3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231

citizensadvice.org.uk

22 January 2021

Dear Sir / Madam

We are writing in response to your invitation to provide feedback on the interim report of your Net Zero Review. This submission is non-confidential and may be published on your website.

Citizens Advice has a statutory role under the 2007 Consumers Estate Agents and Redress Act to advocate on behalf of electricity and gas consumers. Our submission concentrates on issues in those sectors.

We make the following recommendations:

- ***Recommendation 1: the Government should move more of the burden of policy costs from bill levies to general taxation.***
- ***Recommendation 2: rebalancing policy costs between electricity and gas would be environmentally progressive but may be socially regressive. We encourage the Government to think through the distributional implications carefully before considering such an option.***
- ***Recommendation 3: we encourage the Government to make quick progress on removing small supplier exemptions from participating in the ECO and WHD schemes.***
- ***Recommendation 4: per meter cost recovery is more regressive than per unit, and should be avoided. The Government should make a binding commitment that the Green Gas Levy should be recovered on a per unit basis from introduction.***
- ***Recommendation 5: the Government should re-introduce regular reporting of the cumulative impact of energy policies on consumer bills. This should be sufficiently detailed to allow for public understanding of the distributional impacts of policies, and whether they are offering value for money.***
- ***Recommendation 6: achieving the net zero emissions target will only be possible if we inform, protect and support people with the changes that we all have to make to our homes. The Government should make consumers a Net Zero Homes Guarantee that delivers this.***

The remainder of this submission contains the background to these recommendations.

Paying for the low carbon transition through taxes versus bills

A significant proportion of the costs associated with decarbonising the energy system are currently paid for through consumer bills, £11.4bn in 2019/20.[1] Paying for policies through bill levies rather than taxes is widely agreed to be regressive, as it results in a greater proportion of the total spend being met by those in lower income deciles. In its 2013 report on Prices, Poverty and Profits the Energy and Climate Change Committee noted that

> *'The use of levies on bills to fund social and environmental programmes will add to the burden faced by energy bill payers, particularly in low-income households. Public spending is less regressive than levies in this respect.'* [2]

In 2018, the UK Energy Research Council considered alternative models for funding policy costs,[3] comparing the status quo (the green bars in the 'Figure 4' chart below), with moving those costs to business consumers (the light blue bars) or to general taxation (the dark blue bars). It concluded that

> *'Placing policy costs on businesses, or funding the costs from general taxation would lower the burden on the poorest households. The general taxation approach would better align energy demand with policy costs, and would reduce costs for 70% of UK households. The poorest households would pay nothing, saving them £102 a year, while the richest households would pay an additional £410 a year (under £8 a week).'*

[1] 2.42, 'Net zero review: interim report.' Treasury, December 2020.
[2] 'Energy prices, profits and poverty.' Energy and Climate Change Committee, July 2013.
[3] 'Funding a low carbon energy system.' UK Energy Research Council, March 2018.

Figure 4

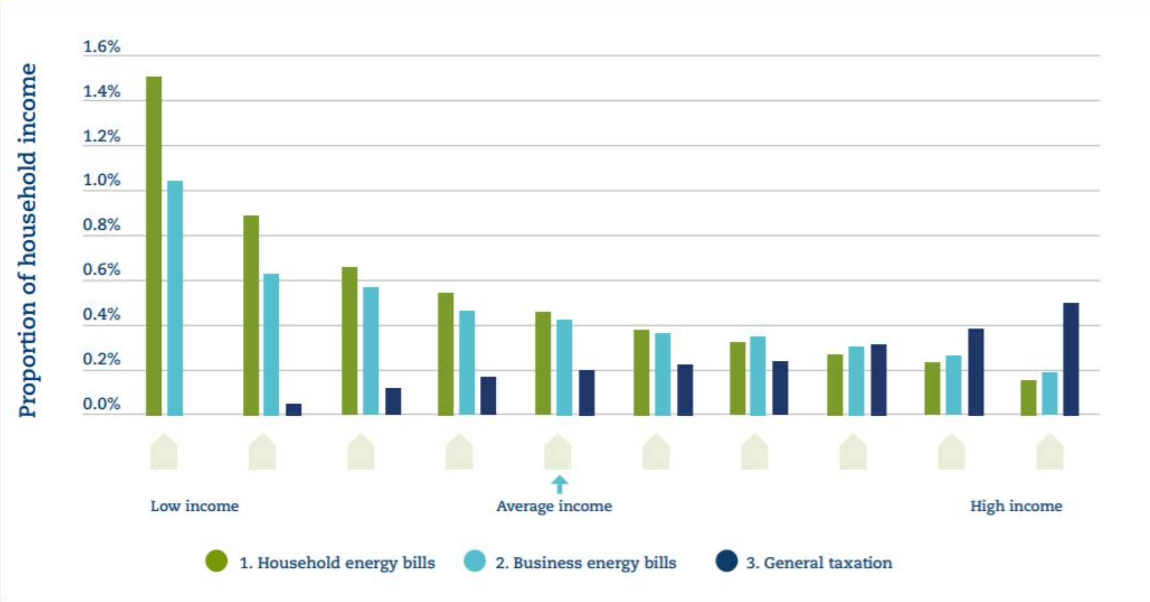


Figure 4: Proportion of household income required to meet different energy policy funding approaches

A third of the population has less than £600 in savings, and one-in-eleven has no savings at all.[4] The use of household credit to meet essential bills like utilities, whether explicit (eg using credit cards or loans) or implicit (eg incurring banking fees for going overdrawn) is likely to be common. These costs will be additive to the headline distributional impact of paying for policies through bills rather than taxes.

We recognise that the public finances are under significant strain and that this situation has deteriorated due to the pandemic. But we think it is important that the Treasury gives detailed consideration to the possibility of moving some policy costs from bills to taxation. This appears important if we are to mitigate the impacts of the transition on lower income households. Avoiding a public perception that the costs of policy are unfairly distributed and/or unaffordable for some will be crucial to ensuring public acceptance of the low carbon transition, and the current regressive approach to cost recovery endangers this.

Recommendation 1: the Government should move more of the burden of policy costs from bill levies to general taxation.

Rebalancing gas and electricity levies

There is ongoing debate in the energy sector on whether policy cost levies should be reallocated from electricity bills to gas bills. Currently, they are principally recovered

[4] 'Savings statistics: average UK savings in 2020'

through the former, with social and environmental policy costs accounting for 23% of the typical household electricity bill but only 2% of the typical household gas bill.[5]

Our pathway to net zero will require significant electrification of both heat and transport. This could be impeded if policy costs are largely recovered through electricity bills as it will erode the financial benefits of switching fuels from gas to electricity. It can also be argued that as the volume of electricity that is provided from low carbon sources continues to accelerate that it may be perverse to levy more costs on a relatively cleaner power source than gas. For these reasons, it is argued that there is a reasonably strong environmental case for moving policy costs from electricity to gas.

We recognise, and agree with, those arguments, but think it should be recognised that while the environmental case for rebalancing levies between fuels is strongly positive, the social case is more problematic.

The reason for this is that while almost every household is on the electricity network, only around 85% of households are on a gas network. This has several potentially adverse distributional implications.

The first is that there is a leveraging effect. Because only some consumers would be paying for policies, rather than ~all, the amount that the majority would have to pay would have to increase to reach the same overall policy spend. Conversely, the minority of consumers now effectively exempted from policy costs would see their bills drop. The impacts of this on affordability and the pattern of fuel poverty would need to be understood before such a step could be taken. As households progressively move from using gas to electricity for domestic heating, this leveraging effect would increase over time. Given the upfront costs associated with electrifying properties it is likely that early adopters of heat pumps may be more affluent than the average household, and that policy costs may fall more heavily on those less able to afford to pay them.

Secondly, there is a moral question over whether some households should be effectively exempted from policy costs. Climate change affects all of us, and every home and business benefits from the significant ongoing investment in decarbonising our power system that these policies pay for.

Finally, there are locational distributional implications. While at national level, around 85% of households are on the gas grid, this varies significantly by region from 93% in north west England down to 76% in south west England.[6] Recovering policy costs solely from those on the gas network is therefore like to result in some

[5] 'Understand your gas and electricity bills.' Ofgem, January 2021.
[6] Table 5, 'Sub-national electricity and gas consumption 2018.' BEIS, December 2019.

regional rebalancing of who pays for policy costs away from regions with lower than average proportions of the population on the gas grid (like the south west, inner London, the east of England and Wales) onto those with higher proportions (like the north east, north west and Yorkshire and the Humber). This may be perceived as regressive, particularly given some of the 'losing' regions would be among the UK's poorest.

An alternative to moving policy costs from electricity bills to gas bills to try and incentivise electrification could be to alter the VAT treatment of domestic energy use. Currently, both electricity and gas are subject to the reduced rate of 5%. The application of different rates for electricity and gas could create an incentive effect for fuel switching. The advantages and disadvantages of rebalancing VAT costs between fuels as an alternative to rebalancing policy costs are likely to be similar.

Recommendation 2: Rebalancing policy costs between electricity and gas would be environmentally progressive but may be socially regressive. We encourage the government to think through the distributional implications carefully before considering such an option.

Removal of supplier exemption thresholds

The recently published Energy White Paper sets out the government's intention to consult on removing small supplier exemptions from the Energy Company Obligation and Warm Home Discount schemes. We warmly welcome this.

Small supplier exemptions from policy costs have multiple adverse effects on consumers.

Firstly, they are likely to distort competition by giving a cost-to-serve advantage to exempt suppliers. This is likely to encourage unsustainable pricing as all suppliers have to compete for the same cohort of potentially acquirable customers regardless of whether they benefit from exemptions or not. Ultimately the by product of unsustainable pricing is supplier failure, the costs of which are socialised over all consumers. These costs are significant, at least £255m by December 2019.[7]

Secondly, it exempts some customers from the costs of paying for social and environmental policies. Past analysis by the CMA suggests that poorer customers, and those in vulnerable situations, are less likely to shop around.[8] So the

[7] 'Picking up the pieces: updated analysis,' Citizens Advice, December 2019.
[8] Figure 2, 'Appendix 9.1: CMA domestic customer survey results,' CMA, 2016.

exemptions have the effect of pushing more of the burden of paying for policies onto those least able to pay.

Finally, by reducing the support available to consumers in vulnerable circumstances who switch to those exempt suppliers, it disenfranchises those consumers from the market, making them unable to access the cheapest deals.

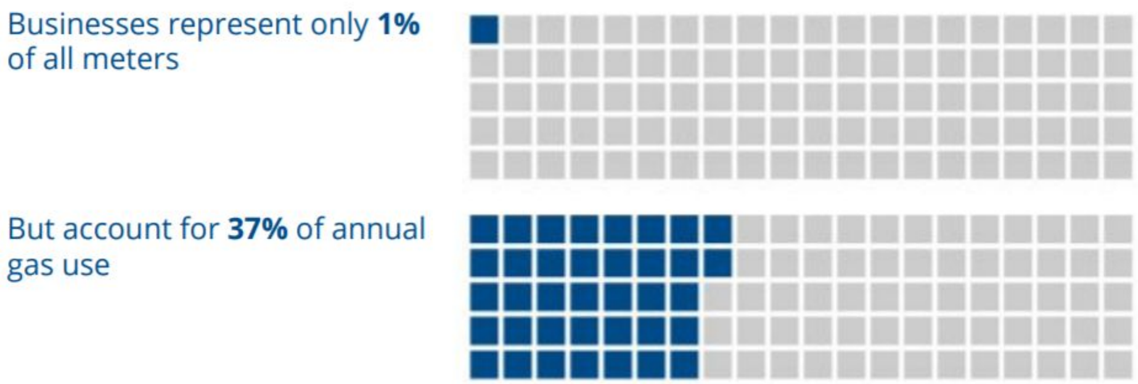
Recommendation 3: We encourage the government to make quick progress on removing small supplier exemptions from participating in the ECO and WHD schemes.

Recovering policy costs on a per unit basis rather than a per household basis

The government does not prescribe how suppliers recover the costs associated with existing social and environmental policies that are levied through bills. However our understanding is that suppliers usually do so in a manner that is consistent with their exposure to those costs. This is usually on a per unit basis.

BEIS has recently consulted on introducing a Green Gas Levy that would be levied on a per meter basis, rather than a per unit basis.

This would have regressive implications. Firstly, it would mean that the levy would be almost exclusively recovered from household consumers, despite those customers only accounting for around three-fifths of total gas usage.



Within the household cohort, it would mean that every consumer paid the same amount towards the policy, regardless of income and usage. As your own analysis shows, wealthier households tend to use more energy, so this would constitute a cross-subsidy flowing from the poor to the rich.

Finally, it would dull incentives to improve energy efficiency when compared to a per unit approach. Efficient users would face the same levy as inefficient ones.

BEIS does appear to recognise some of these issues and has stated a desire to move from a per meter point charging approach to a per unit approach 'in 2024/25, or as soon as possible thereafter, subject to the current feasibility challenges being overcome.'[9] But this commitment is not binding, the lead time is long, and the wording allows for slippage.

While we acknowledge that the volume of monies to be recovered through the Green Gas Levy is relatively small, we are concerned about the setting of a precedent that policy costs may be recovered on a per meter basis, particularly given the live debate over whether more policy costs should be moved to gas.

Recommendation 4: per meter cost recovery is more regressive than per unit, and should be avoided. The government should make a binding commitment that the Green Gas Levy should be recovered on a per unit basis from introduction.

Accountability for costs

There will be significant costs and benefits associated with the net zero transition, and it is important that there is public accountability for these, so that the public can have confidence in the decision-making of government.

The National Audit Office,[10] the Public Accounts Committee and the now defunct Energy and Climate Change Committee have all recommended that the government should report regularly on the full costs and impact of all its levy-funded schemes, but it has not done so since 2014. In its 2017 review of the Levy Control Framework, the PAC recommended that:

> *'The Department should report much more openly and regularly on the Framework and also publish a consumer prices and bills report annually in an easily understandable format so that consumers can see clearly what they are paying. The next edition should be published before April 2017. It should also publish a clear account of the assumptions underpinning Framework forecasts each time those forecasts are published.'*

In the March 2017 Government response[11] to that recommendation it noted (emphasis added):

> *'4.1 The Government agrees with the Committee's recommendation. Target implementation date:* ***Spring 2017****. 4.2 The Department recognises the*

[9] 'Proposals for a green gas levy.' BEIS, September 2020.
[10] Para 18, 'Controlling the consumer-funded costs of energy policies.' National Audit Office, October 2016.
[11] 'Government response to the Committee on Public Accounts on the thirty-fifth to forty-first reports from session 2016-17.' Treasury, March 2017.

importance of consumers having regular, reliable data on the costs and impacts of Government energy policies and on energy prices and bills. 4.3 The Department will publish its latest estimates of the impact of Government energy policies on domestic bills in the near future'

This still has not happened.

Recommendation 5: the government should re-introduce regular reporting of the cumulative impact of energy policies on consumer bills. This should be sufficiently detailed to allow for public understanding of the distributional impacts of policies, and whether they are offering value for money.

Net zero homes guarantee

People must be at the centre of plans for economic recovery. For energy and heat, this means ensuring that the energy transition is fair - whether that is in relation to costs, choice, consumer protections or decision making.

Citizens Advice is calling for the government to establish a net zero homes guarantee. This would be a government-backed scheme focused on giving people confidence to install low carbon heating systems or energy efficiency measures. The guarantee would help people to make informed decisions, and establish simple, enforceable, protections, so people can engage with confidence. It must include support for people through funding, finance and incentives.

A net zero homes guarantee will be essential to:

- Improve the energy efficiency performance of homes, keeping people's bills low and homes warm
- Replace fossil fuel based heating systems and move homes on to low carbon options to achieve the net zero ambition.

Now more than ever it is important to ensure that the costs of the transition to net zero are paid for fairly. The impact coronavirus has had on incomes and affordability must not be overlooked.

Achieving the net zero emissions target will only be possible if we inform, protect and support people with the changes that we all have to make to our homes.

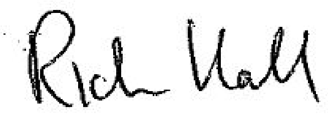
Public support will be crucial for a successful transition to a low-carbon future.

Our recommendations for the key components of a Net Zero Homes Guarantee can be found here.

Recommendation 6: Achieving the net zero emissions target will only be possible if we inform, protect and support people with the changes that we all have to make to our homes. The government should make consumers a Net Zero Homes Guarantee that delivers this.

We trust that this submission is helpful, and would be happy to discuss the issues that it raises further.

Yours sincerely



Richard Hall
Chief Energy Economist