Rising energy costs

Centrica have rounded off the season for the Big six energy companies to increase prices with a substantial inflation busting rise of its own. This is bad news for consumers, and will sustain a higher inflation rate than is welcome for a bit longer following the impact of higher oil prices on our inflation earlier this year.

There is general agreement amongst political parties that these increases are undesirable. There is also some measure of agreement that the companies need to be made to try harder to keep the costs under control, with continuing discussion of regulatory action to sharpen competition or to broaden the scope of price controls or caps.

What is less discussed by the politicians is the impact of their own policies and actions on domestic energy bills. The main rises this year have come on the electricity part of dual fuel bills. According to Ofgem 14.9% of the typical electricity bill is now to pay for environmental and social costs imposed by the EU and UK government. There is the renewables obligation, the energy Green deal, EU targets, the carbon floor, the Warm homes scheme, feed in tariffs and smart meter promotion costs, adding up to a substantial sum. As more and more of our power is generated from renewables with the necessary back up we should also expect wholesale electricity prices to rise.

The government has passed the issue over to the Regulator, pointing out that they have powers to control prices or stimulate competition. The Regulator has rightly warned that introducing a general price cap might lead to a reduction in investment at a time when we need to expand our potential electricity capacity. Threats of price caps tend to encourage companies to raise their prices as much as possible in advance of the imposition of one, and have led to sharp increases in prices in some countries that have tried them when they have been removed.

The new team at the Energy and climate change department need to think through with the electricity industry our needs and the impact of both government and company policies on prices. As readers of this site will know I want to see more and cheaper energy, both for domestic consumers and for industry. The most important thing the government could do for an Industrial strategy would be to pursue a policy of cheaper energy that requires rethinking much of the present complex energy policy, which contains so many interventions, some now seeking to offset other interventions.

Brexit policy and how to negotiate

I am glad the PM has made clear we will end freedom of movement and have our own migration policy on exit, as I reminded people here on this blog last week. She has also clarified the issue of a transitional Agreement. The UK has not asked for one. We still have 19 months left to negotiate a proper Agreement. Negotiating a transitional one would require prior consent to a full Agreement, then allowing discussion of how to transition from the one to the other. It is not intrinsically easier to negotiate a Transitional Agreement than a permanent Agreement, and requires consent to where the two parties are going during transition.

There are those in the Opposition, the media and business who seem to want to turn the EU/UK talks into a negotiation amongst ourselves about what we are trying to achieve. This is damaging to the UK’s official negotiating strategy, as it leads some in the EU to think that if they delay and prod the UK will change its mind and offer to carry on with budget contributions, freedom of movement and the other items that so favour the rest of the EU. MPs and others in senior positions in the Labour party keep changing their minds about membership of the single market and customs union, long after Parliament has voted decisively both to send the Article 50 letter and to exit both the single market and Customs Union.

Let’s have another go at reminding people what the UK has already decided. The people voted to leave the EU. They did so with both official campaigns pointing out this meant leaving the single market and customs Union. They voted leave to take back control, especially of our money, our laws and our borders.

Remain supporters then forced legislation and Parliamentary votes to test out the will of the people. Parliament voted overwhelmingly to leave the EU. The Commons since the election has voted to leave the single market and customs union as part of that, as was always implied in the previous Parliamentary votes.

Some Remain supporters now want to invent a Transitional Agreement, requiring the UK to go on paying budget contributions, accepting freedom of movement, and continuing to accept new EU laws. This is not government policy, and is clearly against the wishes of the people as expressed in the Referendum.

When asked why they want this, they usually argue that the other EU member states will damage their trade with us and our trade with them if we do not accept continuing features of EU membership. It is a cruel irony that the most pro EU are the most negative about the nature and likely actions of our EU partners. They are also going to be proved wrong on this as on so much else about Brexit. WTO rules work fine, if the rest of the EU really does want to damage its valuable exports of agricultural produce and cars. Their more voluminous exports will attract far more tariff than our sales to them. Under WTO rules and international law the EU cannot stop companies and individuals in its territory buying and selling things with the UK.

The figures for HS2

I voted against HS2 and lost heavily. Parliament has decided it wants this project, and the government is now pressing ahead. It needs, however, to be aware of the need to control costs vigorously and to think again about how to raise revenue from the line when built.

The forecasts rests heavily on the assumption of dramatic demand growth for London to Birmingham travel in the years ahead. When the new line is available they will have train paths for 18 trains an hour carrying up to 1000 people on each. Their estimates think that by 2037 there will be an additional 290,000 extra trips.

HS1 forecasts were similarly elevated when the decision was made to build it, but the outturn was well below forecast. The consultants expected 20-28 million passengers by 2010. The actual was only 9.5m. As a result HS1 fell miles short of the use and revenue they were expecting.

HS2 forecasts assume that they will charge the same fares as the competitor lines that remain in place, and that the fares charged will be higher in real terms than today. It is difficult to see why this should be the case. With such a huge increase in capacity becoming available it is likely the existing train operators will have to cut their ticket prices to try to hold on to business. This will mean lower revenues than expected on HS2. If the government and Regulator step in to keep the fares up it will be difficult to attract extra passengers needed to try to fill some of the large increase in capacity.

HS1 was hit by aggressive fare competition from the established ferry companies. HS2 assumes easy pickings from air and road competition. Maybe these will not materialise as planned. The operators could cut their prices.

However you look at it, this project can only limit the losses it will incur for the taxpayer if there is very strong cost discipline, and realism about how many trains can be run on these new lines. It would be good to hear more from the operators about why they think there will be such a surge in Birmingham/London train travel and how they will promote this.

Planning gain

One of the most fraught parts of the debates about new housing and the need to find sites to cater for the expanding population is the issue of planning gain. Greenfields or derelict land come quite cheaply. Land with planning permission to build is very expensive. The gain is created by the planning system. It keeps the supply of building land tight, causing scarcity, and then allows substantial windfalls to the fortunate few who own the land that gets the permissions.

There are usually three interests in claiming the gains in a typical development. There is the original landowner. He or she expects a good profit to make it worthwhile releasing the land for development. There may be some element of compensation if the owner intends to carry on living nearby, for loss of open space and amenity. There is the developer, who expects some gain for the effort of drawing up the plans, and seeking the permission. A developer often has to apply for several sites to get one granted, with substantial costs to produce the wealth of detail planning authorities expect. The developer expects to recoup these costs on the winner and to make an additional profit as reward for the effort. There is then the Council granting the permission, which expects to get a substantial portion of the gain to assist them with the provision of infrastructure to support the new development. They also impose charges to recoup the costs of the planning function itself.

The people who do not necessarily receive any part of the gain are all the people living nearby whose views, amenity and access to public service may be adversely affected by the development. Occasionally developers offer compensation to neighbours to smooth the passage, but it remains a minority event. The Council may claim to be acting for neighbours by claiming and spending money from the gains,but so often the extra facilities offered are the minimum needed to deal with extra demand from the new homes so they do not add to the quality of life of people already living there.

The latest way of handling this is for Councils to impose an infrastructure related levy on the development. These are very variable, and attract everything from full support to hostility from critics who think it is wrong for the permit granting body to be a kind of financial beneficiary of the permit.

Does the present system need reform? Does it get the financial balance right? Or should it be kinder to the neighbours who do not get any compensation. Do Councils spend the money wisely when they have claimed it?

How good is public capital investment?

There is in the UK debate a general assumption that all capital investment is good. It is true that the UK could boost its productivity – and therefore its incomes – by investing in more machine power, internet processing power and the like. The more people have better tools to do their jobs, the more they can produce and deliver to customers. This is the main reason people automatically assume investment is a good idea.

Not all capital spending achieves this aim. Public investment in particular may not achieve this to the extent planned in the way intended. Indeed some desirable public investment is not in anyway about raising productivity. It is about keeping up with the big growth in population we are experiencing.

Capital spending is treated differently from day to day or revenue spending because it is meant to create an asset of value which will be available for use for many years to come. If the state builds a new school, there will be many years of use. The costs of the building can be spread out over many years of teaching by borrowing the money and repaying it gradually. Making such an investment, however, usually increases future costs, as it is usually built to accommodate growth in population and pupil numbers. It is not necessarily going to raise productivity or cut overall costs. Similarly, building a replacement school may be desirable or necessary to provide a better modern environment for staff and pupils. Again it may not reduce annual costs.

In the public trading sector where people pay for use of the service provided there is meant to be a proper analysis of the productivity and revenue consequences of the investment. Unfortunately the public sector often gets its sums wrong. Look at the case of the railways. Commuters often pay the cost of their travel but other railway users are in the main heavily subsidised to go by train. Major investment programmes often fail to raise productivity much, and sometimes fail to capture the extra use and fare revenue they estimated. HS1 has never reached the optimistic forecasts for use, and HS2 looks as if it too will fall well short of the bullish estimates of how many people will use it once built.