Control Framework for DECC levy-funded spending

Questions and Answers

8 December 2011

The control framework for DECC levy-funded spending forms part of the Government's public spending framework, which the Treasury has responsibility for. Its purpose is to make sure that DECC achieves its fuel poverty, energy and climate change goals in a way that is consistent with economic recovery and minimising the impact on consumer bills. The control framework is available to view via the Treasury website. These supporting Questions and Answers provide more information on what the control framework is and its implications for new and existing policies.

QUESTIONS

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RENEWABLE HEAT INCENTIVE

Q. Is the Renewable Heat Incentive (RHI) a levy, and how is RHI spending controlled?

Q. Which policies are covered by the control framework?

A number of government policies place the obligation of financing the policies onto energy companies, which is then passed onto the consumer. In the case of the three policies currently within the control framework, the consumer means energy bill payers. The policies are the Renewables Obligation (RO), Feed-In Tariffs (FITs) and Warm Home Discount (WHD). The Office of National Statistics (ONS) has classified the cost of the RO as a tax and the money that is spent on the renewable energy generation as public expenditure. The ONS are also considering the classification of FITs and WHD, but based on the ONS's rationale for its classification of the RO and an unofficial (and non-binding) initial view offered by the ONS, the Government judges that FITs and WHD are also likely to be classified as tax and spend and so has provisionally included them in the public finance aggregates.

Q. Why are some energy and climate change policies treated as taxation and public expenditure?

Because of the way they work. For example, the RO involves placing an obligation on energy suppliers to pay a premium to renewables generation. As this funding is mandated by the Government it is classified as public expenditure. The cost of the RO, which is passed through to energy consumers, is classified as a tax as the transfers are compulsory and not a direct payment for a good or service. The tax and spend generally net to zero automatically, with no money actually passing through Government. The final decision on which policies are judged to be tax and spend rather than regulation is made by the independent Office of National Statistics, based on the European System of Accounts 1995, and is not a decision for Government. However, Government does as standard make judgements on likely classification ahead of formal ONS decisions and provisionally reflect these as appropriate in public finance reporting.

Q. What is the purpose of the control framework?

The purpose of the control framework is to help ensure that these policies achieve their objectives cost effectively and affordably. Exceeding the spending on an ongoing basis could lead to an unsustainable increase in electricity bills, for example. The spending through the policies needs to be monitored so that we achieve our targets while managing tax and spend pressures within the economy. While we will aim to manage these policies to stay within cost limits, the control framework does provide some flexibility around these limits.

POLICY CHANGES

Q. Under what circumstances will there be policy changes as a result of this framework and will industry be consulted on policy changes?

Where a policy is forecast to overspend against the envelope, DECC will have to develop plans to bring spend back within the cap, taking into account impact on energy bills and progress towards our targets. How and how quickly these changes are implemented will depend on the various factors pertaining to the policy at the time; however, DECC will follow all required procedures such as statutory consultation and Parliamentary scrutiny.

Q. How will future policy changes affect existing investment decisions?

The Government is committed to its policy not to make retrospective changes and to maintain support levels for those existing investments where we have said we would do so. The control framework will not alter that policy, and is intended to enforce it, by ensuring that the affordability pressures of levy-funded spending policies are managed proactively to ensure they are affordable on a sustainable basis. This seeks to learn lessons from other countries where it has been deemed that support policies are no longer affordable.

Q. When a policy is reviewed, how soon will the policy changes be implemented?

If Ministers take a decision to adjust a policy, DECC will follow all required procedures, such as statutory consultation and Parliamentary scrutiny. Exactly how and when these changes will apply will be determined on a case by case basis.

Q. Will any policies, currently under review, be reviewed again in the future?

Regular review is a feature of all control framework policies. However, we recognise the importance of policy stability to provide the right incentives to secure the level of investment required to help meeting our targets.

RENEWABLES TARGETS

Q. How does the control framework work alongside the Renewables Delivery Plan?

The levy-funded policies are designed to meet our renewables targets. The control framework is designed to help ensure that these targets are met as cost effectively as possible.

SPENDING LIMITS

Q. What is the spending envelope for the policies within the Spending Review period?

LEVIES BUDGETS, £m	**11/12**	**12/13**	**13/14**	**14/15**
Renewables Obligation (adjusted)	1,750	2,156	2,556	3,114
Feed in Tariffs (adjusted)	94	196	328	446
Warm Home Discount (unchanged)	250	275	300	310
Total	**2,094**	**2,627**	**3,184**	**3,870**

Note:These spending limits reflect a technical adjustment to previously published budgets as explained below.

Technical note on Levies Budgets

The spending limit for the Feed in Tariffs (FITs) scheme as originally published (and set out in the table below) referred to **additional** expenditure on installations of less than 5MW over and above the baseline of installations that would have happened anyway (because some installations would have come forward under the Renewables Obligation (RO)). We have now incorporated that baseline into the spending limit for FITs so that it is clear what the **total** spending limit is for FITs and the RO. This technical adjustment to the published spending limits merely provides a more accurate picture of the money that was always available for installations above 5MW and for installations below 5 MW. We have not made more subsidy available for FITs or less for the RO.

Previously published levies spending limits

Spending Review Levies BUDGETS, £m	11/12	12/13	13/14	14/15
Renewables Obligation	1,764	2,191	2,615	3,203
Feed-in Tariffs	80	161	269	357
Warm Home Discount	250	275	300	310
Total	**2,094**	**2,627**	**3,184**	**3,870**

Our original cost estimates for FITs were modelled in a different way to the current cost estimates. Originally, we took as a baseline the number of renewable installations of less than 5 MW that would have come forward under the RO if FITs did not exist. The orginal cost of FITs was presented as the cost additional to this baseline – i.e. it did not include cost of installations of less than 5 MW that would have been incentivised under the RO.

During the 2010 spending review, the modelled increases in cost above baseline from the extra installations were the basis of setting the FITs spending limit, while those incentivised by the RO were included in the spending limit for the RO.

However, for some generating stations below 5 MW the eligibility criteria for the RO and FITs schemes overlap. Some generators, therefore, have a one-off choice to accredit under either the RO or the FITs scheme, and there is uncertainty as to whether these installations will take up the RO or FITs. In making the above adjustment we have made the assumption that it is more likely that installations of less than 5MW in size will take up FITs rather than the RO, and have included all spend from installations of less than 5MW under the FITs spending limit, and taken it out of the RO spending limit. This is purely a technical adjustment in order to provide a more accurate picture of the spending limits for each policy and, as can be seen from the *Totals* row, makes no difference to the actual amount of subsidy available for these levies schemes.

It should also be noted that the size of this overlap and whether it is appropriately allocated to the RO line or the FITs line is not fixed because, some generators have a one-off choice and can only accredit under either the RO or the FITs scheme and the relative attractiveness of the two schemes will vary over time. We therefore expect to revisit this calculation from time to time depending what our expectations are about which scheme 50kW-5 MW installations will choose and future technology costs.

The Warm Home Discount spending limit remains the same as previously published.

Q. What happens if DECC thinks spend might be on course to exceed its envelope?

If we think that spend might be on course to exceeding its envelope (either in the short term or at some point in the future) we will consider making an adjustment to the policy, taking into account the impact on energy bills and progress towards our targets. Decisions on adjustments will be taken by Ministers at the appropriate time and will be judged on a case by case basis. A core principle through all of this is that the Government policy is to maintain support levels for those existing investments where we have said we would and not to make retrospective changes for these investments.

If Ministers take a decision to adjust a policy DECC will follow statutory and other required procedures.

Q. Will DECC be publishing details on expenditure or projected expenditure?

Ofgem publishes actual expenditure data in several publications (in the annual Renewables Obligation report or the quarterly Feed-In Tariffs updates; whether and when expenditure data on the Renewable Heat Incentive is published is yet to be determined). Ofgem will also publish an annual report on suppliers' spending under the Warm Home Discount scheme. The Office of Budget Responsibility will include their latest projections of tax and spend through DECC levies policies in their twice yearly economic and fiscal forecasts.

NEW POLICIES

Q. In the future within the Spending Review period, will other energy and climate change policies be introduced within the framework? If they will, will the Spending Review limit stay the same?

If other DECC policies are classified by the Office of National Statistics as tax and spend and yet are deficit neutral then they will fall within the control framework. How new policies are accommodated within the control framework will be determined on a case by case basis, but the general presumption is that new policies will not be introduced outside of a Spending Review process unless they would leave central projections of overall spending within the agreed cap.

It is too early to say whether the new Electricity Market Reform policies will be classified as levies and therefore subject to the control framework.

RENEWABLE HEAT INCENTIVE

Q. Is the Renewable Heat Incentive (RHI) a levy and how is RHI spending controlled?

The spending under the Renewables Heat Incentive is subject to a separate budgeting framework than DECC's levy-funded spending policies, as spending through the RHI is funded from general taxation and therefore it has a direct impact on government borrowing and debt. The RHI budgeting arrangements aim to keep annual spending to the agreed profile, but recognise that there may be some short-term fluctuations that cannot be rigidly capped. Overspends in the short-term will therefore be allowed but will need to be offset by savings below the profile in future years.

The Government is committed to its policy not to make retrospective changes and to maintain support levels for those existing investments where we have said we would. Where a policy is forecast to overspend against the cap, DECC will have to develop plans to bring spend back spending within the cap. How and how quickly these changes are implemented will depend on the various factors pertaining to the policy at the time; however, DECC will follow all required procedures such as Parliamentary scrutiny.

The agreed limits for the Renewable Heat Incentive over the period are set out in the table below.

	11/12	12/13	13/14	14/15
Renewable Heat Incentive (£m)	56	133	251	424

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