INSTITUTE FOR GOVERNMENT

Addressing rising energy bills

What could the new prime minister do?

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Summary

Big increases in energy bills mean that UK households are set to face a very difficult winter. Annualised bills for a typical household are currently £1,971, already 50% higher than in March, but they are expected to increase to £3,600 in October, and even further, to £4,600, from January. The government has already provided some support, but more is likely to be needed. This paper lays out the government's options.

Our key findings are:

The government's support package was generous, but bills are now expected to increase much further. Government support so far, including tax cuts, rebates and specific payments to vulnerable households, will cost £33 billion, which would have been enough to offset almost 90% of the higher bills this financial year on average based on expected bills in May. But bills are now expected to increase much further, and that package is now only enough to offset around 50% of the increase this financial year.

The measures committed to by Liz Truss and Rishi Sunak will make only a small dent in the costs now expected this winter. Both candidates to be prime minister have promised to take some action on energy bills, but policies committed to so far (cutting green levies and VAT from Truss and Sunak respectively) would save around £150–£200 per year on average energy bills, only enough to offset around 10–15% of the increase in the forecast for bills this winter that has occurred since May.

Extending the Johnson government's support package to account for higher energy bills would cost £23bn. If the new government wanted to offset almost 90% of bill increases this financial year, retaining the generosity of the May 2022 package, it would need to spend an additional £23bn. It would cost less – just £10–12bn – to do this only for low-income households, pensioners and those with disabilities.

Capping energy bills would avoid gaps in support but would be expensive. The Labour Party, among others, have proposed capping prices at the current £1,971 per year for a typical household. This would have the benefit of providing more support to high-energy-use households, who under current government policy get the same cash support as those with lower bills. But this would be expensive – costing just over £40bn for six months. It would also mean that households would face a lower energy price, and so have less of an incentive to save energy.

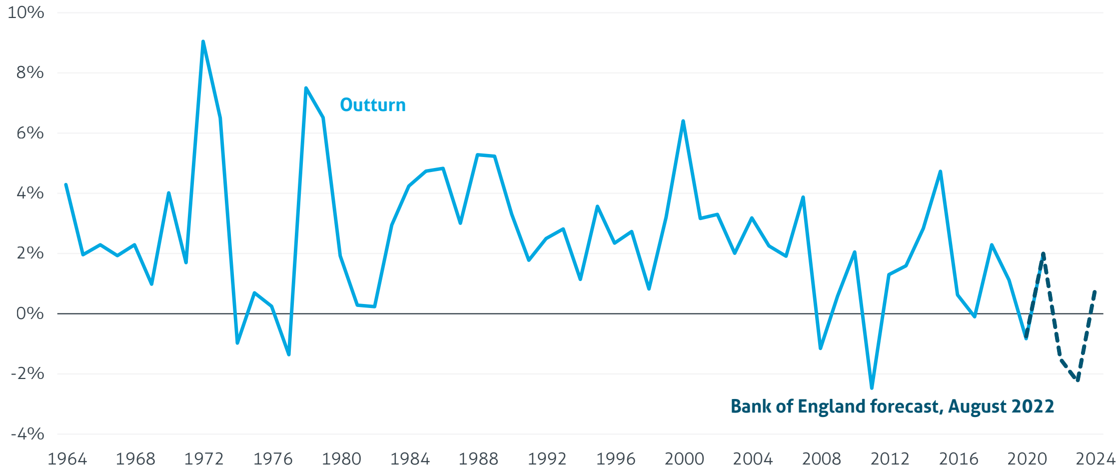
Support is likely to be needed beyond this year. So far support is all focused on winter 2022/23, but current projections are for energy prices to be just as high, if not higher, next year. The new prime minister will need to be ready to provide further support again. Offsetting the same proportion of bills next year would cost around £90bn. Given how long the crisis is expected to last, the government should also look at other measures to deal with the high energy bills, including investing in energy efficiency.

Introduction

UK households are experiencing a severe cost of living crisis. Earlier in August the Bank of England (BoE) published a dire forecast. The economy is expected to enter recession at the end of this year; unemployment is forecast to rise by almost 1 million by September 2025; inflation is expected to peak at 13.3% in October; and real household incomes are predicted to experience their largest fall on record across 2022 and 2023 – declining by 3.7% over the two years, as shown in Figure 1.

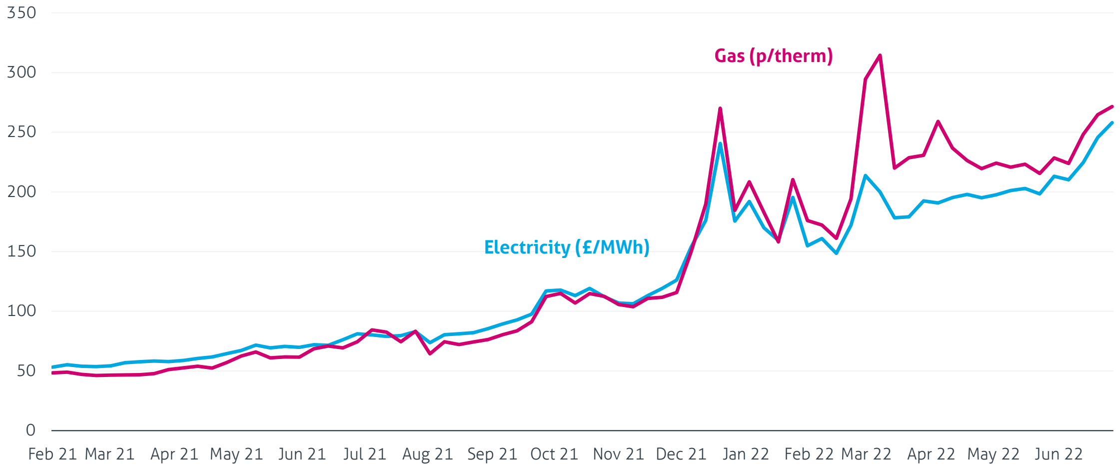
The main driver of these economic problems and the cost of living crisis facing households is the surging wholesale price of gas prompted by Russia's invasion of Ukraine. The price of gas soared when the invasion happened in February and has risen even further since, as concerns grow around the risk of Russian gas deliveries to Europe being completely cut off. With electricity prices in the UK usually set by the price of gas, this surge in gas prices has fed through into a sharp rise in the wholesale price of electricity as well. Figure 2 shows this using industry standard measurements for each: pounds per megawatt hour (£/MWh) for gas and pence per therm (p/therm, approximately the amount of energy in 100 cubic feet of gas) for electricity.

Figure 1 **Annual growth in real post-tax household income, outturn and Bank of England forecast**



Source: Institute for Government analysis of Office for National Statistics, GDP first quarterly estimate, Office for National Statistics, UK Economic Accounts, Office for National Statistics, Quarterly National Accounts, Bank of England, Monetary Policy Report August 2022.

Figure 2 **Wholesale gas and electricity prices**



Source: Institute for Government analysis of Ofgem, Wholesale Market Indicators.

Households have experienced some of this rise in energy prices already. The energy price cap set by the energy market regulator Ofgem, which regulates the price that suppliers can charge households for their electricity and gas, increased from £1,277 a year for the average household between October 2021 and March 2022 to £1,971 from April 2022. When he was chancellor, Rishi Sunak announced various policies to help offset some of this extra cost for households – taken together, these announcements were expected to offset on average almost 90% of households' higher energy costs in 2022/23 compared to 2021/22.

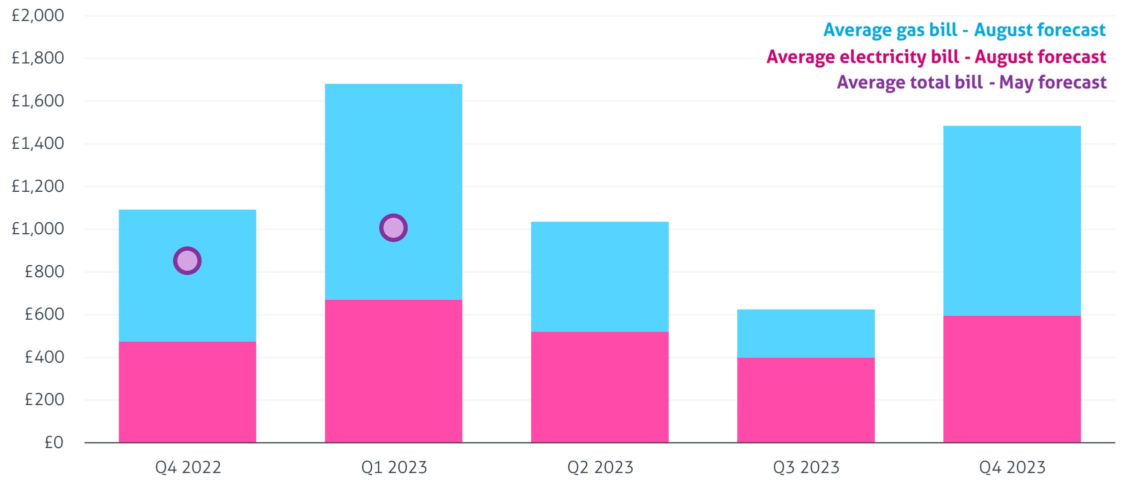
However, households have not yet felt the full brunt of the price rises, which will feed through to bills only when the price cap is adjusted again in October 2022 and then every three months thereafter. Recent independent forecasts suggest that the price cap is likely to rise to the equivalent of around £3,600 per year in October and could rise further to £4,600 in January 2023 and to £5,300 in April (Figure 3) and could remain high thereafter.[1]

High energy prices tend to affect some households more than others. Lower income people tend to spend a greater fraction of their budgets on energy, while some disabled people have higher than average energy use, and pensioners tend to have greater heating needs than others. According to researchers at the University of York,[2] if the price cap were to increase to, for example, £4,400, more than half of households would be in fuel poverty in the absence of further support from the government. That means they would be spending more than 10% of their disposable income on energy. Energy use is especially high in winter, so an even higher proportion would be spending more than 10% of their income on energy during those months.

With energy use set to rise sharply as households turn their heating on for winter, the candidates in the Conservative Party leadership election have come under increasing pressure to spell out what they would do to help offset the expected rise in the price cap. For whoever becomes the next prime minister, this will be one of the most urgent decisions they have to make.

This paper sets out what Boris Johnson's government did to cushion rising energy costs, what some of the main options are for the next prime minister and how much they would cost. The paper also highlights the energy cost pressures facing businesses, which have so far received almost no support from government, and sets out some complementary policy measures that the new government should consider to improve energy efficiency.

Figure 3 **Estimated quarterly energy bills**



Source: Institute for Government analysis of Cornwall Insight, 'Cornwall Insight's Price Cap predictions jump after Ofgem release new guidance', 24 May 2022; Cornwall Insight, 'Price cap to remain significantly above £3,000 a year until at least 2024', 2 August 2022; Ofgem, Price cap – Decision on changes to wholesale methodology – Annex 2 – Wholesale cost allowance methodology.

The Johnson government offset most of the rise in energy prices since October 2021

The Johnson government announced several measures to help households with the cost of living – and particularly with higher energy bills – in three separate packages announced between February and May 2022, worth a total of £33bn.

In February, the chancellor announced a loan of £200 to households to help with energy bills and a council tax discount for most households in response to Ofgem's announcement that the energy price cap would be rising from £1,277 to £1,971 per year from April 2022. Then, following Russia's invasion of Ukraine and a further spike in wholesale gas prices, he announced more support at the Spring Statement in the form of a rise in National Insurance thresholds and cut to fuel duty. These two packages were criticised for not targeting support at those on low incomes, who were most vulnerable to energy price rises. The Spring Statement package in particular gave more support to those on higher incomes. The third package – announced in May – contained much more targeted support for pensioners and recipients of means-tested and disability benefits. Although the final package provided channelled support to those on lower incomes, the impact of all three support packages was broad-based across the income distribution.[3]

At the time Rishi Sunak announced the final package in May, the energy price cap was expected to rise to the equivalent of £2,800 a year for the period October 2022 to March 2023 and then to fall.[4] We estimate that the total package of support announced since February, worth £33bn, would have been sufficient to offset almost 90% of the increase in energy bills between 2021/22 and 2022/23 had the cap increased to £2,800 and stayed there until April 2023.[*] Virtually all of the increase in bills would have been covered for those on universal credit and pensioners.

Energy prices are now expected to rise much further...

Wholesale energy prices have risen by more than expected since May. This means that households and businesses will be paying even more for energy this winter, and probably beyond, than the government had expected when calibrating the previously announced support measures.

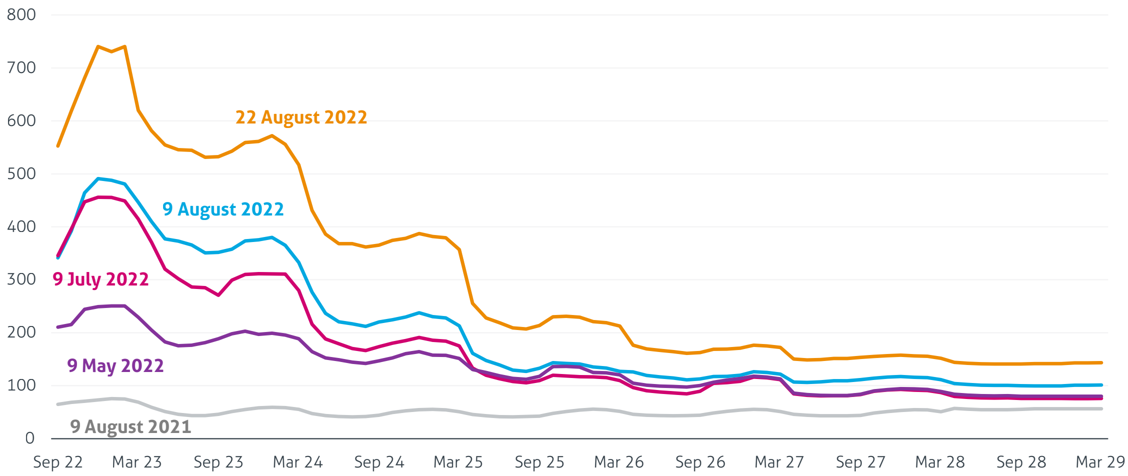
Prices for wholesale gas futures (which is what determines Ofgem's cap) have soared higher as the Russian invasion of Ukraine continues and uncertainty over Europe's energy supply grows (Figure 4). Prices for delivery of gas in December 2022, for example, doubled between 9 May and 9 August, and then increased by another half between then and 22 August.

* This figure is calculated by comparing the aggregate increase in electricity and gas bills to the total set of fiscal measures announced since February 2022. It does not, therefore, capture other increases in living costs, such as petrol, diesel and food costs. The methodology we have used focuses on estimating aggregate costs. This is different from that of others (such as the Resolution Foundation) who have used household survey data and simulations. As a result, our results may slightly differ.

Reflecting these even higher wholesale costs for energy, analysts at Cornwall Insight now predict that the price cap will rise to around £3,600 in October and rise again to around £4,600 in January, above the £2,800 predicted by Ofgem in May.[5] This means the Ofgem cap for October to December 2022 will be 27% higher than expected when the most recent package was announced in May. Prices are then expected to be 66% higher between January and March 2023 than was expected in May. Taken together, and adjusting for seasonal variation in energy demand, this suggests that the average household will pay around £900 more for energy bills between October 2022 and March 2023 than was expected when May's support package was announced. The three support packages announced so far will offset only almost 50% of the rise in energy bills, revised down from an estimate of around 90% in May.

Beyond the direct impact of higher-than-expected energy bills, households will also face additional cost of living impacts from indirect effects: businesses facing higher wholesale energy costs are likely to increase the prices that they charge consumers for goods other than energy.

Figure 4 **Evolution of the forward curve for gas prices over the past year, p/therm**



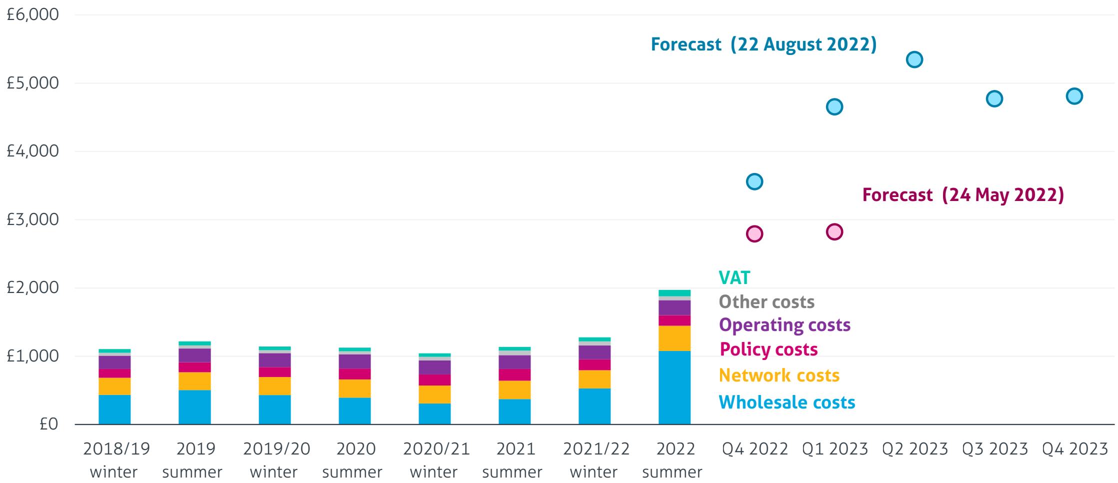
Source: Institute for Government analysis of International Continental Exchange, UK Natural Gas Futures.

...and to remain high for longer

What is perhaps most striking about the latest projections for energy bills is not the rise in expectations for energy bills this winter, but the length of time for which these high prices are expected to persist. Energy prices are expected to continue increasing after October, rising in January 2023 and then again in April (Figure 5). Ofgem will change the cap every three months from October onwards rather than every six months as it has to date. If Cornwall Insight's prediction is realised, then households will be paying similar amounts for their energy next winter as this winter.

But the support payments announced so far (and those proposed by opposition parties) do not extend beyond this financial year. Most of the payments from the various schemes will arrive in people's bank accounts in 2022 (with the exception of some instalments of the energy bills rebate, which will arrive in spring 2023).[6] Households therefore face a significant cliff-edge in support for the 2023/24 financial year.

Figure 5 **Ofgem price caps, outturn and forecast (Cornwall Insight)**[7,8]



Source: Institute for Government analysis of Cornwall Insight, 'Cornwall Insight's Price Cap predictions jump after Ofgem release new guidance', 24 May 2022; Cornwall Insight, 'Price cap to remain significantly above £3,000 a year until at least 2024', 2 August 2022; Ofgem, Breakdown of the default tariff price cap (GBP £, direct debit).

But there is considerable uncertainty about future energy prices

We can predict with reasonable certainty what the energy price cap will be for the period October–December 2022 because most of the necessary information is already available. But there remains huge uncertainty about how energy prices and thus the cost of living crisis will evolve thereafter.

It is possible that prices could rise even more sharply than Figure 5 suggests – if, for example, Russian gas deliveries to Europe are entirely cut off.[*] Alternatively, some respite might be provided by energy market reforms on which the government is currently consulting, although these would not have any impact until next winter at the earliest.

Figure 4 shows how much futures prices for gas (on which the Ofgem price cap is based) changed between May and August 2022. They could easily move substantially again over the next few months.

* The Office for Budget Responsibility considered a scenario of this kind in its *Fiscal Risks and Sustainability* report, July 2022, https://obr.uk/frs/fiscal-risks-and-sustainability-july-2022

Responding to this winter's cost of living crisis will be one of the most urgent tasks facing the new prime minister

Boris Johnson has declined to announce any further support for households with energy bills, with a spokesperson saying it is "not for this PM to make fiscal interventions during this period".[9] The leadership candidates have therefore come under pressure to say what they would do and it is likely to be one of the most pressing tasks facing whichever one wins.

Liz Truss has proposed suspending green levies

Liz Truss has proposed a temporary "moratorium" on "green energy levies". This seems to refer to what Ofgem calls "policy costs" – a range of charges that are passed on to customers via energy suppliers, some of which help support renewable energy generation or energy efficiency improvements, while others provide support for low-income households.

A moratorium on all policy costs would reduce energy bills by around £150 per year on average. However, because some of these levies are directly linked to measures that support low-income households (such as the Warm Homes Discount), the impact on household finances would depend on whether Truss plans to move the policy costs to general taxation or borrowing or to scrap the policies altogether.

The latter would be unwise. Some of the renewable energy levies are legacy contracts from previous support schemes and would likely be subject to legal challenge if the government attempted to stop paying them entirely. The current renewable energy support scheme – Contracts for Difference – is likely to reduce bills slightly from October, as renewable energy falls in price relative to fossil fuels, so attempting to suspend it might increase bills. Meanwhile, removing support for low-income households during a cost of living crisis would seem counterproductive.

If Truss did abolish all of the levies, the average saving per household between October 2022 and March 2023 would be around £100, assuming that this tax cut could be delivered relatively quickly following an emergency budget. This would reduce the total average energy bill between October and March from around £2,800 to £2,700 (meaning that households would still be paying just over £800 more over that period than was expected in May).

Having previously said that she was not in favour of giving further "handouts" to help people with energy costs,[10] recently Truss has suggested she is considering offering more direct support, though has not said exactly how this will be done.[11]

Rishi Sunak has pledged cuts to VAT and further targeted giveaways

Rishi Sunak has announced that he will suspend VAT on energy bills for 12 months if the price cap rises above £3,000, as expected. On the basis of Cornwall Insight's latest projection, that would save households around £200 on their annual energy bill, with larger savings for those who consume the most energy.[12]

The average saving per household between October 2022 and March 2023 would be just over £100 given seasonal patterns of energy use – only slightly larger than the saving from Truss's proposal to suspend green levies. Sunak has said that he would go further, expanding the types of policies he announced in May to compensate households for the additional energy costs they are now likely to face.[13] He has not yet confirmed the precise level of support, saying that he will wait until the October price cap is announced. But he has said there will be three prongs to his package – as there was in his May package: targeted support for the "most vulnerable", for pensioners, and "support for everyone".

There are various options if the candidates want to help households more this winter – all of which imply different trade-offs

The additional measures that Sunak and Truss have committed to so far would offset only a small part of these higher bills. If they wanted to go further, they would need to weigh up a range of issues.

The global energy price shock has imposed an economic cost on the UK driving high inflation. The Bank of England judges that the economy is running close to capacity. As a result, any net tax cut or spending giveaway is likely to be offset at the aggregate level by tighter monetary policy to help ensure that inflation is kept under control. This means that the government cannot insulate everyone from experiencing some economic pain. But it can decide how the pain is allocated and to what extent households are squeezed through higher energy prices (if it limits any fiscal support) or through higher interest rates (if it offers greater fiscal support but this is offset by higher interest rates).

The net cost of any support for particular groups will depend on how far the new prime minister wants to go in cushioning higher energy prices and whether he or she is able to raise additional revenues to cover the costs – for example, by expanding the energy profits levy announced by Sunak earlier this year.

There are various options open to the next prime minister. In choosing between them, he or she will face four main choices:

- **Extent of coverage:** The first choice the new prime minister faces is about how much of the price rise to try to offset. More expansive policies will be more expensive.
- **Targeted or universal support:** A second, related, choice is about whether to offer the same degree of support to everyone or whether to target help at specific groups – for example, those with the highest energy needs or those on the lowest incomes. For example, Sunak's policy of giving £400 energy bill rebates to every household cost £12bn, whereas his policy of giving a further £650 just to those on means-tested benefits cost only just over £5bn.

- **Whether to link levels of support directly to energy use:** If the prime minister did want to target support, they face a choice about whether to do this based on households' characteristics (such as age, income or size) or on the amount of energy that households use. The benefit of targeting based on energy use is that it provides most help to those who use most energy and so – in cash terms – are hit hardest by the price rises. The disadvantage of this approach, though, is that it will tend to provide the largest cash support to higher income households, who have larger homes and tend to use more energy; this is out of line with most other aspects of the existing tax and benefit system.
- **Whether or not to retain energy price signals:** There is also a choice to be made about whether support is offered in such a way that it affects the price of each unit of electricity that households buy or whether the support leaves the energy price unchanged. The advantages of the former are that it helps to target support in proportion to energy use and also may reduce measured inflation, as the energy price level is factored into the measure of consumer inflation. The disadvantage, however, is that it will dampen the incentives that people face to reduce their energy consumption and to adopt energy-saving measures – both of which will ultimately be needed if the government is to achieve its target of net zero carbon emissions and which would also help to control households' energy costs in the longer term.[*]

Broad-based cash transfers to offset most of price rise for all households

The new prime minister could use fiscal policy to provide broad-based support for all households. Through the three packages this year, Rishi Sunak announced a level of support that, based on expectations at the time, should have offset almost 90% of the total rise in electricity and gas bills in aggregate. However, as detailed above, expectations for the cost of energy have significantly increased since May. There are two ways in which further broad-based support could be delivered – either by sending cash directly to households (discussed in this subsection) or by requiring energy suppliers to sell energy at a cost below the Ofgem cap (discussed in the next subsection).

The most obvious option for a broad-based cash transfer to households would be an expansion of the energy bills rebate that households are already receiving. To maintain the same broad-based offset of around 90%, the new government would need to spend another £23bn in total (or an average of around £800 per household). The two main downsides to this method of delivering support are that it does not vary according to households' energy use and that it provides more support to those with multiple properties, who are typically higher income.

Offsetting the price rise for all households by reducing the cost of energy

A second approach is to try to reduce the unit price of energy. Sunak and Truss's proposals for cutting taxes on energy achieve this result to a limited extent. Many European governments, including in Germany and the Netherlands, have also reduced taxes on energy.[14]

* The International Monetary Fund has argued in favour of retaining energy price signals and instead offering targeted support to vulnerable households through direct transfers. https://blogs.imf.org/2022/08/03/how-europe-can-protect-the-poor-from-surging-energy-prices

The opposition Labour Party[15] (as well as the Liberal Democrats[16] and Gordon Brown[17]) has proposed to go further in this direction by stopping the Ofgem price cap from increasing. It has suggested that the cap should stay at its current level, and the government should pay suppliers directly for providing energy to customers at a loss (since the cap would then be well below what suppliers have paid for electricity on the wholesale market). Capping bills at this level until April 2023 would cost just over £40bn.[*] This sort of approach has already been adopted by the French government, among others.[18]

This approach has the significant advantage of targeting support in direct proportion to energy use and will not have the holes in support that direct transfers risk. However, this would make the policy less progressive than direct transfers since higher income households tend to spend a larger amount on energy in cash terms – though not as a proportion of their total income. The main disadvantage of such an intervention is that it could be very difficult to reverse – if prices stay high for another year or even longer, the government could find it difficult to withdraw this policy, and it would be very expensive to maintain. French households have been protected from rising energy prices since October 2021 by a price cap of this sort. But, with the price cap due to end in 2023, an ally of President Macron recently warned that his countrymen were like passengers "drinking champagne in an aeroplane, unaware that it is going to crash into a mountain". [19]

Another disadvantage is that it would mean households did not face the true marginal cost of additional energy use and so did not face such a strong incentive to reduce energy demand and invest in the kinds of energy efficiency measures needed to achieve the government's ultimate aim of net zero carbon emissions. The International Monetary Fund has argued against these kinds of measures for this reason.[20]

Targeting vulnerable households

Another approach would be to deliver transfers in a more targeted way, for example by expanding the one-off payments to pensioners, households in receipt of means-tested benefits, and those who receive disability benefits that Sunak introduced as part of his May package.

Taking together universal energy bills support and one-off payments, those on means-tested benefits will have received at least £1,200 per household by the end of this fiscal year. They are also likely to see an additional benefit – to the tune of a few hundred pounds – from the cut in fuel duty and change to the National Insurance threshold (though these latter two policies benefit high earners more). Based on forecasts for energy bills in May (a rise of £1,300 compared with the previous financial year), it was reasonable in May to expect the combined effect of these policies to, on average, completely offset the rise in energy bills for those receiving means-tested benefits.

* Note that our calculation is larger than Labour's own estimate of £29bn. It appears as though its costing did not account for higher energy use during the winter.

The new government could choose to expand support only to vulnerable groups. If the chancellor wanted to maintain the objective of broadly completely offsetting energy bill increases for those on means-tested benefits, he or she would need to spend around £800–900 per household on means-tested benefits. Doing so would cost £6–8bn.

The chancellor may also wish to extend additional payments to pensioners and those on disability benefits. The worst-off in these groups will be eligible for means-tested benefits (pension credit and employment and support allowance respectively), so will already receive the support for those on means-tested benefits (discussed in the preceding paragraph). However, the government may still wish to make one-off payments to pensioners and disabled people because of incomplete take-up of means-tested benefits and because these groups tend to have higher than average energy use. Scaling up the payments that have already been announced for pensioners and disabled people by a similar proportion to the scale-up in means-tested benefits described above would mean pensioners receiving £700 (instead of £300) and those on any disability benefit receiving £350 (up from £150). This would cost just over £4bn, taking the total cost of extending support to the most vulnerable to £10–12bn, compared with the £23bn necessary to maintain a high level of support for all households.

For each of these interventions, each household receives the same lump sum payment, and our calculations represent how much the payments will knock off an *average* household's energy bill. In reality, energy use (and therefore bills) varies and the actual offset for individual families will vary – some will be relatively undercompensated, while others will see a total benefit that is larger than their rise in energy bill.

Generating revenue

The government can afford to borrow more in the short term to address this temporary cost of living crisis. But as part of his May 2022 fiscal package, Rishi Sunak announced a new 'energy profits levy' (also known as a windfall tax) to extract some of the excess profits that oil and gas companies had earned as a result of unusually high fossil fuel prices and to partially fund the spending measures. At the time, this was expected to generate around £5bn over the next year. Further increases in gas prices since then mean the levy is now likely to raise more revenue. Sunak also said that he would look at extending the energy profits levy to renewables generators, since many of these – the ones operating on older Renewables Obligations Contracts, as opposed to more recent Contracts for Difference – have also made substantial profits as high gas prices have fed through into high electricity prices.

If the new prime minister wanted to raise more revenue, he or she could increase the energy profits levy or extend it to renewables generators.

The new prime minister may also come under pressure to help businesses

The government is also likely to come under increasing pressure to do something to support businesses with rising energy costs. So far business has seen very little financial assistance from government, particularly when compared to households, yet it has been facing the same surges in energy prices without any protection from the Ofgem default tariff cap (which applies only to households). There are some schemes in place to help energy-intensive industries but these apply only to the non-wholesale elements of bills, whereas it is the wholesale elements that are driving up prices.

Cornwall Insight projections from earlier in August suggest that businesses might see prices rise from around £250/MWh in 2021/22 to more than £500/MWh in 2022/23 (having previously been lower than £150/MWh in 2020/21). Fixed contracts for businesses' energy tend to renew around 1 October every year so it is likely that financial stress for businesses will increase sharply at the same time as for households.

The case for the government to step in is typically greatest where there are concerns over a loss of competitive advantage or the potential for problems to spill over from one business to another. There may also be a case for supporting other businesses if they are not able to obtain credit to tide them over during this period of temporarily increased costs; this may be especially difficult for smaller businesses. As the IMF has said: "Support for firms could be justified only when the price shock is large but temporary, and firms are liquidity constrained. In this case, limited support measures for viable firms that would have ceased operating in the absence of support policies could help prevent economic scarring."[21]

Other countries have done more to help businesses with energy costs. In France, for example, the government has reduced the electricity tax from €22.50 to 50 cents per megawatt hour. The French government also introduced discounts on the price of fuel and direct grants to road hauliers. The Spanish government has also provided direct support to businesses in the transport, food and energy-intensive sectors and introduced measures to cap wholesale electricity prices.

But, as the IMF has described: "It is difficult to implement a well-targeted support scheme for firms without introducing distortions and disincentivizing energy conservation." A well-designed scheme to support businesses would "take the form of temporary liquidity assistance, and be conditional on hedging energy price exposures going forward and, where feasible, on increasing energy efficiency and lowering [greenhouse gas] emissions… [G]rants or subsidies… should not be proportional to energy usage but should ideally be offered on a lump-sum basis (or linked to past levels of energy usage) to incentivize energy savings".[22]

While the political pressure to help businesses may grow the longer prices remain high, the economic rationale for doing so diminishes. If the current price rise proves persistent, at some point businesses will have to adjust or go under and the government cannot prevent this indefinitely.

More action may be needed next year

Given that some analysts now expect prices to be as high next winter as they are this winter, the new government will need to decide whether to extend fiscal support into the next financial year. The decision over what to do in 2023/24 will be far more consequential financially – both for households' real incomes as well as the government's fiscal position – than the decision about what more to do this year.

As outlined above, if the new prime minister wants to compensate households for around 90% of the additional higher energy costs now expected this year relative to May, he or she would need to spend around £23bn more. But if he or she wanted to continue that same level of support throughout next year (2023/24), that would cost just over £90bn, if the latest forecasts for energy prices from Cornwall Insight prove correct.

There remains huge uncertainty around the future path for energy prices. This means the new government should not lock itself into a course of action too early. Any plan to support consumers through this shock should have contingencies to deal with such risks – both to scale back support if energy prices fall more quickly than expected and to be clear if and how the government will respond if energy prices go even higher.

One course of action that the government should start preparing for is uprating benefits more substantially next April. So far payments to help benefit recipients (those on means-tested benefits, disability benefits and state pensions) with energy bills have been made as lump sums, rather than in proportion to the other income they receive from the state. Sunak justified this in part by saying that there had not been time to adjust benefit uprating calculations. But with more time to prepare before next winter, the government should put itself in a position to use this mechanism. People's other benefit payments are calibrated to take account of differences in – for example – family size, spending needs and other sources of income. Therefore, increasing benefit payments would target help in proportion to the needs that the state usually judges these people have and may therefore be better targeted than making the same lump sum payment to all households.

The new government could do more to improve energy efficiency and reform the energy market before next winter

For winter 2022/23, the government's options are limited: there is little that can be done to reduce energy demand or to alter the energy market to mitigate the worst of the price rises and so offering direct financial support to households is the most likely course of action. However, looking ahead to next winter, the government has more options.

The first approach is reform of the wholesale electricity market, which is currently based on 'marginal pricing'. That means that the most expensive generator that is needed to meet electricity demand sets the price paid to *all* generators in the UK. In the UK, the marginal producer of electricity is most often gas. That means the price of all electricity is set by the (currently very high) price of gas, even though around 60% of the UK's electricity is generated by much lower cost renewables or nuclear. This means that the low cost of renewable generation is not being passed on to consumers, leading to excess profits for some (renewable and nuclear) generators.

The government has launched a review of electricity market arrangements (REMA).[23] This is intended to discuss and decide on the appropriate market arrangements for 2035 in a net zero, renewables-dominated market. The REMA consultation is considering many options to break the link between wholesale gas and electricity prices. This is mainly for reasons relating to market structure, but it would also bring significant benefit to consumers, delivering cheaper electricity even in the presence of high gas prices. Several options are being considered, one of which is splitting the market into a 'green power pool' to be run in parallel to the electricity spot market.[24] The introduction of such a policy could provide significant help to consumers next winter, if delivered in time. However, government should not rush through market reforms to help consumers if that jeopardises the degree to which policies can achieve the longer-term objective of providing the right incentives for the net zero transition, which should be the primary aim of REMA.

A second approach to improve households' resilience to high and/or volatile energy prices in the medium term is to encourage greater energy efficiency. The government missed an opportunity to do this in its March 2020 energy security strategy, and failed to set out any public information, behavioural, or energy efficiency measures.[25] Since then the government has launched an energy advice service[26] on gov.uk. However, ministers could go a lot further in making public appeals to use less gas, for example by telling consumers that turning down thermostats or changing boiler flow settings could reduce gas demand immediately by as much as 10–15%. Many charities and industry players are helping to communicate this sort of information to the public, but a concerted effort by government ministers could significantly help.

The government should also invest in residential energy efficiency. The UK has among the least efficient housing stock in Europe and successive governments have a record of failure on improving this. No new policies or funding that might have been able to start making a difference to bills this winter were implemented. But a concerted effort to improve building efficiency beginning immediately could help protect consumers next winter and beyond from further spikes in energy prices. They are also necessary to achieve the UK's net zero objective.

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