



Economic Bulletin

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The Bleak Midwinter

The Impact of the Energy Price Crisis

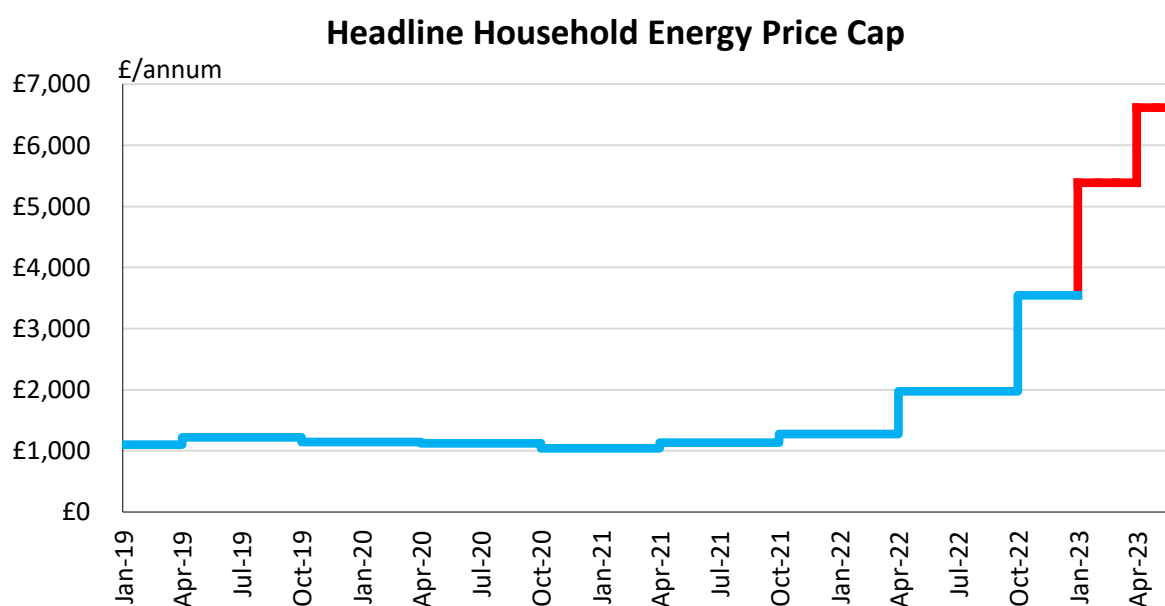
by Karl Williams

- Energy bills have increased threefold in the space of a year, to unprecedented levels. Millions of households are at risk of being driven into poverty and debt this winter, tens of thousands of businesses could go bust, and in a worst-case scenario we could be facing rolling blackouts.
- By any measure, energy prices are inducing a state of economic emergency, which is going to present the Government with some very uncomfortable, not to mention costly, choices and trade-offs over the coming months.
- Britain is not alone in facing this crisis, and it is helpful to examine the policy response in other European countries. Broadly speaking, policies fall into five categories: household handouts, energy price interventions, business support, tax cuts and regulating consumption. Most countries are simultaneously pursuing multiple approaches to mitigate the crisis. No one has found anything like an ideal solution.
- Our view is that as a matter of principle, Government should avoid nationalisation, eschew punitive windfall taxes, strive to uphold market prices as much as possible, and alleviate cost of living pressures by reducing the tax burden and targeting extra help to the most vulnerable, insofar as state capacity allows. That said, given the sheer scale of the emergency, it is easy to see why ministers may resort to fixing the price of energy. Whatever the solution, it will be extraordinarily expensive. We will probably have to eat up the costs through borrowing, and rely on economic growth and the consolidation of the state to get public finances back on track over the longer term.
- While the focus needs to be on getting through the immediate crisis, we also need to start planning for next winter and beyond. That means prioritising cost of living pressure broadly, improving state database management, grabbing the low-hanging fruit on the insulation front and embark on radical supplier-side reform across renewables, nuclear and natural gas, supported by reforms to business taxation and investment incentives.
- As the energy crisis makes plain, cheap energy is intrinsic to the welfare and prosperity of individuals, families and the country. In the long term, the government's growth agenda needs to aim at energy abundance through growing renewables output, building more nuclear plants and – at least for a few decades – using fossil fuels offset by carbon capture and storage.



Macroeconomic Winter is Coming

Britain is in an energy emergency. Just 12 months ago the average household was paying £1,138 per annum for gas and electricity. But as Ofgem has now [confirmed](#), from October that same notional household will be facing an unprecedented annual energy bill of £3,549 – a threefold increase in the space of a year. Some forecasters expect prices to rise further in January 2023, and then again in April, with the energy price cap [ratcheting up](#) first to over £5,000 and then to over £6,000.



Data Sources: Ofgem, and Cornwall Insight - late August forecast.

There are of course two great uncertainties here – the weather, and Putin’s war in Ukraine. It is impossible to know how either will play out. However, BEIS is reportedly preparing for a worst case scenario of [rolling blackouts](#) and energy rationing – a scenario that will look increasingly likely following Russia’s decision to shut down Nord Stream 1 [indefinitely](#). Even the more optimistic market analysts expect energy prices to remain elevated compared to 2021.

Put simply, supply and demand fundamentals in global gas markets are badly out of kilter due to both short-term shocks and longer-term structural factors (of which the [signs](#) were there well before Ukraine), and it is likely to take at least a couple of years for rebalancing to play out through substitution, demand reduction and new gas supplies coming to market. And the situation has been made worse in Britain, as the Centre for Policy Studies has repeatedly warned, by our failure to take energy security seriously or to plan for the long term. Unfortunately, there is now little that can be done on the supply side to slow rising energy costs and mitigate two decades of energy policy [failure](#) before the cold and dark is upon us. If we avoid the prospect we [highlighted](#) in March – ‘double-digit inflation, rolling blackouts and a new Winter of Discontent’ – it will only be because of government intervention on a staggering scale. But whatever happens, it will involve making hugely difficult choices.



While still shielded by the price cap from the from the worst of high wholesale prices, millions of households are at risk of sliding into debt and poverty. Everyone is going to feel some pain, but whereas households in the top 30% of the income distribution normally spent around 5% of their disposable income on energy before the crisis, those in the bottom decile spent around 14%. And as Neil O'Brien MP has [pointed out](#), there is a huge amount of variation even within this group, with a quarter (roughly 700,000 households) spending at least 23% of their household budget on energy.

Such '[high use, low income](#)' energy consumers tend to live in older, badly insulated and often rural dwellings, and many of them are pensioners. With energy prices having tripled in a year, these households will now be spending upwards of half of their disposable income on energy alone – unless they can sharply cut back on consumption (though among other things, shivering pensioners are not exactly going to help with the towering NHS [backlog](#)).

[Polling](#) by Public First indicates that 70% of voters are personally taking action to deal with price rises already, although 34% still worry that they will be unable to pay energy bills in the next 12 months.

It is important to remember here that household energy bills are surging against a broader backdrop of rising prices and falling real wages in most sectors of the economy. Already in March, the Office for Budget Responsibility (OBR) was [projecting](#) that average real wages after taxes would not recover to 2021 levels until after 2026. The Bank of England [expects](#) inflation still to be running at around 9-10% by autumn 2023, and some worst-case scenarios have it topping 20% in early 2023. Meanwhile, the Resolution Foundation is [forecasting](#) that by mid-2023, average real wages will have dropped back to 2003 levels.

Yet at least households are afforded some protection from wholesale energy prices. Without a price cap mechanism, tens of thousands of businesses – from restaurants, hotels and small high street shops to factories, fertiliser plants and data centres – are on the brink of ruin, their energy input costs having risen at least [fourfold](#). According to one industry survey, [seven out of ten pubs](#) expect to go bust this winter because of energy bills (which would leave the UK with just 12,000 pubs, after around 28,000 closures). Another industry survey suggests [six out of ten manufacturers](#) could go under.

Even if these estimates prove overblown, business sentiment is clearly in a terrible state. And if firms do go bust en masse, the one bright spark in the macroeconomic gloom – low unemployment – could easily be snuffed out.

On top of this, there is the additional strain that will be put on the public finances, which are already in a parlous state. State pensions and a range of other benefits will be uprated according to the inflation level this autumn, while bills to heat schools, hospitals and offices over the winter are set to soar by billions of pounds. Previous assumptions around taxation, spending and borrowing are all up in the air as a result.

In this dire macroeconomic environment, there are no good options for supporting households and businesses – only trade-offs and hard choices between lesser evils. Civil servants have been busy beaver away in the background, preparing options for ministerial consideration upon the



formation of the new government. But we do not yet fully know what those are, so politicians of all stripes have been filling the vacuum. Various policy approaches are also being pursued in different European countries, which are mostly in similar or even worse straits than Britain.

We have therefore pulled together key comparator data and attempted to create a framework for categorising and analysing the various strategies being put forward. If nothing else, this could help to clarify the unpalatable choices facing the new Prime Minister as we head into the very dead of winter.

What are European countries doing to help households and businesses?

Different countries are adopting different policy mixes to cope with the looming winter energy crisis, and there are potentially approaches that the UK can look to for inspiration. There are two important caveats to note, however.

First, few if any of these measures are directly translatable to the UK because every country has a different energy mix. For example, around 35% of French primary energy consumption is met through nuclear (or would be if not for droughts and malfunctions) and 65% of Norwegian energy demand is met through hydropower.¹ Every country also has different economic institutions, legal frameworks and political levers to pull. In some countries, the nature of their social security systems and state databases has made it much easier to target support to the households most at risk of being pushed into poverty.

Second, policy is changing quickly, as governments adapt to volatile energy markets, mutable weather forecasts and the latest geopolitical developments, not to mention rising public desperation and anger over falling living standards. The volatility of energy prices is also continuously affecting the precise policy costs.

But the approaches catalogued here and elsewhere to tackle the imminent crisis are nevertheless instructive – not least the fact that other countries are also having to spend vast amounts.

Taken together, the policies that have been announced so far can be organised into five broad categories:

1. **Direct support for households** (or individuals) through handouts or loans to get them through the winter. These can take the form of one-off or recurring payments, and may be narrowly targeted or broad-based.
2. **Direct state intervention into energy markets**, for example through price controls, liquidity backstops, fuel subsidies or outright nationalisation, with governments taking an equity stake in companies.

¹ Data basis *BP Statistical Review of World Energy 2022*. [Link](#).



3. **Support for businesses**, whether in the form of temporary tax breaks, direct handouts or the use of specific energy price controls for companies; these can be narrowly targeted on energy-intensive sectors, or broad-based.
4. **Tax cuts** to reduce cost of living pressures, especially those due to energy and fuel consumption, for example VAT on petrol.
5. **Consumption policies** designed to reduce energy usage by households, companies and public sector organisations, including through public information campaigns, insulation, restrictions on energy usage at certain times or settings, and full-blown rationing.

Measures to mitigate the effects of the energy crisis, selected European countries

	Household handouts	Price/Market interventions	Business support	Tax cuts	Consumption policy	Gross costs to date
UK	All households to get a one-off £400 energy bill discount; households on means-tested benefits to also get a one-off payment of £650; pensioner households to receive an extra £300 winter fuel payment; people on disability benefits to get a one-off £150 payment.	Energy price cap at £3,549 for the average household from October, i.e. c.£250/MWh; 25% windfall tax on fossil fuel producers aiming to raise £5bn; some electricity providers effectively nationalised in Q4 2021, though 29 went under.	No price cap; no financial support made available yet.	Mooted cuts to VAT on fuel (5%), green levies (around £150 for the average household); talk of broader tax cuts, e.g. to NI, to ease cost of living pressures.	BEIS reportedly planning for energy rationing in the worst case scenario.	Estimated at £37bn; c.£550/capita.
France	One-off payment of €100 (£85) for households with a monthly income below €2,000 (£1,700) after tax. People in regular employment to get a one-off rebate of €300 in September; students and welfare recipients have already received double their usual lump-sum payment.	EDF totally nationalised and forced to offer more than a quarter of its production to suppliers at a huge discount; gas prices frozen and electricity price rises limited to 4% until at least end 2022; fuel subsidies of 15c/litre; no windfall taxes.	-	-	Rationing is not the base case, but the government is looking at which companies to prioritise should rationing be imposed; households and businesses asked to limit their energy use; air con banned in shops; light advertising reduced.	Estimated at €38bn (£32b); c.£470/capita.



Germany	One-off payment of €300 (£255) for pensioners and those in lower tax brackets; one-time bonus of €100 (£85) per child, doubled for low-income families; €200 (£170) for students; expanding number of people eligible for housing allowances from 0.64m to 2m.	Subsidies for public transport (€9 transport ticket made permanent); energy price cap under discussion; windfall tax on electricity producers aiming to raise €65bn (£55bn); €15bn bailout of Uniper, taking a 30% stake in the company.	Tax breaks for 9,000 energy-intensive businesses worth €1.7bn.	€10bn worth of tax cuts: Fuel duty cut by 30c on petrol and 14c on diesel; VAT on reduced to 7% down from 19% for goods (including gas) considered to be essential or of cultural value (blanket VAT cut prevented by the EU).	As part of stage two of a three-stage plan, lights and heating turned down in public buildings, swimming pools closed, housing associations limiting heating and hot water. Stage 3 would entail rationing. Aiming to get gas storage to 85% capacity on Oct 1 and 96% on Nov 1.	Estimated at €100bn (£85bn); c.£1,030/capita.
Netherlands	One-off payment of €1,300 (£1,100) to the lowest-earning households, including those on social assistance benefits.	-	-	VAT on energy cut from 21% to 9%; fuel duty on petrol and diesel cut from 21% to 0% until the end of 2022.	Government reportedly planning to give large industrial users incentives to cut their consumption.	Estimated at €6bn (£5bn); c.£290/capita.
Spain	One-off payment of €200 (£170) for households with an income <€14,000 (£11,900) p.a.; those on lower state pensions have had payments increased by 15% (€60 or £51 more per month).	Electricity capped at €40 (£34) per MWh for six months, rising by €5 every month to €70 per MWh after a year; fuel subsidies of 20c/litre, 5c of which is paid for by a windfall tax on energy firms which aims to raise €7bn.	Targeted support for businesses across transport, food and energy intensive sectors.	VAT on energy bills cut from 10% to 5% (down from 21% in 2021); special tax on electricity consumption cut from 7% to 0.5%.	Air conditioning cannot be below 27C, heating cannot exceed 19C; shop doors must be kept closed in winter; shop fronts must go dark at 10pm; aim of reducing gas usage by 7%; energy efficiency inspections to ensure compliance.	Estimated at €21bn (£18bn); c.£380/capita.
Italy	Households earning under €12,000 (£10,200) have had their energy bills frozen. One-off payment of €200 (£170) per person for pensioners and those on <€35,000 (£29,800) p.a..	No national price cap, but has supported an EU-wide price cap; windfall taxes reportedly in the works.	20% tax credit for energy-intensive companies experiencing a 30% rise in prices; extra relief for agricultural sector (which has also been hit by drought.)	Income tax cut worth 1.8% for workers earning under €35,000 (£29,800); 30c/litre fuel duty cut.	Radiators lowered by 2C in winter, street lighting cut by 40%, public offices close early and shops shut by 7pm, restaurants by 11pm. Already, aircon cannot be below 25C and heating cannot exceed 19C in public buildings. Rationing under consideration.	Estimated at €35bn (£30bn); £504/capita.



Poland	One-off payment of up to €306 (£260), covering c.7m households, augmented by a one-off payment to households depending on type of energy used ranging from €105 (£90) for LPG users up to €629 (£530) for coal.	Price increases for households, schools and hospitals capped until 2027 (suppliers able to apply for state compensation); state-owned companies to buy an extra 4.5m tonnes of coal.	Package of measures to support the agricultural sector.	Cuts to VAT on food, gas and fertilisers to 0%, on heating to 5% and on petrol and diesel to 8%.	-	Estimated at €9bn (£7.7bn); c.£200/capita.
Norway	-	Government pays 80% of the cost of electricity generated at over 70,000 NOK/MWh (£6/MWh); this is set to rise to 90% from October.	-	-	Plans to limit gas exports in the event of steep price rises in Norway.	Estimated at £1.9bn; c.£350/capita.
Sweden	Consumers of 400-2,000 kWh per month (1.8m households) to receive compensation of 2,000Kr (£161) a month for Dec-Feb; payment of between £83 and £124 for car owners.	Plans to provide emergency liquidity of 250bn krona (£20bn) to utility companies to forestall collapse and reduce pressure on Sweden's financial system.		Tax on diesel and petrol will to be reduced by €0.17/litre to the lowest level permitted under EU regulations.		Estimated at 91-340bn krona (£7.3-27bn), depending on how much of the liquidity backstop is used; £700-2,570/capita.

Data sources: numerous publicly available media reports and government press releases.

It is immediately obvious from this table that nobody has *the* solution to the winter energy crisis – probably because there is not a single silver bullet. Almost every country (bar energy-abundant Norway) is pursuing multiple approaches simultaneously, supporting certain households and businesses with cash transfers and tax cuts while also intervening to a degree in markets and attempting to influence consumption through law or persuasion. Whether by design or more likely reactive accident, countries are seeking to strike a balance between targeting the most needy, helping everyone, maintaining price signals and preparing for worse case scenarios. The purism of just tax cuts or just helicopter money or just market intervention has gone out of the window.

Interestingly in light of some of the criticism levelled at the Government, the amount of support pledged so far by the UK seems to be pretty much in line with the rest of Europe on a per capita basis, at around £550. This is much less than in Germany, which thanks to its direct dependence on Gazprom really is at the frontline of the crisis, but more than the Netherlands, Spain, Italy and France, for example. And this is just based on announcements to date, not anything the Truss Government might announce in the next few days.



There are however two areas where the UK does stand out: in its approach to limiting consumption and the level of business support. Bar propping up utility companies last autumn/winter, the UK Government has yet to do anything much to help businesses facing vastly increased input costs. In contrast, the German, Spanish, Italian and Polish governments have introduced support measures for specific energy-intensive industries.

Most European countries are also already introducing a mix of mandatory and advisory measures – such as lowering thermostats in public buildings – to cut heating and electricity demand and so fill up more of gas storage capacity right now. Given the UK’s lack of storage capacity, this might be a moot point here. But the urgency with which continental governments have so far approached the crisis is notable in contrast to the UK – though that looks set to change now we have a new government in place.

One other thing to note is a benefit of Brexit: several countries have been constrained in their national response to the crisis by the EU enforcing rules on, for example VAT. The UK has greater flexibility to respond to the crisis in the national interest.

Energy bills and inflation, selected European countries

	Average household energy bill	Inflation
UK	£1,971 (current price cap), £3,549 (October price cap)	10.1% (Aug)
France	€2,800 (£2,380)	5.8% (Aug)
Germany	€3,400 (£2,900)	7.9% (Aug)
Netherlands	€2,800 (£2,380)	10.3% (July)
Spain	€2,000 (£1,700)	10.4% (Aug)
Italy	€2,000 (£1,700)	8.4% (Aug)
Poland*	2,003zł (£366)	16.1% (Aug)
Norway	€2,590 (£2,200)	6.8% (July)
Sweden	35,000kr (£2,816)	8.5% (July)
Average	£2,220	9.4%

* Poland is an outlier on household energy bills because coal makes up over 40% of the country’s primary energy consumption, compared to a European average of around 12%; inflationary pressures stem from oil prices and the rising cost of agricultural inputs, including gas.

As the table above shows, the October price cap will make the UK an outlier on household energy bills (though not on overall inflation), with average bills 60% higher than the rest of Europe.

We need to be careful in this comparison, however, as different national statistics use different sized households and are measuring different lifestyles. Also, in some cases, countries are shifting energy costs from households to general taxation. At the one end of the spectrum is France, where the nationalised EDF is being underwritten by the state to hold energy prices down – although the size of France’s nuclear fleet makes this somewhat less costly than would otherwise be the case (and also helps to explain relatively low inflation). Circumstances are also forcing other countries down this route, notably Germany with Uniper – though the €15bn (£12.8bn) set aside for Uniper could [run out](#) by the end of this month already, drawing the German taxpayer into an even larger bailout.



In other cases, countries are capping retail energy prices for households in a similar manner to the UK, but at much lower levels – around £34 per MWh in the case of Spain, as compared to about £250/MWh under the UK’s October price cap (and £138/MWh currently). This forces energy companies to shoulder losses on the difference between retail and wholesale prices. But as Sweden for example is finding out, this will only work in the longer term if the costs of doing so are moved from the balance sheets of energy companies to the government balance sheet, with the state becoming the lender of last resort.

The fact that UK bills will go so high without Government intervention is partly due to our dependence on gas, and our lack of storage capacity. However, another big factor is the state of our housing stock. UK dwellings are [older](#) than in much of Europe, and therefore less energy efficient. On average, UK dwellings [lose heat](#) three times faster than German dwellings. Clearly this is important to bear in mind when comparing energy bills and considering what steps we should take over the coming months.

The UK’s options for getting through the winter

Public [frustration](#) with the prospect of crippling energy bills, an imminent recession and falling living standards is on the rise – as reflected in the still fringe but [growing](#) ‘Don’t Pay’ campaign. The recent CPS/Public First paper [‘The New Majority’](#) highlighted the anger and frustration among lower-income voters, and the damage this is doing to the Conservative vote – not least because a proper national conversation on how to cope with the winter has effectively been on hold while the Conservative Party leadership contest has played out.

Now though is time for clear communication and decisive action. But what are the Government’s options in seeking to balance tax cuts, household handouts, business support, energy market interventions and consumption policies this winter?

Tax cuts

With the tax burden at a 70-year high, reducing taxes would undoubtedly be one way to help ease cost of living pressures for many people. In the [forecasts](#) produced by the OBR for the March budget, higher taxes – notably the increase to National Insurance – meant that average living standards would not return to 2021 levels until at least 2026. Without tax rises adding to cost of living pressures, living standards would have been expected to return to 2021 levels by 2024.

The Truss administration’s plan to reverse the increase in NI is therefore to be welcomed. So too is the plan to scrap the planned increase in the headline rate of corporation tax from 19% to 25%, which would have sent exactly the wrong signal at a time when Britain needs all the business investment it can get – not least in the energy sector. Other tax cuts should also be seriously considered, alongside reforms to the tax system – including full expensing and fixing the mess that is business rates.



However, in terms of helping with the winter energy crisis, there are two limitations to tax cuts: scale and distribution.

To completely offset the energy price cap rise from £1,971 to £3,549, the Government would have to cut taxes by around £44bn – equivalent to about 8p off the basic rate of income tax, according to HMRC [ready reckoners](#). If the cap were to rise to around £6,600, tax cuts would have to amount to around £130bn – abolishing the basic rate of income tax and then some.

While we should be looking to make non-trivial public spending cuts to help pay for this disastrous winter, no government efficiency drive is going to fill such a vast fiscal black hole overnight.

Moreover, millions of those who are on course to suffer the most this winter pay no or very little income tax, usually because they are on benefits or their main source of income is the state pension. As the Prime Minister [rightly recognises](#), this is not an argument against tax cuts – but it means tax cuts in themselves are not going to deliver all the support that might be needed this winter.

One partial way around this would be to cut taxes on energy consumption, such as the 5% VAT on fuel, as well as fuel duty, as many European countries have done. Scrapping green levies (c.£150) or at least moving them onto general taxation (as proposed by the CPS in the early stages of this crisis) would also help to ease the pressure on households.

However, given elevated energy prices, shaving off 5% is not going to do much to help households in grand scheme of things. And again, there are still issues around distribution, with poorer households using a much larger share of their disposable income on energy already, as highlighted above.

It looks as though tax cuts will be part of the Government's policy mix for dealing with the winter crisis, and rightly so. But we still need to think about how to reach the most vulnerable households.

Household handouts

The options available to an incoming government when developing a cost of living support package are limited by both the delivery methods for sending out cash and the data needed to work out who needs it.

A universal approach is in some ways easiest, as it does not require any assessment of eligibility, but there is no obvious mechanism to simply pay a cash sum to every single household. The £400 energy bills discount was an attempt to do this. However, as has been covered extensively in the media, this means paying per property, giving an extra discount to people who own multiple properties. Questions also remain about what happens in circumstances where a landlord pays the bills but then charges their tenants.

Universalism also suffers from the obvious criticism that many people will be receiving money they do not need. One of the main criticisms levied at Labour's plan for an energy price freeze, for example, is that it gives taxpayers' cash to the wealthiest.



The problem with a more targeted approach, however, is that it is a lot easier to say which sorts of people you think should get help than it is for the Government to actually identify where those people are and pay them. You will commonly hear, for example, that at a minimum support should not go to households earning more than, say, £100,000.

Unfortunately, the Government does not have accurate data on overall income, broken down by household. We do just about know which households have an individual taxpayer earning over £100,000. That is why this cut-off is used for various existing state schemes such as childcare subsidies. But it is messy and inherently unfair, in particular on couples where only one person works.

If we want to do things by household, the tax system's usefulness is limited. The council tax system is one option, which was used for the £150 rebate earlier this year – where council tax bands (which have not been properly updated since 1991) were used as a very blunt proxy for indicating household income. Councils had to administer a separate fund for people who were struggling but happened to live in a higher council tax band.

We then turn to the benefits system. This has much to commend it – the whole point of the benefits system is to base eligibility on need. That is why payments worth £650 are being given out automatically to recipients of Universal Credit or other means-tested benefits. Pensioners will receive an extra £300 per household, and anyone on a disability benefit will get a £150 payment.

Again, however, there are limitations. Disability and pensioner benefits are not means-tested. Do very wealthy pensioners really need an extra £300, when they may be better off than some working-age households not getting that support? As for the means-tested benefits, a benefit like Universal Credit is tapered – so someone could be receiving just a few hundred pounds a year of UC but will still get the £650 cash boost. Payments have also been administered per household. An unemployed twentysomething living with their mum and dad and claiming UC will receive the same £650 as a couple with several children and rent to pay.

There is, in short, no perfect way to deliver support in a way which is both speedy and well-targeted. This does not mean we should not use these levers to support households, but we need to recognise that whatever we do, unfairness is baked into the system and that some people will inevitably fall through the cracks.

Another proposal to support lower-income households that is gaining [traction](#) is a 'social tariff', similar to those in the telecoms industry for people receiving benefits such as Universal Credit. Essentially this would involve lower-income households being put on a heavily discounted tariff for their energy bills, funded either through general taxation or via surcharges on the energy bills of higher earners. While there are different versions of how exactly this programme would work, most envisage a social tariff going on top of the existing price cap system.

Again, however, implementation would be far from straightforward and run into many of the same difficulties laid out above. Deciding exactly who would be eligible for this tariff and what level to set the discount at would be difficult and politically fraught in a time of such high prices. Another



question is who would administer the scheme. Suppliers could run it themselves, albeit with significant data-sharing from DWP, or this could be left to BEIS or even Ofgem, but each option brings implementation difficulties.

Price/Market interventions

According to reports, the Government is wisely steering away from the radical option of out-and-out nationalising utility companies by taking over shareholders' equity. The reason this is wise is that it would do nothing to solve the underlying problem – the price of gas on international wholesale markets, which we cannot set by legislative fiat (British gas fields account for just 1% of global natural gas production). It would also involve spending tens of billions to compensate shareholders, often foreign sovereign wealth funds. Nor would the process necessarily be smooth – even in *dirigiste* France, EDF is currently suing the French government. There are also longer-run dangers from nationalisation, for example that a lack of competition will degrade the quality of the information upon which decentralised economic coordination in the marketplace is based.

Retail price caps – as introduced into the British household energy market by Theresa May's government in Q1 2019 – represent a less destructive form of intervention. But even this has been tested to the point of destruction, with 29 energy companies going bust or being bailed out by the government in Q4 2021. As long as a gap remains between the retail and wholesale costs of energy, someone is going to have to pick up the tab.

For a short period of time, this may be companies. But as Sweden and Germany are discovering, over more extended periods, the government – or rather the taxpayer – will sooner or later have to step in to underwrite burgeoning debts and ensure there is enough liquidity in the system.

Freezing the price cap at £1,971 or some other point below wholesale market rates is politically attractive – not least because it is simple for the public to grasp – but creates exactly the same sort of problem. Under such a scheme, either the difference between wholesale and retail prices would either have to be paid through general taxation, as with furlough in the pandemic (borrowing in the short term, and taxation in the long term), or the Government would extend loans or shoulder the risk of energy providers defaulting on loans in the money markets (basically a bailout by the backdoor). Once the crisis had passed, the costs would then need to be paid back, presumably through charges on energy bills. Either way, the consumer or the taxpayer ends up paying.

In short, setting the current price cap in stone would act as a price smoothing mechanism, spreading the cost of highly elevated energy prices out over many years, instead of concentrating payments into two or three years. There is some merit to this sort of approach, if implemented well. But there are also risks. The crisis could last much longer than anyone anticipates, for example: both Labour and the Conservatives could end up going into an election with effectively unlimited liability for household energy bills for next five years.

Similarly, while it is true that higher prices have already incentivised people to change their behaviour, a price freeze would not incentivise people to ration further – a good thing in terms of the impact of those shivering grandmothers on the NHS, but a bad one if we entered a scenario of



acute scarcity, in the absence of significant policies designed to limit consumption (which, as mentioned above, the rest of Europe is well ahead of us on). Overall, any such policy would need very careful implementation to avoid misaligned incentives, bailouts by the backdoor and a politically obdurate regime of centralised price controls.

However, even then, the sums involved in would be eye-watering. So far this year, [government borrowing](#) is running at around £115bn on an annualised basis. If wholesale prices were to force a rise in the notional energy price cap in line with forecasts, an energy prize freeze could in itself double the deficit.

Notional annual price cap	Average cost per household to hold at April 2022 cap	Total cost to hold at April 2022 cap
£1,971	£0	£0
£3,549	£1,578	£44bn
£5,387	£3,416	£96bn
£6,616	£4,645	£130bn

Even if the benchmark price cap were allowed to rise from the current £1,971 to, say, around £2,500, the costs would still be massive.

Notional annual price cap	Average cost per household to hold at £2,500	Total cost to hold at £2,500
£3,549	£1,049	£29bn
£5,387	£2,887	£81bn
£6,616	£4,116	£116bn

It is also important to remember that this is just the cost of supporting households. If businesses were also to benefit from any such energy price cap freeze, the costs of this policy could become truly astronomical.

Business support

On which note, it is striking that the impact of energy prices on employers is only now rising up the political agenda. Yet having your energy bills frozen at a 'mere' £1,971 is not going to do you much good if you lose your job when your employer goes under.

As we saw above, many European countries have provided tax breaks or funding, in particular to energy-intensive industries. But it's not just those kinds of firms that risk going under in the UK – witness the figures for pubs above. Again, this partly relates to poor energy insulation in UK buildings and structures. But this means that there will understandably be calls for broad-based support for SMEs, not just energy-intensive smelting, manufacturing and chemical plants.

One model to follow here might be the [Recovery Loan Scheme](#), used during the pandemic to support SMEs with an annual turnover of less than £45m with up to £2m per business group. In this scheme,



the government guaranteed 70% of the finance to the lender (from a list of accredited lenders), with the borrower 100% liable for the debt.

A potential major downside to a broad-based business support package is fraud, as in the Covid pandemic. The inability or unwillingness of the Treasury to reclaim at least an [estimated £5bn](#) in money lost to fraudulent support claims led to the resignation of Lord Agnew, Minister of State for Efficiency and Transformation, in January. He [noted](#) that loans were given out to more than 1,000 companies which were not even trading when the pandemic happened.

If the Government does go down a similar route to support businesses through the winter crisis, it needs to be sure that lessons have been learnt from the maladministration of business support schemes during the pandemic.

Windfall taxes

One option advocated by the Labour Party and others to pay for all this is a windfall tax on oil and gas producers in Britain, whose greedy shareholders – including most people with a pension plan – are said to be profiteering from the crisis. It is also wildly popular with the public, as shown in ‘The New Majority’. But the numbers simply do not add up. The 25% windfall tax on fossil fuel producers already implemented when Rishi Sunak was Chancellor aimed to raise £5bn. Even raising this to 100% – which is obvious crazy – would not cover half the annual costs of the likely bailout schemes, even if energy prices remain at October levels.

Moreover, Labour’s windfall tax proposal – retroactive to January – would be disastrous for investment. Offshore oil and gas projects have large up-front costs and can take years to show a return, especially in the case of frontier projects in the harsh, deepwater West of Shetlands area. Stability and predictability are therefore vital for locking in investment. In its absence, there are dozens of other regions all over the world in which energy companies can choose to invest instead of the North Sea.

Aside from undermining business confidence, a windfall tax would destroy jobs, limit domestic oil and gas supply growth and undermine British energy security – since we would just end up importing more energy from state-owned energy conglomerates like Saudi Aramco and Petrobras. On top of this, the infrastructure and skilled engineering workforce of the North Sea has a key role to play in Britain’s energy transition, for example via Carbon Capture and Underground Storage (CCUS) and hydrogen. A windfall tax which undermines North Sea employers and supply chains would hold back the green industries of the future.

If the Government does decide to do anything more around windfall taxes, the priority should be extending the existing tax to renewable energy producers, many of whom are enjoying extremely large profit margins at the moment because of how renewable energy contracts were structured historically, before contracts for difference and strike prices were introduced.



Consumption policies

Belatedly, the Government has launched a public information [campaign](#) on the additional support available to households this winter. But we are also going to need a public information campaign on how households and businesses can safely cut down their energy usage and save on bills this winter too. Ideally this would be fronted by a figure like Martin Lewis, for maximum public awareness and traction. It should aim to capture something of the unifying spirit of the 'dig for victory' campaign of the Second World War.

It is encouraging to know that civil servants at BEIS have been hard at work devising rationing plans for worst case scenarios this winter. However, ministers should endeavour to provide more clarity on what this could look like once they have signed off on plans, so that the public is prepared. For example, an energy crisis and an NHS winter crisis could interact in some really scary ways – so is diesel being stockpiled so hospital backup generators can keep going if things get really bad? And what will rationing look like in terms of the balance between households and industries, and which industries will be prioritised? Might it be worth telling office workers to work fully from home for a few months instead of commuting, as in the pandemic, so as to save on fuel and power demand? Or will it be more efficient for people to use the heating in their offices and turn down the thermostat at home?

In a similar vein, it is worth considering what can be done in the time available to improve domestic energy efficiency and hence bring down overall demand as well as household energy bills. As noted above, British houses are among the least energy-efficient in Europe, so improving household energy efficiency is a key lever the government could pull. The [Energy Company Obligations \(ECO\) scheme](#) has made progress on this front in recent years by partially or fully subsidising the costs of improvements such as boiler upgrades, cavity wall insulation and loft insulation for families on benefits or lower incomes.

However, there is still much more to be done. According to [BEIS data](#), as of the end of 2021, 30% of properties with a cavity wall had not had insulation installed (c.6m homes) and 34% of properties with a loft were in the same position (c.9m homes). These particular upgrades are relatively 'low-hanging fruit', in that the payback period is relatively quick – cavity wall insulation for example [pays for itself](#) after 3-5 years (depending on the type of house), and even quicker given the elevated energy price environment we find ourselves in.

Of course, not all properties fit these specifications. Solid walls for example are much more expensive to insulate. But with millions of homes still lacking relatively 'easy' insulation upgrades, this could make a substantial difference in the near term.

The two big questions are around affordability and capacity. Many households are simply unable to afford the upfront costs of insulation, especially given wider cost of living pressures. Borrowing to fund energy-efficiency measures might be an option for a number of those without ready capital to hand, but with interest rates rising, this is going to look less attractive than before. The insulation industry is also quite limited in scale, reflecting lack of demand when energy was much cheaper than



today. Installers were also burnt by the Government's Green Homes Grant scheme in 2020/21, where centralised command-and-control administration of the scheme undermined its operation.

A further flaw in the Green Homes Grant was that installers did not have the skills, equipment or material to fulfil demand stemming from the voucher scheme, which was a short, time-limited program, so there was also limited incentive for businesses to invest in adapting or upgrading their capabilities. If insulation and heat pump installers were able to write off some portion of the costs of installing green upgrades against their tax bills, this could give installers the certainty and stability they need to invest in the requisite skills and equipment, and a clear incentive to do so.

This approach could be combined with a new (less top-down) voucher scheme for lower-income households in areas where housing stock is known to be generally old and energy inefficient (if government can join up the data, which is not a given). There is also an argument for new (but better-run) voucher scheme: since the Government may find itself supporting households with further handouts next winter (and beyond), it seems logical to spend the money on plugging the fiscal hole of energy-inefficient housing, rather than just shoving more money into people's pockets to make up the difference.

This late in the day, it is not clear how much difference such a scheme would make before the cold really sets in this winter. On the other hand, it would certainly help with energy security in the longer term, and could also have a really significant impact on national energy demand and household bills for millions of people by next winter.

Conclusion

The scale of the winter energy crisis has essentially put us on a war footing. The immediate priority needs to be protecting people and their employers from the worst of the energy price shock this winter and next. This is not just an economic imperative, but a political one: as James Frayne argues in ['The New Majority'](#), the Government needs to show people that it is on their side, not least because many people 'think the Conservatives are sitting idly by as their lives collapse around them'.

We will find out within days what approach the Truss administration will take. As we outline above, this is the definition of a problem with no easy answers. On the whole, the Government should avoid full-blown equity nationalisation, eschew punitive windfall taxes, strive to preserve the price mechanism as much as possible and alleviate cost of living pressures by reducing the tax burden and targeting extra help to the most vulnerable, insofar as state capacity allows. However, it is easy to understand why ministers may feel they have no option but to simply freeze prices, and rely on economic growth and the consolidation of the state to get public finances back on an even keel over the longer term.

By comparing our situation with Europe's, we can see that no country has yet come up with a silver bullet – in fact, Britain's level of support has been more generous than many, and is about to become more generous still. But we can also highlight gaps in our policy response, chiefly the failure



to do anything to help businesses and the lack of action on consumption and demand. We hope ministers will address both of these in the coming days.

But we also need to start thinking about next winter – and the winter after that. As noted above, indications are that energy bills will at least remain elevated through 2023, and may well rise much further before they significantly fall again.

Of course, it is easy to criticise policy decisions (or the lack thereof) in hindsight. But there is no reason to repeat the mistakes of last winter by assuming global gas markets will rebalance on a politically convenient timescale. We need to be ready for the next phase of the crisis.

On the basis that every little helps, wider (and essentially fiscally neutral) reforms aimed at easing cost of living pressures should also be prioritised in the year ahead, as for example outlined by the Centre for Policy Studies in [‘Cutting the Cost of living’](#) and [‘Solving the Childcare Challenge’](#). These should be set alongside other pro-growth reforms, such as those outlined in [‘Why Choose Britain?’](#).

Improving the database structure of the British state so that further household support can be better targeted should also be a priority, as per [our Director’s dictum](#): ‘the most important part of modern government, and its most important limitation, is database management’. At the very least, we need to look into the feasibility of linking up tax, benefits and residency data ahead of winter 2023/24.

Meanwhile, on the demand side, we should support the growth of the home insulation industry as outlined above – through tax incentives for installers and potentially a voucher system for lower-income households.

But most importantly, as Liz Truss has highlighted, there are supply-side measures the Government could set in motion now that would improve the country's energy security and which could just about start to have a measurable impact on bills by this time next year. These include:

- Greenlighting onshore wind projects as well as solar farms – [polling](#) shows both of these to be widely popular, and after the next few months, it would be surprising if support did not increase further.
- Greenlighting shale exploration and production by private sector companies. Nimbyism could be combatted by offering anyone living within five miles of a shale well 50% or even 100% off their energy bills for the next two years. In other words: stuff their mouths with gold.
- Making it easier for companies to redevelop depleted offshore gas fields like Rough into storage caverns by cutting through planning red tape. For reasons of security and price, energy needs to be prioritised in the growth agenda.
- Incentivising greater investment in energy production, transportation and storage through reforms to the tax system. New energy infrastructure should be permanently exempt from



business rates, while full expensing – not just for plant and machinery, but also buildings and structures – should be introduced throughout the energy sector.

- Ensuring that we remove the investment penalty on Britain’s oil and gas assets, which has grown up as part of the ESG culture. In the current review on the Green Taxonomy, we should look at following in the EU’s footsteps in classifying natural gas as a green fuel.

Britain has made massive progress on decarbonisation, cutting greenhouse gas emissions around by 43% since the Kyoto Protocol was signed in 1990. Indeed, we have made more progress than any other G20 country, of whom only five (including the UK) have actually succeeded in cutting emissions on 1990 levels at all. We should be proud of our achievement and continue decarbonisation. But we also need energy security to stand alongside it as a pillar of our energy policy. That way the UK can continue its global leadership role, not just in decarbonisation but also in standing up to Putin and countering his weaponisation of gas flows to Europe.

However, there is a real risk that even now, in the depths of a partly self-inflicted energy supply crisis, the [mistakes](#) of the past two decades will be repeated, from prevarication over planning permissions for renewables and nuclear projects through to the bashing of oil and gas producers. This winter is going to be bad. But we still have a window in which to stop things getting even worse ahead of next winter. We need to act before it closes, to stop people’s living standards and the public finances deteriorating even further.

As the current crisis makes plain, cheap energy is intrinsic to the welfare and prosperity of individuals, families and the country. In the longer term, we need to aim for energy abundance, through growing renewables output, building more nuclear plants and – at least for a few decades – using fossil fuels offset by carbon capture and storage.

To achieve this growth agenda, we will need to reform planning laws, improve tax incentives, greenlight onshore wind farms and shale gas extraction, remove market-distorting subsidies, reform electricity markets, accelerate North Sea project approvals and use government investment where necessary to crowd in private sector funding, for example with new large-scale nuclear power stations. However, most of these measures – with the [possible exception](#) of shale gas production – will take years to bear fruit.

Many of the things the Government will have to do in the immediate future are not attractive propositions: they will be extremely costly in the short term, they will burden future generations, and in some trade-offs will go against bone-deep conservative instincts. But in the circumstances, the alternative of doing nothing is too appalling to contemplate. Needs must when the devil drives.