

Stephen Littlechild



The energy tariff cap was a huge mistake and has to go

Suppliers have fled the market, leaving consumers worse off - and now an opt-in opt-out policy will make matters even worse

Back in 2013 Ed Miliband proposed a 17-month energy price freeze. David Cameron suggested it was Marxist and a gimmick. Boris Johnson called it meddling jiggery-pokery. Yet in 2017 the Conservative election manifesto promised an energy tariff cap. It was introduced in 2019 until 2023 at the latest. And now a reportedly free-market Conservative secretary of state is proposing to extend its life. How can this be?

The answer is that in 2016 the Competition and Markets Authority (CMA) claimed excess profits and inefficient costs in the energy market cost customers £1.4bn per year on average, and £2bn in 2015. Ofgem and the CMA itself advised against a tariff cap. But the £2bn "detriment" featured heavily in the 2017 election, and a tariff cap was unavoidable.

The CMA calculation was quite simply a mistake. The CMA compared actual costs against "a hypothetical construct" that was essentially "an idealised perfectly competitive market" with unrealistic costs. This was inconsistent with conventional economic analysis, with previous competition authority practice, and with the CMA's own guidelines.

So there is not, and never was, a detriment of £1.4bn to £2bn a year. Consequently, the tariff cap is simply a mistake. Rather than looking to extend it, the Government should be looking to remove it. The Department for Business, Energy & Industrial Strategy (BEIS) is worried about customers paying a "loyalty penalty" if they don't switch supplier repeatedly.

That also harks back to the CMA's world view of 2016 too, and the coalition government's steer to the CMA in 2013 that "markets sometimes fail to work effectively because consumers struggle to compare products". The CMA could not understand why many customers did not switch to lower priced suppliers.

But customers are more rational than the CMA realised. They see differences in energy product - fixed or variable, more or less green, with or without exit penalties, paper or online. They see differences between suppliers - in customer

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service, complaint rates and resolution times, vulnerability commitments, business experience, financial backing and reputation.

And they read stories along the lines of "more than a million households have seen their energy firm go bust in the last few years". Cornwall Insight found that, on average, four of the 10

lowest priced suppliers subsequently went out of business. After accounting for these differences, available price savings may be rather small.

Low income and other vulnerable customers, wishing to avoid worry by being loyal to their present supplier, are not being irrational. Reluctance to switch, and the claimed "loyalty penalty", are not the problems that they previously seemed.

Nevertheless, BEIS now proposes opt-in and opt-out switching. Even setting aside data protection issues, which are not negligible, price is not the only factor for customers, and different customers have different priorities. Is Ofgem to choose one supplier that is suitable for all customers? Should customers reluctant to switch be urged to move to suppliers with poor service records or a dicey financial situation? Or, worse still, be transferred unless they opt out? This may increase switching numbers but it doesn't seem to be in customers' own interests.

Moreover, more switching will not eliminate any "loyalty penalty". Price differentials are driven by competition. Companies have to cover their overhead costs wherever they can.

If more customers are persuaded to switch supplier, that could well increase prices to those that don't. And regardless of the amount of switching, competitive markets will not produce whatever prices a regulator thinks are "fair" (or convenient for regulators).

Repeated switching is surely inconsistent with customer loyalty. Why should firms try to provide good service and new products if Ofgem is constantly trying to take their customers away? Why should companies invest in this sector, and seek to build up relationships with customers to assist them with energy efficiency and low carbon heating, if BEIS and Ofgem are repeatedly urging them to move to another lower priced supplier? Again, it doesn't make sense.

The tariff cap has had significant adverse effects. Even before the Covid downturn, it seems to have halted the steady increase in switching since 2015. Essentially all energy suppliers are now loss-making. Suppliers are leaving the market rather than entering, often with the bailouts of their customers paid for by other customers. And this is ongoing: a recent forecast is that "a massive train crash is about to happen" with "a raft of insolvencies".

In sum, the tariff cap was a mistake. It was not the solution to a problem, and it has now become the problem. It is reinforcing a misunderstanding of the sector, limiting competition, increasing financial pressures, imposing bailout costs on other customers, and making the sector uninvestable. Opt-in or opt-out switching is not the answer: such policies could divert customers to less suitable suppliers, and will discourage investment, innovation and energy efficiency.

The aim should instead be to remove, not renew, the tariff cap, and to achieve other policy aims in more appropriate ways.

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