The government’s help to people and businesses hit by the energy crisis. Letter from PM

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THE PRIME MINISTER 8 September 2022

Dear Colleague,
SUPPORTING PEOPLE AND BUSINESSES WITH THEIR ENERGY BILLS

On the steps of Downing Street on Tuesday, I pledged to take action to bring down energy bills. Today, within 48 hours of taking office, I have delivered on that promise.

This Government will bring forward emergency legislation to establish a new Energy Price Guarantee which will ensure that the average British household pays no more than £2,500 per year for their energy bills for the next two years from October.

This will save the average household at least £1,000 per year – giving certainty on energy prices so people can get through the winter, slowing inflation and making incomes go further. We will fully compensate energy suppliers for the cost of this emergency action – with the Chancellor setting out further details in the fiscal statement later this month. The new guarantee will apply to households in Great Britain, with the same level of support made available to households in Northern Ireland.

As part of the Energy Price Guarantee, we are temporarily suspending green levies – contributing £150 to the £1,000 yearly average saving. At this difficult time, it is right that households do not bear the cost of low-carbon electricity generation, but instead benefit from it.

And we will maintain the £400 Energy Bill Support Scheme for everyone, and the £1,200 of support for the most vulnerable households already announced earlier this year.

But I know that not everyone will be eligible for the schemes I have outlined above – especially those living in park homes, or who use heating oil in rural areas in constituencies such as mine. We will set up a discretionary fund to make sure that no one is left behind this winter.

Businesses will be offered an equivalent guarantee for six months for those hit by rising prices, and after those six months we will provide further support for vulnerable sectors, such as hospitality, including our local pubs. We will work with businesses to review where this should be targeted.

But we are also taking action to ensure that we are never in this position again. That means ending decades of short-term thinking which has allowed Putin to weaponise energy supplies as part of his illegal invasion of Ukraine.

We will ramp up energy supply and fix the regulation of our energy market. This will include establishing a new Energy Supply Taskforce, in the style of the Vaccine Taskforce, to negotiate new long-term contracts with suppliers to bring down energy costs.

Together with the Bank of England, we have secured a new £40 billion facility, so energy firms have the liquidity they need to manage volatility in energy markets, stabilising the market, reducing costs for the exchequer, and decreasing the chances of energy companies needing our support.

To fix domestic supply, we have to be bold. I want the UK to be a net energy exporter by 2040.

We will end the moratorium on shale extraction to get gas flowing as soon as six months' time, boost renewables including wind and solar, launch Great British Nuclear later this month, and create a pro-investor environment to get more domestic supply projects off the ground, faster.

A review will be held to fix the longstanding problems within our energy regulation, and we will bring forward fundamental reforms to make our energy market fit for the challenges Britain faces today.

The Rt Hon Member for Kingswood, Chris Skidmore MP, will also lead a review to ensure we deliver net zero by 2050 in a way that is pro-business and pro-growth.

When I took office, I was clear that the next few months would not be easy. But I have every confidence that the resolve of the British people is strong enough to see us through the storm. Today's package sends a clear message that this Government is with them every step of the way.

Yours Sincerely,

All MPs and Peers

The energy package

Today we are told to expect a new energy policy. This note is based solely on press accounts of what the government may announce. There will be two different parts to it. The first is to tackle the underlying problem. We have too little domestic energy. We are too dependent on imports from an energy starved Europe. We need to produce more of our own oil, gas, hydro power, renewable energy and nuclear energy. We need to prolong the lives of those gas, coal and nuclear stations where it is safe to do so, as we wait for the new investment to go in and provide us with sufficient alternative supply. I look forward to bold steps to promote more UK onshore and offshore oil and gas, which will bring in substantial tax revenues, create more well paid jobs and lower the CO2 generated compared with importing more LNG. I look forward to decisive action to commission new nuclear facilities through smaller nuclear reactors, to explore the commercial roll out of more ways of storing and using wind power and to ensure the lights and heating stay on this winter and next.

The second part is the need for immediate action to deal with the cost of living and business crisis created by extreme price movements in the gas and electricity markets here and on the continent, affecting our imports. If the government decides on a comprehensive price control as a temporary measure this would indeed take the worst pressure off business and families and save many jobs currently threatened by unaffordable business energy bills. It will also bring with it a substantial bill for taxpayers and the state in the form of borrowings needed to subsidise the supply of energy below the cost of production and purchase. That is why the government needs to reassure markets and taxpayers that everything will be done to eliminate the demand/supply gap to bring prices down and to speed an elimination of price controls. Whilst they are in place the government will need to ensure it encourages investment in new energy supply. This requires prompt granting of licences, ending some of the penal taxes on the energy produced from new facilities and allowing contracts to supply that are reliable and make economic sense. Government itself needs to cut its own energy usage to show the way to reducing demand pressures on the currently limited supply. One thing that most people do agree about in this contentious debate is the desirability of more insulation of buildings and more fuel efficient machines and processes where these can be afforded.

So the important questions are likely to be

How will the government ensure proper incentives to greatly expand UK energy supply from domestic resources?

What can be expected of demand management in the public sector, and how can government help the private sector cut demand whilst still keeping warm and carrying out the work?

What controls will there be on the costs of this intervention?

Central Banks need to remember recessions bring more state borrowing

as well as economic misery.

In recent years a lot of economic advice and analysis has got too complex and out of touch . As a result the Bank of England misread inflation and presided over a major surge in prices that set in before an unexpected and unwanted European war made it worse. The Office of Budget responsibility in the last two years was way out in its underestimates of tax revenue and far too pessimistic in claiming a need for tax rises to cut the deficit. Its models did not realise revenue can be strong when there is more growth. Throughout the West the authorities decided fast money growth did not matter, and Central Banks could keep interest rates at zero whilst buying up state debt in large quantities so governments could borrow plenty on the cheap.

Central Banks are now wanting to correct their past inflationary mistakes, and are turning instead to tough money policies, pushing up interest rates, reducing their holdings of state debt and taking cash out of markets that might otherwise drive up prices. The danger is they now overshoot too far the other way, leading some countries into longer and deeper slowdowns than are needed to curb price rises. The new PM does not want the Bank to go easy on inflation, though it would also be bad news if they grew too tough. It would help them get it right if they took the growth in money and credit seriously, and watched those figures alongside evidence of any change in behaviour about how quickly the money circulated. They have tightened money substantially as they needed to do and should now wait for the impact on inflation to come through.

The new government team should want the Bank in its required reports on why inflation is running above target to provide its latest analysis of why inflation is five times target and to report on what actions it is taking to amend its models to help it forecast inflation more accurately. It would be good to hear from them about what role they now recognise the large programmes of buying bonds played in the inflation. More importantly they need to consider carefully how much impact rolling back all those bonds will have, as it will cut liquidity and slow the economy. It will make borrowing more money by the government more difficult and more expensive. Some of that is necessary. Too much of that brings on recession and paradoxically increases the debt and deficit as a result.

The OBR forecast of £99bn as I have argued before for this year’s deficit looks too low and needs to be adjusted. Without policy stimulus the economy will slow too much which will cut revenues and raise spending. With a policy stimulus which now seems likely some of the slowdown will be offset but there will be greater borrowing to cover the stimulus costs of helping people with their energy bills.

If the government decides on a large increase in state borrowing it will need the goodwill of the Bank and the markets to finance its needs. Raising the money from the long bond market is not inflationary. If rates go too high in the process that will impede growth. If Sterling falls too far that will import more inflation. There need to be sensible limits on public spending and borrowing.

My Conservative Home Article: Tackling the energy crisis is the key to defeating both recession and inflation

Below you will find my latest Conservative Home:

The new prime minister will want to finalise plans to tackle the cost of living crisis within days of taking office.

We read that there have been preparations both in her transition team and at the Treasury under the outgoing chancellor, speeding the task of bringing together the ideas and the official appraisal of options to produce an early statement to Parliament.

The immediate task is to see off a long and deep recession by putting enough money back into the economy that sky-high energy costs will be taking out.

Some of the extra cash removed from people and companies has been lifted by the Treasury itself, a winner from all the extra VAT, energy profits taxes and other energy levies that high prices bring. Some of the extra cash is effectively a tax imposed on us all by overseas energy markets, as the UK needs to import oil, gas and sometimes electricity to get by.

We cannot get any of this back, nor can we tax it, but we do need to take it into account when deciding how much help to offer people and businesses. It is a deadweight cost to all of us and a big loss for our country’s finances.

Many people and businesses can benefit from the promised tax cuts. Where they remove taxes on energy, they also help get the inflation rate down; it is a pity Rishi Sunak did not get agreement that the £400 effective cut to all electricity bills should help lower the rate.

The Government will need to do more to help those who rely on benefits, as well as choosing tax cuts that have the best effect on tackling the squeeze brought on by the price hikes. Cutting the inflation rate by removing taxes from energy prices is particularly helpful, given the adverse impact of high inflation on public finances.

There are medium-term tasks as well if we are to chart a course out of this rolling energy crisis. It is a double problem. There is the severe jolt to the system and ratchet in prices caused by the war in Ukraine and the need for Europe to replace all its Russian gas and oil imports.

There are also the underlying issues posed by the long road to Net Zero, where we are at that point where substantial renewable power on the system is good when the wind blows and the sun shines, but causes difficulties at other times. Then we need back up power usually from fossil fuels, whilst we await commercial roll out of storage and hydrogen technologies that could underpin a further major expansion of wind turbines.

All this points to the need to develop our energy policy around three objectives: environmental sustainability, affordability, and availability. The overriding environmental objective of recent years has skimped us on the other, two leaving us too dependent on imports.

Recent events also remind us how we need an energy policy that responds to the phases of the electrical and renewable revolution at the pace it occurs. It was always going to be the case that Europe and the UK would need a lot of fossil fuel this decade. All the time most people still have gas boilers with petrol or diesel vehicles and industry runs on gas we will need plenty of gas as a transition fuel.

It was never a good idea to rely too much on imported gas. Now we know Russia will use it as a weapon that is even clearer. Imported gas means paying more than for domestic gas, if only because of the higher transport costs, and can mean desperate last minute bidding for additional supplies in a world market chronically short of offers.

If it comes as LNG rather than piped gas, it means generating a lot more CO_2. Compressing and transporting the gas by sea uses a lot of extra energy. It means far fewer well paid jobs at home. It means we miss out on the often substantial tax revenue collected from those producing gas.

There are things current producers are doing and can do in the North Sea to lift output from existing fields using existing investment. Flows can sometimes be turned up, maintenance periods shortened. Specifications of gas used to supply pipes might be safely flexed.

There is then the possibility over a matter of months of adding extra wells to an existing field, tied into the present production facilities. There is the opportunity to drill the production wells in known field deposits where they can be tied into existing production facilities and pipes nearby.

Finally, there is the longer term opportunity to invest in an entirely new field with new production facilities, and to explore to find new deposits.

There is also a huge opportunity to develop onshore fields away from centres of population, with revenue or gas sharing with local residents. This would need to be done with agreement.

As we are not about to produce sufficient gas to cover all our needs, we also need to put in more storage capacity which we can fill in summer or other times of low demand as a protection against shortages in global energy markets and a way of smoothing prices.

Price controls distort and deter investment. They make the imbalance between supply and demand worse, when you need to bring the two together. Nationalisation of energy businesses would impose a huge strain on finances as current owners would need compensation. More supply is the true answer to dear prices born of shortages.

The Government needs to work as it has been doing with the nuclear industry to see if the productive lives of our current nuclear fleet can be safely extended and to see how a new fleet of smaller nuclear reactors could be commissioned at sensible prices and in a realistic time frame.

Promotion of renewables needs to continue alongside work to encourage commercial development of battery storage and the green hydrogen roll out. If we are going to have an electrical revolution we will need a great deal more generating capacity to fuel it. Government and industry in the meantime need to ensure there is enough reliable capacity to meet our power needs on days when the wind does not blow and the sun does not shine.

We are fighting inflation and recession at the same time. As energy is the single biggest contributor to the price rises, supplying more and cutting energy taxes is important. As the big loss of spending power brought on by the big energy price hikes is the single biggest cause of economic slowdown, so again improving the energy position is crucial to fighting recession.

Zimbabwe, Venezuela, Sri Lanka – three poster countries for price controls

Venezuela has been brought low by printing lots of money, by price controls and nationalisation. A potentially rich country with the world's largest oil reserves, Venezuela has seen its income per head fall from $12,000 in 2011 to just $1877 last year after a decade of price controls and nationalisation.

Zimbabwe, once a relatively prosperous agricultural state with plenty of food has seen its income per head fall to $1362 a head and lived through food shortages. Compulsory land transfers and price controls have not been kind to the economy.

Sri Lanka has been less extreme but has seen its income per head fall to $3698 last year and experienced food and other shortages as controls have been used. As a Professor at Colombo University wrote of their price control "it has never sorted out our supply shortages, but is has eliminated the quality goods from the market, and it has created a black market for good quality products, and it has not helped in any way eliminate poverty"

Food riots, protests against government, high inflation and damaging price controls have created misery in each of these potentially successful countries. Price controls have taken too many goods off the shelves, have bankrupted businesses that could otherwise have supplied more, have driven foreign companies out and put off more investment in capacity to supply. They have bred black markets, fostered smuggling subsidised and price controlled goods out of the country to sell at better prices elsewhere and prevented imports.

Why do so many people think they would work? Why will they not study what happens when they are used widely in inflation ridden economies?