Social Market Foundation

How do you think the poverty premium affects low income families?

There is no doubt that low income households in the UK face a poverty premium for some goods and services - paying more than higher income households. This has a negative impact on the living standards (real incomes) of these households.

What is the extent of the poverty premium, in which areas of service or goods provision does it exist, and why does it exist?

Research by the University of Bristol and Save the Children suggests that the poverty premium is significant, leaving low income households paying hundreds of pounds more for essential goods and services (£490 per year in 2016, according to the University of Bristol study).

Social Market Foundation (SMF) research which builds on these studies suggests that low income households in the UK potentially face a range of poverty premiums, including:

• Using higher-cost credit due to poor credit scores.
• Not paying by the cheapest billing method - low income households are more likely to pay bills by a channel other than direct debit.
• Premiums related to where people live – for example, low income households often face higher home and car insurance costs due to living in relatively high crime areas.
• Energy-related poverty premiums – low income households are more likely to be on poor value standard variable tariffs, and more likely to be on relatively expensive pre-payment meters. In addition, they are more likely to pay extra to receive paper bills.
• Paying to access money – low income households are more likely to use ATMs which charge for cash withdrawal.
• Not being on the best telecommunications tariffs – SMF research shows low income households are less likely to switch telecommunications provider.
• Not being able to benefit from bulk discounts such as season tickets for public transport – those on lower incomes may not be able to afford the best value annual or monthly season tickets, leading to them paying more to use public transport.

What else could be done by local authorities, national government or public bodies to mitigate the situation?

Despite the potentially significant impact of the poverty premium on low income households, there is still no official, regularly tracked measure of the poverty premium and its negative impacts on UK households. This contrasts with multiple measures of income poverty.

The SMF recommends the development of a methodology that government, regulators and statisticians could adopt to quantify and track the total size of the UK poverty premium over time. We provide what we believe would be an appropriate methodology in our March 2018 report, "Measuring the Poverty Premium".

We recommend that this (or similar) methodology is adopted by regulators and government departments and reported regularly (in the same way as income poverty measures).

Without good measures of the poverty premium and its underlying drivers, policy aimed at tackling poverty risks being inappropriately targeted – for example with a focus on incomes over expenditure, and a focus on some types of price premiums (such as those in the energy market) over other relevant poverty premiums (such as those faced when purchasing insurance).

The SMF is shortly publishing a report, "Eliminating the Poverty Premium in Energy", which examines the measures policymakers can take to reduce the size of poverty premiums related to energy in the UK. The SMF expects to publish the report soon and will provide the Committee with a published version for quotation.

In the report, we recommend that policymakers consider:

•Redesigning the Warm Homes Discount (WHD) – the WHD is currently poorly designed and targeted, which means it fails to benefit many low-income households. We would like to see standardised eligibility criteria for the WHD across energy suppliers. We would also like to see the WHD provided by all suppliers.
•State energy suppliers – the report argues that there may be a role for regional suppliers to address specific local problems (such as high use of prepayment meters in some localities) and to seek to encourage inactive poorer consumers to switch. But the report also urges caution, as state suppliers will be unable to fulfil a promise of achieving the best deal in the market.
•Ensuring that the proposed price cap is time-limited, and removed once other measures are put in place to make the energy market function more effectively. In the long-run, a price cap risks becoming politicised and distorting energy prices.
•An automatic switching mechanism which automatically switches those that have been on poor value standard variable tariffs for several years onto better value tariffs. The report sets out in detail how such a scheme could be designed to meet the needs of low-income consumers.
•Ensuring that smart meters continue to be taken up equally among low-income consumers as among the wider population. If necessary this may involve targets for installing smart meters in households rather than just offering them.
•Exploring the case for ending extra charges for paper billing and spreading the costs across all consumers.
•Requiring energy suppliers to offer the same deals to PPM consumers as they do to other consumers. This would force suppliers to innovate and to work with social enterprises and technology companies to reduce the operating costs associated with PPMs. Ofgem could set a target date for such a policy, e.g. 2023.

Are there key sectors which leave low-income consumers with no alternative other than to use a premium-charging provider? If so, please say which sectors.

The extent to which poverty premiums are "imposed" varies significantly across different types of low income households - some have much more discretion in their choices than others. Degree of choice depends on a household's financial decision, decision-making capabilities and place of residence, for example.

There are several poverty premiums that are imposed on some low income households and difficult to avoid:

1) Facing higher credit charges due to having a relatively low credit score.
2) Paying higher insurance premiums due to living in a relatively deprived/higher crime area.

3) Paying more for public transport due to being unable to afford an annual season ticket.

Other types of poverty premium such as being on a poor value energy tariff are arguably more discretionary. However, such premiums can also be regarded as "imposed"; there is a growing body of academic literature which highlights the negative impact poverty has on individuals' abilities to make rational financial decisions. The stress of being on a low income can make it harder for people to make optimal decisions on things such as choice of energy provider and choice of tariff.

Further, there is evidence that suggests risk aversion can trap some low income households into certain poverty premiums. For example, focus group research the SMF undertook with low income households suggested that some are unwilling to switch energy provider because of the risks involved - and the possibility of the switch worsening their already precarious financial positions. Some were concerned about ending up actually paying more for energy, and others were concerned about the (incorrect) prospect of their electricity or gas being cut off if something went wrong with the switch.