disproportionately penalising the poorest families. Any strategy to help the JAMs should therefore address the critical issue of energy costs.

Figure 1: Fuel and power costs as a proportion of household expenditure

(By decile)



Source: Office for National Statistics

2.1 Controlling renewable energy subsidies

The UK's legal commitments the EU Renewables Obligation imply that over 30% of electricity must come from renewables by 2020. To achieve this target, direct renewable energy subsidies, which are levied onto consumer energy bills, are set to reach £10.7 billion by 2020-21 in nominal terms, according to the Office for Budget Responsibility (OBR) (see Table 1). Action to tackle the costs associated with renewable energy subsidies would offer major relief to the cost of living for the JAMs – given that increases in energy bills act as a regressive tax.

A review into renewable energy policy could offer substantial benefits to the JAMs. For example, if renewable energy subsidies were frozen at 2016-17 levels until 2020-21, the cost saving would equate to an average of £173 per household per year in nominal terms.[1] One third of this cost would come directly off household energy bills and the other two thirds would come off business energy bills. Households would also benefit from the reduction in business energy bills via lower prices for products and potentially higher wages.

Table 1: Forecast cost of renewable energy subsidies

(Nominal terms £bn)

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
FITs	0.0	1.3	1.3	1.4	1.4	1.5
ROs	3.9	4.6	5.4	6.2	6.5	6.6
Cfds	0.0	0.1	0.7	1.3	1.9	3.1
Renewable energy subsidies	3.9	6	7.4	8.9	9.8	10.7

Source: OBR (November 2016)

PROPOSAL 2

The government should review the current impact of energy and climate levies on low and middle income families, with a view to capping or reducing the increase in costs of renewable energy subsidies.

2.2 Ensuring reliable energy supplies and avoiding price spikes

From 2012 – 2030, the UK should be building 26GW of new CCGT gas capacity to shore up the UK's energy supplies, according to the Government's 2012 Gas Generation Strategy. The recent Capacity Market auctions, which are vital to ensuring that this target is achieved, are not particularly encouraging in this respect. The previous three auctions have failed to attract any significant new gas plant onto the UK electricity system. There were only two substantial new build gas generating entrants accepted from the latest capacity auction, leading analysts at Barclays to conclude that the auction "will largely be viewed as a disappointment by the UK government in terms of securing the significant levels of new gas generation capacity they hoped for".

In September, a series of incidents led to power prices temporarily surging by over 2,000%. A lack of baseload power could see this reoccur on a more regular basis.

Source: Daily Telegraph

[1] Cost of renewable energy subsidies (£6 billion in 2016-17 and projected to be £10.7 billion in 2020-21). No of households in 2016 was 27.1 million. £173 = (£10.7 billion - £6 billion) / 27.1 million.

Earlier this month, a former boss of National Grid claimed that the UK has enough energy capacity to meet demand. This pronouncement comes despite National Grid's latest Winter Outlook suggesting the UK's electricity margins are narrow.

Yet even if the UK is not set for blackouts, there are still some troubling developments in the UK's electricity market. The premature closure of many baseload power stations without an adequate replacement of new baseload capacity could be detrimental for energy bill payers. It could lead to a surge in power prices at any given point in time, which could be highly costly for the JAMs. In September 2016, for example, a series of incidents – including an interconnector outage and low wind output – led to power prices temporarily surging from £40/MWh to £999/MWh.

PROPOSAL 3

The Government must urgently address problems with the current capacity market auctions, which are failing to incentivise adequate new gas plants onto the UK's electricity grid.

2.3 Lower costs and more innovation for water bills

Water bills are not as costly as some other types of utility bills, but they still comprise a considerable proportion of low income household expenditure. For example, the National Audit Office estimates that water bills represented around 2.3% of average household spending in 2013, rising to more than 5% for the poorest decile of households.

Retail competition in the residential sector could help promote better value and more innovation for customers. Ofwat's most recent estimate suggests that residential retail competition in the water industry could provide £2.9 billion of direct benefits over 30 years (see Table 2).

It could also help achieve innovation in the water industry, leading to better outcomes for all consumers. That means not only offering modest reductions in water bills, but also opening the opportunity of indirect benefits such as new innovative offers to customers. For example, retail competition could lead to water efficiency services and multi-service bundles (such as energy-water dual utility bills), which could make customers' lives easier, according to Ofwat's latest analysis.

Table 2: Estimates of Net Present Value of Residential Retail Competition in Water Industry after 30 years

Scenario	Net present value
1. Low cost, widespread innovation, strong competition among retailers	£2,917 million
2. Low cost, less innovation, competition among retailers	£1,214 million
3. High cost, less innovation, competition among retailers	£185 million
4. High cost, little innovation and weaker competition among retailers	-£1,445 million

Source: Ofwat link

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PROPOSAL 4

As a small part of a strategy to help the JAMs, the Government should announce its intention to introduce retail competition into the residential water market.

2.4 Promote competition in the broadband industry

The current broadband infrastructure market appears to be anti-competitive in some respects, leading to a conflict of interest in two key ways. BT runs the UK's broadband infrastructure through its subsidiary BT Openreach and service providers are forced to use this infrastructure. BT also uses its own infrastructure to provide internet services to customers, which is a major disadvantage to its retail broadband competitors.

Many internet service providers have long complained that BT Openreach abuses its monopoly position by providing poor quality and customer service. Vodafone, for example, has argued that BT Openreach has failed to meet its obligations to them by delaying provision of Ethernet services and then failing to offer the appropriate compensation. The company claims that half of the lines it has taken from BT Openreach were delayed. It is also worth noting that BT Openreach's own Chairman has admitted that BT should have invested more in broadband.

Structural separation of BT Openreach from BT could, however, provide a market with a level playing field between all players, where the infrastructure that service providers rely on would not be owned by one company. There is every indication to suggest that a structurally separated BT Openreach – with various investors – might be more likely to invest in higher speed broadband provision and promote better value for customers. International precedents from Singapore and New Zealand provide favourable evidence for the structurally separated model.

Proposal 5

Although this is a matter for Ofcom and potentially the CMA, Ministers could announce its support for greater competition in the broadband industry and state that structural separation of BT Openreach should remain an available option.

2.5 More competition on the UK's railways

Competition on the UK's passenger railways occurs in the bidding stage for franchise contracts. With a handful of exceptions, competition after this process effectively ceases. The UK's transport authorities have been resistant to open access competition on passenger routes, mostly because they are concerned that revenue streams from franchises will be reduced. Open access

From 2007 – 2012, on the East Coast Mainline average fares increased by only 11% at stations with competition, compared to 17% at those stations without competition.

Source: Evidence to Transport Select Committee operators are train companies that secure track access agreements for individual routes and are not subject to franchising agreements.

However, open access competition has proven to benefit passengers on the East Coast Mainline. According to a Competition and Markets Authority (CMA) document published in 2015, the open access operators have a 94% satisfaction rate for passengers, which is the joint highest score across all operators.

Furthermore, fares in areas of the line where the franchise holder competes with open access operators are more competitive compared to areas of the line that face no competition, according to evidence given by Tony Lodge at the Transport Select Committee. From 2007 – 2012, average fares increased by only 11% at those stations with competition, compared to 17% at those stations without competition.

The Transport Select Committee has also recently argued that evidence points to greater benefits for an expanded role of competition on long distance routes – a view shared by the CMA. However, the Government has yet to formally declare its support for the principle of open access on the UK's railways despite warm words in the recent past.

PROPOSAL 6

The Government should publicly support competition on UK rail and show its commitment by easing the path for those seeking to deliver competition against franchise holders. This could promote lower fares for many rail passengers commuting long distances.

2.6 Scrapping Air Passenger Duty

Table 3: Fiscal Impact of abolition of Air Passenger Duty (2010 prices)

	Year 1 after abolition	Year 2 after abolition	Year 3 after abolition
Dynamic costing	+£0.57bn	£0.38bn	£0.36bn
Static costing	-£3.1bn	£-3.2bn	-£3.4bn

Source: Pricewaterhouse Coopers link

The Government has made welcome moves on air passenger duty by scrapping the tax for the under 12s, and subsequently scrapping the tax for the under 16s. The Air Passenger Duty (APD) rate for adults remains at £13 for short haul flights and £75 for long haul flights, meaning that APD brought in over £3 billion to the Treasury in 2015.

However, there is strong evidence to suggest that this tax is counterproductive. When using dynamic modelling (which analyses the impact on economic activity flowing from tax change), Pricewaterhouse Coopers estimate that the abolition of the tax would, in fact, boost the Government's overall net fiscal position by over £500m in the immediate term (see Table 4) –

despite the loss of direct revenue. This would arise from the stimulation of economic activity, which would lead to higher tax receipts from indirect taxes, corporations and individuals.

PROPOSAL 7

It is welcome that the government has scrapped APD for the under 16s, but Ministers should go further and scrap the tax altogether. It would offer welcome cost savings to air passengers and evidence suggests that it would also benefit the Treasury's overall fiscal position.

3. PROMOTING GROWTH OUTSIDE THE SOUTH-EAST

Promoting the shale industry and introducing free ports

3.1 The Shale Industry

It is estimated that without any UK shale development, 75% of the UK's gas would need to be imported by 2030, according to the Oil and Gas Authority. A greater dependence on imported gas would increase energy insecurity and increase costs for consumers. Transportation, liquefaction and regasification of gas can add up to 50% to the wholesale price, according to UKOOG. An Ernst & Young (EY) report has also identified that around 64,500 jobs could be created as a result of the UK's shale industry. Given most of the prospective shale resources are in the north of England, these jobs would mostly be created in areas outside the South-East.

Importing gas can add up to 50% of cost to the wholesale price.

Source: UKOOG

This highlights the need for the Government to make adequate preparations for a thriving shale gas industry in the 2020s. The JAMs would benefit from lower cost energy and the promotion of jobs in the north of England. The salary ranges for direct jobs are estimated to be between £36,000 and £160,000.

Proposal 8

It is vital that exploratory drilling continues to take place promptly so that a true assessment of the UK's shale can be realised. The Government must ensure that there is no slippage from this timetable, and should update the House of Commons on current progress.

3.2 Free Ports – More growth in areas of high socio-economic deprivation

Brexit could provide the UK with new economic freedom and Britain could use this opportunity to create Free Ports across the nation. Free Ports would simultaneously: increase manufacturing output, create employment regionally where it is needed, and promote trade.

A free port is an area that is inside the UK geographically but legally outside of the UK customs territory. Goods can be imported, manufactured or re-exported inside the Free Zone without incurring domestic customs duties or taxes. These are only paid (often at reduced rates) on goods entering the domestic economy. The UK's membership of the EU currently forbids this to take place as almost 80% of revenue generated by tariffs goes directly into the EU's budget.

Free Ports could create up to 86,000 jobs for the British economy if they were as successful as the United States' Foreign Trade Zone programme. Job creation arising from Free Ports would disproportionately be created in areas outside London where economic need is higher. Of the UK's 30 largest ports, 17 are in the bottom quartile of Local Authorities when ranked by the ONS's Index of Multiple Deprivation and three quarters are in 'below average' Local Authorities.

Proposal 9

Although Free Ports cannot be introduced until the UK leaves the EU, the Government should examine areas around the country where free trade zones could be established.

Daniel Mahoney and Tim Knox
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ANNEX: INFRASTRUCTURE POLICY RECOMMENDATIONS FOR THE JAMs

Policy Area	Recommendations
Housing	The Government's White Paper on housing is encouraging in many aspects. It suggests some modest reductions to planning regulations and stipulates that councils must have an up to date local development plan. It is also very welcome that the White Paper welcomes invitations for comments on the CPS' idea of "pink zones", and we hope that this idea will makes its way into any subsequent Bill.
Energy: Renewables	The government should announce a review of the current impact of energy and climate levies on low and middle income families, with a view to capping or reducing the increase in costs of renewable energy subsidies.
Energy: Baseload capacity	The Government must urgently address problems with the current capacity market auctions, which are failing to incentivise adequate new gas plants onto the UK's electricity grid. A lack of adequate domestic baseload power plants could lead to temporary price surges for the cost of electricity.
Water industry	As a small part of a strategy to help the JAMs, the Government should announce its intention to introduce retail competition into the residential water market, which will offer modest price decreases and more innovation.
Broadband	Although a matter for Ofcom and potentially the Competition and Markets Authority, Ministers could announce its support for greater competition in the broadband industry and state that structural separation of BT Openreach should remain an available option.
Rail fares	The Government should publicly support competition on UK rail and show its commitment by easing the path for those seeking to deliver competition against franchise holders. This could promote lower fares for many rail passengers commuting long distances.
Air passenger duty	It is welcome that the government has scrapped APD for the under 16s, but Ministers should go further and scrap the tax altogether. It would offer welcome cost savings to air passengers and evidence suggests that it would also benefit the Treasury's overall fiscal position.
Shale industry	It is vital that exploratory drilling continues to take place promptly so that a true assessment of the UK's shale can be realised. The government must ensure that there is no slippage from this timetable, and should update the House of Commons on current progress. Indigenous shale could hold down gas prices and promote growth in the north of England.

Ports industry	Although Free Ports cannot be introduced until the UK leaves the EU, the Government should examine areas around the country where foreign trade zones could be established. Free Ports would simultaneously: increase manufacturing output, create employment regionally where it is needed, and promote trade.