

# POVERTY AND THE COST OF LIVING: AN EVIDENCE REVIEW

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**This literature** review examines evidence for links between poverty and the cost of living. It looks at how this relationship differs between types of goods, markets and population groups, and considers some policy options.

- JRF's Minimum Income Standard, which calculates the cost of goods and services considered essential to meet basic needs and participate in society, represents a greater proportion of the budgets of households in poverty than it does for average/high-income households.
- Low-income households are disadvantaged by having less access to 'enabling goods' such as the internet, a bank account or a car that would increase their ability to reduce costs.
- Termed 'the poverty premium', this effect is examined in relation to groups facing both specific and enhanced additional costs, such as the disabled or people living in remote areas.
- The concept of 'consumer vulnerability' in respect of an anti-poverty strategy proves useful in describing individuals or groups who cannot participate fully in today's competitive marketplace.
- Third-sector organisations have a role in responding to markets that disadvantage certain groups, for example by developing new products or by targeting support.
- The report finds that public policy, and in particular its expression through regulation, has a direct bearing on the cost of living.
- Factors such as regulated fares, the management of competition and the imposition of universal service obligations on suppliers can reduce or compensate for the poverty premium.

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# 1 INTRODUCTION

## Poverty and the cost of living: an evidence review

This report reviews the literature on the links between poverty and the cost of living. It looks at how this relationship differs between types of goods, markets and population groups, and considers the policy options.

Key points:

- The essential goods and services set out in JRF's Minimum Income Standard are in line with international conceptions of what is essential to meet basic needs and participate in society. These items take up a relatively larger share of low-income budgets.
- The price of essential goods and services has risen relatively quickly in recent years, meaning the cost of living has risen faster for those on low incomes. Some groups, such as people with disabilities and those living in rural areas, have specific or enhanced costs of living as a result of additional costs, higher prices or greater quantities.
- Low-income individuals are less likely to be 'active consumers', for example switching suppliers and shopping around. This is in part due to a lack of access to so-called 'enabling goods' that give consumers advantages in markets, such as a bank account to pay for goods in different ways, or internet access to compare prices across a wide range of suppliers, or to buy online.
- Public policy has a direct influence on the cost of living, for example through the level of indirect taxes such as VAT, direct price regulation (such as water bills or regulated rail fares), and through stewardship of competition in the market. Sometimes essential costs are reduced or compensated for by providing, for example, discounts for targeted energy customers, ensuring all can afford a basic service through the universal service obligation in the telecoms sector or money to offset specific costs such as housing and childcare.
- Third-sector organisations can play an important role by responding to markets that do not work well for all low-income households, for example through the development of new products and services, or the provision of targeted support.
- Regulators are increasingly using the concept of 'consumer vulnerability', meaning individuals in vulnerable situations that may affect their ability to engage in markets. It is a more dynamic and flexible concept than that of 'disadvantaged groups'. There are, however, concerns over how the term is used in practice, and how poverty and low income fit into this framework.

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- A range of policy options can be used to target the cost of living and its link to poverty – those that target low-income households, those that target high-cost households and those that affect the whole population but may be of particular benefit to either low-income or high-cost groups.

## How do low-income budgets differ?

The concept of ‘essential goods and services’, such as those set out in JRF’s Minimum Income Standard, is common across developed countries. In the UK, low-income households spend a higher proportion of their income on essential goods and services compared with better-off households. This means these households experience a variation in the ‘headline’ rate of inflation. In recent years, those with low incomes have tended to experience a higher rate of inflation, although this was not generally the case between the 1970s and the 2000s.

Among low-income households, there can also be a different relationship between costs and poverty. For example, some groups face ‘special’ and ‘enhanced’ costs. Special costs are those that other groups do not face, whilst enhanced costs are costs that other people do face, but not to such a large degree. For example, a disabled person with restricted mobility faces the special costs of home adaptations, and the enhanced costs of heating a home they spend more time in. Those in rural areas have special costs to some extent in the form of greater transport needs and may have enhanced costs, for example through higher heating bills.

## The ‘poverty premium’

The poverty premium is a term used to describe a situation in which people in poverty pay more for equivalent goods and services than those with higher incomes. For example, people on a low income may be required by a supplier to pay for energy through more expensive prepayment meters, or find themselves paying more because they lack banking facilities for direct debit payments, or pay higher fixed costs because of low consumption.

This poverty premium does not just affect those in poverty; nor does it consistently affect those in poverty. For example, people in poverty are more likely to live in deprived areas, where home contents insurance premiums are higher, but most people in poverty do not live in such areas, and most people living in those areas are not in poverty. The idea of a premium often relates to a greater chance of paying a higher price, often associated with something related to poverty but not necessarily poverty itself. Being in poverty may also mean lacking the resources to get around the problem – for example, being able to afford transport to a supermarket rather than relying on higher cost local shops.

There are lots of examples of the poverty premium, yet it is difficult to quantify. There have been no estimates of an ‘average’ effect or the number of households that might be affected.

## Public policy and the cost of living

Almost all economic decisions made by government and firms have the potential to affect people’s cost of living. For example, trade policies can raise or lower the price of imported goods. Planning policies can raise or lower the cost of land, and so the cost of housing.

This research identifies the policy decisions made by government or public bodies that have a direct and immediate influence on the cost of some essential items. This takes various forms including: housing benefits for low-income families for costs in some areas; restrictions on the uprating of water and rail charges; and stewardship of the market to ensure competition (see Table 1).

Government intervention can increase as well as reduce the cost of essentials. There is some debate in the literature over whether indirect taxes, such as VAT and excise duties, weigh more heavily on low-income households. These policies do not apply exclusively to people in poverty, and indirect taxation represents a smaller share of the minimum socially acceptable budget than of average expenditure – assisted by the fact that some key areas of spend, like food and energy, are subject to either no VAT or reduced VAT. Moreover, the costs of some essentials, such as food and energy, are influenced by global market factors as well as domestic policy.

**Table 1: Cost of living policy interventions relevant to people in poverty**

Category of intervention	Redistribution and compensation	Reduction and control	Market functioning
Category description	Compensation for costs incurred; includes parts of the social security or tax systems	Reduced or controlled costs (through prices or quantities that need to be consumed)	Measures that ensure the competitiveness and smooth operation of various markets
Examples	Housing (e.g. housing benefit) Childcare (e.g. childcare element of tax credits) Council tax (e.g. setting and reduction schemes)	Water (e.g. voluntary tariffs) Heating and electricity (e.g. price regulation for distribution and transmission; Warm Homes Discount; and Energy Companies Obligation) Transport (e.g. price controls on regulated fares)	Heating and electricity (e.g. tariff simplification) Food and drink (e.g. investigation into price collusion) Communications (e.g. universal service obligation, monitoring competition) Transport (e.g. competitive tendering for bus services) Financial services (e.g. investigation into high-interest loans)

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## The role of companies and regulators

Regulators are increasingly using the concept of ‘consumer vulnerability’ in their work to refer to people in vulnerable situations that may affect their ability to engage in markets. It is a more dynamic and flexible concept than that of ‘disadvantaged groups’, which preceded it. There are concerns over how it can be used in practice, and how poverty and low income fit into this framework. However, it is clearly a concept with which an anti-poverty strategy could engage since it raises the question of whether regulators should intervene in the market only for the general consumer, or whether they should intervene for particular types of consumer too.

Regulators such as Ofcom, Ofgem and the FCA are leading the field, seeking to move companies from a reactive to a strategic approach when dealing with issues of consumer vulnerability. This involves working closely with individual firms, consumer groups and other bodies to empower those tasked with addressing consumer vulnerability issues and facilitating co-ordination across regulators and companies alike.

Regulators monitoring how markets are working for different groups can also help to reveal which parts of the market are not well served and assist companies in identifying commercial opportunities for addressing cost and access issues. Further promotion of good practice among companies could also help.

As a possible type of policy, consideration could be given to the development of modern universal service obligations (USOs), which guarantee a basic, low-cost service. Whilst there is a USO in place for phone lines, there is no equivalent for internet connections. The internet is now a necessity on the basis of a Minimum Income Standard (MIS), which might act as a guide for such things.

## The role of individuals and the third sector

Governments and companies are not the only actors, however. Individuals are expected to play a role as active and informed consumers, finding the best deal for essential goods and changing suppliers. However, evidence suggests that low-income families are less likely to do this than average or higher income families.

Access to so-called ‘enabling goods’ helps people access better and cheaper deals, but the evidence suggests those on low incomes are more likely to lack these enablers. Examples of such goods include bank accounts that allow customers to pay bills by direct debit, which is often cheaper, or a broadband connection that allows for online shopping and price comparisons. Measures to increase access to enabling goods can be effective, but alone they are unlikely to be sufficient as there is also a lack of products that are well suited to meet the needs of low-income households.

The third sector has a role to play here, and there are examples of organisations responding to markets that do not work well for low-income households, for example through the establishment of food projects and community energy projects. In some cases, new products have been developed to better serve the needs of certain groups, including low-income households. Such interventions have sometimes led to product innovation by mainstream providers, creating more competition and choice.

## Recommendations for an anti-poverty strategy

To address the cost of living as part of an anti-poverty strategy requires engagement with a range of actors including companies, regulators and third-sector organisations. Public policy alone cannot address the issue.

There are also tactical decisions to be made about how an anti-poverty strategy should approach cost of living issues. Table 2 presents two types of household – low income and high cost – and indicates whether the policies that could be applied are specific to the households in the group or whether they apply generally but with a greater impact on those on a low income.

**Table 2: Policies applied to low-income and high-cost households**

	<b>Low income households</b>	<b>Households with specific higher costs</b>
Examples of costs specific to the group	<b>A</b> Cuts in public subsidies and discounts targeted at low-income families	<b>B</b> Costs associated with disability or living in rural areas
Examples of costs affecting whole population that affect the group disproportionately	<b>C</b> Uprating of transport and water costs, consumption taxes	<b>D</b> Costs associated with consumer vulnerability or lacking enabling goods

Much activity and campaigning against poverty focus on group A in Table 2, but there is a need for greater focus on special and/or enhanced costs (group B), among whom low-income households may be over-represented. There is also a case for thinking about costs that affect the whole population but have a greater impact on those with low incomes or higher costs (groups C and D). This may be a way of building a broader coalition for action.

A focus on subsidies, notably the cost of housing and perhaps childcare too, remains crucial but is not enough. Both government and its critics focus on these subsidies. An anti-poverty strategy needs to develop principles that create an intermediate position in which the concerns of both sides can be heard.

Moving beyond this, problems of cost require thinking to develop in three directions. The first is through attention to groups facing special and/or enhanced costs, for example those arising from long-term sickness or disability or those incurred, say, by residents in rural areas. Identification and measurement of these costs will often require close attention to the interplay between private service providers, public subsidy (e.g. in the case of rural public transport) and regulators.

The second development is to turn the focus on those general costs with a disproportionate impact on low-income households. It should not be forgotten that today's attention to poverty is built on a long record of measurement, starting (arguably) with the Rowntree Income and Wealth Study in the early to mid-1990s. Progress will require evidence, both statistical and relating to the institutional framework that drives these costs. While some of these will relate to the operation of free markets (rising world demand), it will be necessary to identify the role of public policy (and private sector reactions), from planning to tax, and to include the 'rules' by which certain administered costs (e.g. regulated rail fares, network energy costs) are allowed to rise.

The third development is toward costs that are higher due to some other disadvantage experienced by particular households (and perhaps

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at particular times). One way forward could be to investigate how far the regulators' emerging concept of the 'vulnerable consumer' could be shaped to serve anti-poverty purposes. Another could be to develop the concept of the enabling good – possession of a bank account, access to high-speed internet, access to good, reliable transport.

All these ideas have potential. Thinking about how consumers, companies and regulators interact – quantifying the losses associated with lacking an enabling good, for instance, or not switching utilities – could help identify candidates for modern USOs and develop a basis for challenging regulators (including planning authorities) over the way they conceive and evaluate customer needs.

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# 2 SCOPE: WHAT COUNT AS ESSENTIAL GOODS OR SERVICES?

## Introduction and summary

The 'cost of living' is generally thought to refer to the prices of those goods and services considered essential to day-to-day life. In order to examine its impact on poverty, it is necessary first to decide what it includes. This chapter presents a review of what goods and services are defined as essential, both within the UK (Section 1.2) and abroad (Section 1.3) It then looks at who creates the definition and what, if anything, it is used for. The UK Minimum Income Standard (MIS) is the reference point with which these different definitions are compared.

The main findings of this chapter are as follows:

- MIS does not differ substantially from most international measures. Having categories for social and cultural participation and holidays puts it in the mainstream of such measures. The omission of health spending reflects that, in the UK, most health care is free at the point of delivery.
- MIS is less generous than some other 'full inclusion' standards as it does not count money set aside for savings as essential.
- Where other countries differ is usually as a result of the intention and methodology of the measure (for example, in the USA, the Self-Sufficiency Standard excludes spending to participate in society) or a reflection of public policy differences (most other countries have no equivalent to council tax).

## Essential goods and services in the UK

A description of what the cost of living comprises depends on the selection of goods and services that are regarded as essential to everyday life. There are various methods for doing this, including: selection by experts, consensual measures (based on what people deem essential), and selection on the basis of recorded expenditure patterns.

There are no official measures or definitions, but two widely used measures in the UK are the Minimum Income Standard (MIS) and the

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Necessities of Life Survey (NLS; currently managed by Poverty and Social Exclusion). MIS is a reference budget approach involving consensual discussion of necessities, with expert input for certain aspects such as nutritional value. It creates a minimum for social participation, rather than a 'low-cost but acceptable' budget. The NLS undertakes polling to assess what a majority of the public consider to be a necessity, and then use a follow-up survey to quantify how many people lack these necessities. The NLS was conducted in 2012 for the first time since 1999 (Gordon et al, 2013).

This review will focus primarily on operationalising the categories contained in MIS. We choose MIS because it constructs a budget with categories of expenditure, which allows for easier international comparisons and assessment of the actual cost of meeting needs.

### What is the Minimum Income Standard?

MIS is defined as 'the income that people need in order to reach a minimum socially acceptable standard of living in the UK' (Hirsch, 2013b:8). It is relevant to the cost of living as it considers only those goods and services deemed by focus groups to be necessary for participation in society. The research involves groups of participants from mixed socio-economic backgrounds engaging in discussions around what constitutes the minimum income for a detailed budget that would permit inclusion in society, with expert checking to ensure it meets, for example, nutritional standards. The full methodology is available in Bradshaw et al, 2008.

### What are the MIS categories?

The household budgets comprising a minimum according to MIS derive from a list of goods and services, classified in the following categories:

- food and drink
- clothing
- household goods and services (including telecoms service, household items, furnishings, and internet connection where appropriate)
- personal goods and services (including healthcare and toiletries)
- transport (public and car where appropriate)
- social and cultural participation (entertainment and holidays)
- housing (includes rent, insurance, energy and water bills, council tax)
- childcare.

Table 3 shows the breakdown of these categories as a proportion of the MIS budget for four family types for 2013.

**Table 3: MIS expenditure on essentials for four main family types**

	Single adult	Couple no children	Lone parent one child	Couple two children
Housing	40%	32%	36%	28%
Food and drink	20%	26%	17%	20%
Social and cultural participation	17%	19%	12%	18%
Transport	8%	7%	13%	13%
Household goods and services	6%	5%	8%	6%
Personal goods and services	4%	6%	8%	8%
Clothing	4%	5%	6%	7%
Total budget	273.85	395.90	365.95	558.04
Childcare amount	0.00	0.00	158.61	156.57

Source: Hirsch, 2013b

For every family type, the largest components of expenditure are rent, and food and drink. Childcare is also potentially very significant for families with children, although in practice these families would be likely to receive support through tax credits. Also substantial are the costs of social and cultural participation and transport.

### How have MIS categories changed over time?

As a consensual budget standard, the categories of goods and services considered essential in MIS are prone to change over time as those focus groups who help determine the standard reflect society's changing norms. Since MIS was established in 2008, there have been some changes to the composition of the basket, which have affected the measurement of the cost of living.

In the first report, a computer and an internet connection were only considered necessary for families with children in secondary education. In the 2010 review, however, they were considered necessary for all families with working-age adults (Davis et al, 2010), and since 2014 apply to all household types. Contract mobile phones were also included in the budget in 2010 if part of a package with the internet and landline, although pensioners are only considered to need a pay-as-you-go phone.

In the 2012 rebasing of MIS for families with children, cars became considered essential. This reflected a tipping point in opinions on an issue that had been previously a matter of dispute (Davis et al, 2012:17). The annual cost to a lone parent family with one child was around £2,480 and £3,100 for a couple with two children, though there were partially compensating reductions elsewhere. In 2010, a computer with an internet connection became considered essential for all non-pensioner households. This involved a net increase for non-pensioner households without secondary-school-aged children of between £110 and £360 a year. There were reduced phone costs with this, which meant there was a slight decrease for families with secondary-school-aged children.

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## Essential goods and services internationally

### How do other countries define essential goods and services?

Essential goods and services are defined in a variety of ways internationally and the differences between these and UK descriptions become clear when examining the goods, services and categories used in different budget standards. There are detailed budget standards such as the UK MIS, or broader categorical measures such as the Swedish 'household budget for a reasonable level of living'. Additionally, they can vary methodologically: the UK MIS is a consensual budget measure, whilst others use expert selection or consumer expenditure patterns. Another important component is the level of 'essentialness' desired. Budgets can be intended as 'modest but adequate', 'low-cost but acceptable' or even simply 'family survival' (Fischer, 2007). An alternative categorisation offered by Fischer is that of subsistence standard budgets compared with full inclusion standards (Fischer, 2007:10).

What should be included in the assessment of the cost of living does not vary substantially between different countries. Table 4 summarises the countries considered. The typology used is:

- full inclusion standards: those that cover all the goods and services considered necessary for meeting basic needs including participation
- basic inclusion standards: more limited budgets that have some reference to participation but exclude other areas of spending
- subsistence standards: budgets that exclude participatory spending.

This categorisation represents the type of budget, whether it is intended to reflect the income necessary to participate fully or partially in society, or whether it is limited to the amount needed to meet physical needs. Many of the studies differ methodologically and would not be comparable, for example, in terms of the final budget figure. However, the interest here is in the broadest categories. Within a given type of budget, the main differences are usually public-policy related.

The organisations that create budget standards do so for varying purposes. (Some do so in order to create a socially acceptable minimum, like the UK MIS and those standards used in Ireland, Japan, The Netherlands and Finland). Others can be as a reference for consumers or the government (e.g., Sweden, Norway and the US Self-Sufficiency Standard), or as a type of poverty measure (as with the American EPI budget).

**Table 4. Comparison of different budget standards internationally**

Country	Type of budget	Conducted by	Purpose	Notable features
Republic of Ireland	Full inclusion standard	Voluntary sector/ academics	Social minimum	Savings, donations and union fees included, internet not essential for all working-age families
Japan	Full inclusion standard	Academics	Social minimum	Includes lifelong education
Sweden	Basic inclusion standard	Government agency	Reference for social security	
Norway	Basic inclusion standard	Government agency	Reference for consumers and government	Basic inclusion budget (includes some participatory spending); does not include holidays, health, housing or energy
The Netherlands	Full inclusion standard	Voluntary sector	Social minimum	Includes savings and health insurance
Finland	Full inclusion standard	Government agency	Social minimum	Very similar to the UK, healthcare insurance included
USA (EPI)	Basic inclusion standard	Think tank	Supplement poverty measure	Fewer categories, bundled as a share of food and housing costs
USA (Self-Sufficiency Standard)	Subsistence standard	Voluntary sector	Short-term 'survival' budget	Excludes participatory spending altogether

### Republic of Ireland

The minimum income standard in Ireland is based on the consensual budget standard method also used by the UK MIS (Collins et al, 2012). The Irish MIS is largely consistent with the UK MIS in terms of both categories and content, though there are some differences.

Some of the differences reflect differences in public policy between the UK and Ireland: for example, healthcare insurance is an essential good in Ireland except when there is eligibility for a medical card (Collins et al, 2012:49). Additionally there is no equivalent local government tax.

There are categories included that do not appear in the UK. Savings are considered essential for a minimum standard of living and life assurance<sup>1</sup> for households with dependants. There is also a category for personal costs, which are donations to charity (although pensioners have an amount for

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donations in their budget in the UK) and the cost of trade union membership for households in employment. The separate consideration of households in employment is another departure from the UK MIS (Bradshaw et al, 2008).

In one respect the Irish MIS is more limited: a computer and internet connection are considered essential only for households with an adolescent in secondary education. This was the case for the UK until the 2010 review. This does not reflect an earlier timing of the Irish MIS, as these were reviewed in 2012.

### Japan

The Japanese MIS was again constructed along the lines of the UK version, using a consensual budget standard. As Davis et al (2013:S1) note, there are 'notable differences' as well as 'striking similarities' in the budgets constructed.

The formulation of what constitutes a minimum in Japan differs from that in the UK or Ireland, as it also includes 'solid future prospects', a temporal dimension. This led to the only major category difference, which was that social and cultural participation in Japan includes lifelong learning. This is considered to be a reflection of the public policy emphasis on continuing education in Japan (Davis et al, 2013:6-7).

There were also differences in the composition of the budgets. For example, Japan has higher food expenditure and lower transport expenditure.

### Sweden

Essential goods and services in Sweden may be understood in practice from the 'household budget for a reasonable level of living', which informs social assistance provision (Veit-Wilson, 1998: 57). The budget is referred to as the national standard, which comprises part of Swedish social assistance, along with more discretionary additional expenses.

The national standard includes food, clothing, some leisure expenditure, household goods and television license fees. Reasonable expenses can be covered for housing and energy costs, insurance, and trade union fees. It can also include medical expenses and travel to see children.

This is narrower than the UK MIS, in the sense that expenditure for items such as holidays or travel is not included. This may reflect the fact that their inclusion would have consequences for public finances, given that it helps set social assistance amounts.

### Norway

The Norwegian standard budget is designed to be more restrictive than some of the other examples considered. Its interest is in calculating a budget for a 'reasonable level of consumption' that is 'acceptable to most people' (SIFO, 2011:1). It is intended to meet health standards or a basic level of social inclusion.

It is calculated by experts in various consumption areas rather than the consensual measure used by other standards. In contrast to the UK, it omits housing costs, or things such as holidays, gifts or the celebration of special occasions.

### The Netherlands

The National Institute for Family Finance Information in the Netherlands (Nibud) has created reference budgets since the 1980s, but in 2010 created a budget using the consensual budget methodology used by the UK MIS (Hoff et al, 2010). The previous budgets were basic in nature (subsistence

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standards) as they excluded participatory spending. The 2010 budget rectifies this through four focus groups looking at what is essential for a family just above the poverty line. It differs from the UK in terms of the inclusion of health insurance and some money for savings, but otherwise reflects the UK MIS in terms of categories.

### Finland

The reference budget for Finland is a consensual budget standard, designed to establish a 'decent minimum standard of living' (Lehtinen et al, 2011:1). It corresponds very closely to the UK MIS in terms of the categories of goods selected. Here, the differences correspond to public policy again: medical services are included, whilst there is no council tax equivalent. Childcare is excluded for methodological reasons, as the cost is dependent on the income of the family (Lehtinen et al, 2011:12). There are also clear similarities; for example, cars are considered essential for families with children.

### United States

The Economic Policy Institute (EPI) Family Budget Calculator is an expert-based measure of an 'adequate but modest' budget, with additional input from consumption data (Gould et al, 2013).

The key differences between this measure and the UK MIS are that there is a considerable healthcare component (both insurance premiums and out-of-pocket costs) and that a car is considered necessary for all family types.

The budget is categorical rather than detailed, and so, whilst it includes housing, food, transport, childcare and health, all other expenses are rolled into 'other necessities', for which income is allocated as a proportion of food and housing costs.

The Self-Sufficiency Standard is a measure maintained by the Center for Women's Welfare, originally as a goal for self-sufficiency whilst on a federal jobs training programme (CWW, date unknown). It represents a much narrower measure than the UK MIS, as it explicitly excludes any budget for recreation or entertainment (or savings or debt repayments). The other categories are also restrictive. Fischer notes that the Self-Sufficiency Standard has been called a 'basic family survival budget' and so 'somewhat stringent' (Fisher, 2007:7).

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# 3 CONCEPTS: THE RELATIONSHIP BETWEEN COSTS AND POVERTY

## Introduction and summary

This chapter considers a broad range of questions on the relationship between costs and poverty. Section 2.2 focuses on the concept of the 'poverty premium'; the extent to which those on low incomes pay more than households on average for the same goods or services. This is followed (Section 2.3) by a review both of how the budgets of low-income households differ from those on average and how increases in costs over recent years have differed between these low-income and average-income households. Factors driving the increase are examined next (Section 2.4), followed by an assessment of factors adding to the cost of living (but not necessarily driving recent increases). The chapter concludes with a review of the particular low-income groups for whom the link between the cost of living and income is likely to be markedly different from the norm.

The main findings of this chapter are:

- The poverty premium is the idea that 'the poor pay more'. It often takes the form of people in poverty facing a higher risk of paying more for a certain good. Often this risk is associated with a correlate of low income, such as living in a poor area, rather than with low income itself, as in the example of home contents insurance.
- The theoretical basis for the premium is clear, but the evidence is not comprehensive. There has been no calculation of the average premium paid by people in poverty.
- As a share of spending, low-income households (in the poorest fifth) spend more on food, water and fuel (around a quarter of total expenditure) than other households (around one-fifth for those on average incomes).
- While prices overall, as measured by the Consumer Price Index (CPI), have risen by 20% over the five years to 2014, food rose by 30% and fuel by 60%. The difference in spending shares (above) means that these increases hit low-income households harder. This is the opposite of the 1990s when prices of essentials were rising more slowly than average.

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- Consumption taxes (including VAT) account for 28% of the share of income of households in the poorest fifth compared with 19% in the middle and 14% at the top. Consumption taxes are less regressive if measured by expenditure rather than income.
  - Certain groups of low-income households can face higher costs, whether because they must incur 'special' costs that others do not, consume more to achieve the same standard of living ('enhanced' quantity) or pay higher prices ('enhanced' price). Those who are disabled, live in rural areas, lack a car or lack the internet face special and enhanced costs. Those living in poor-quality accommodation face enhanced costs.
  - Some of these situations (such as the increased costs for some goods and services faced by those in rural locations) apply to both low-income and high-income households, but others (such as a lack of a car or an internet connection) are more likely to affect low-income households than high-income households.

## Poverty and the cost of living

The definition of poverty used in this evidence review is that poverty is a situation in which the (mainly material) resources of an individual are not sufficient to meet their needs. These resources are mostly financial, but can also include services such as free healthcare. The needs are those required to participate in contemporary society, and so are broader than just sustenance and shelter. This is the definition used in the development of JRF's anti-poverty strategy.

The cost of living here represents the costs associated with meeting these needs. At the most basic level, the costs of these needs are determined both by the price of the essential good or service and the quantity of it required. For example, in the case of heating, there is the price of a unit of energy supplied as well as the amount needed, which can depend on the individual (for example, disabled individuals often need warmer homes as a result of immobility) and other factors (such as the energy efficiency of the home).

The fundamental relationship between poverty and the cost of living is that if the cost of meeting needs increases faster than resources (primarily income, but potentially the value of public services), then, everything else being equal, there will be an increase in the depth of poverty experienced or an increase in the number of households experiencing poverty.

But the relationship is deeper than this because poverty interacts with the cost of essential goods and services in many ways. Some of these different characteristics are the result of low incomes and tight budget constraints, whereas others may be the characteristics of those who make up low-income groups.

The constrained opportunities of those in poverty can lead to households facing higher prices for goods than is normal (the 'poverty premium'). It can also mean an absence of additional goods or services – 'enabling products' – that would reduce other or future costs (such as internet access or insurance). Low incomes also reduce the scope for substitution (if a high share of income is spent on essentials), or lead to substitution with low-quality products (such as less nutritional food). These can be compounded by problems of poor information. It may also cost more for firms to supply certain services to those in poverty.

## Poverty premium

The poverty premium (or poverty penalty) refers to those with lower incomes paying more for the same goods and services than those with higher incomes would. Save the Children (2007; 2010) note that the poor can pay more (through higher prices) for energy (as a result of relying on pre-payment meters, or PPMs), credit, insurance, and on rent-to-buy goods. Money for Life with Family Action (2013:10) use polling that suggests that those on lower incomes are more likely to use rent-to-buy services for goods. It is important to note however that the poverty premium does not necessarily apply across all categories of essential expenditure for all low-income consumers.

Table 5 offers a classification of poverty premiums. This draws on Hirsch (2013a:19--22) and other sources noted.

**Table 5: Classification of types of poverty premiums and suggested causes**

Type of premium	Causes
<p><b>More expensive utility tariffs (1).</b> Being on a payment method with higher charges (such as PPMs (Hirsch, 2013a))</p>	<p>The cause here may be risk aversion (preferring the certainty of PPMs to a direct debit). Those on low income or with low wealth are considered to be more risk averse than those with higher material means (e.g. Diaz-Serrano &amp; O'Neill 2004; Dohmen et al, 2009). This is because the consequences of taking a financial risk are higher, as with a limited budget any negative impact is a bigger proportion of income and may overwhelm any discretionary income and thus cut into essentials. Consumers with arrears may also be transferred onto PPMs.</p>
<p><b>More expensive utility tariffs (2).</b> Being on a suboptimal tariff for a given payment method (Hirsch, 2013a)</p>	<p>Ofgem has noted that those on low incomes are more likely to switch as a result of direct sales activity (and so not compare prices), are less likely to have access to the internet for making comparisons, and more likely to be unable to switch tariffs due to having existing energy debt (Ofgem, 2008:11). This is discussed in more detail in Section 3.</p>
<p><b>Low consumption, paying more.</b> (Hirsch, 2013a)</p>	<p>This is a reflection of what might be called 'size effects.' Pricing involves a mixture of fixed and marginal costs. In general, those with low income and low usage are penalised by a higher share of fixed costs. For small quantities of a good or service, the fixed cost makes up a larger share of the price. Increases in quantities incur only the marginal cost, thus reducing the average cost as consumption increases. This can take multiple forms, for example, bulk buying is often cheaper per unit, but for budget-constrained individuals, it can be difficult to take advantage of this.</p>

<p><b>Additional charges for transaction method.</b> (Hirsch, 2013a)</p>	<p>It is often cheaper to pay utility bills via direct debit; however, as noted above, those on low incomes tend to be more risk averse and because direct debits withdraw an amount set by the supplier. For online transactions, there is also an element of cost reflectivity, as the supplier does not need to send letters.</p>
<p><b>Expensive credit.</b> The cost of credit to low-income households can be very high (Hirsch, 2013a; Hartree and Collard, 2014)</p>	<p>Low income is often associated with poor credit ratings, which can lead to exclusion from mainstream financial services. This is linked to, though separate from, the problem of low-income households turning to high-cost credit to afford everyday items, which is a problem of inadequate income.</p>
<p><b>Higher insurance.</b> Those in poorer areas often face higher insurance premiums (Save the Children, 2007;2010)</p>	<p>As Save the Children note, those in low-income areas can face higher charges for home contents and car insurance than those in high-income areas because of the higher risk (2007:5).</p>
<p><b>'Food deserts.'</b> This refers to areas of limited food availability, such as those areas with only convenience shops</p>	<p>The problem of only being able to shop at smaller shops, which tend to be more expensive, is primarily a problem of mobility. Thus the lack of a car or adequate public transport means cheaper sources are inaccessible.</p>

The unifying theme for the premiums listed in Table 5 is that they are associated with and particularly consequential for those on low incomes. Not all of these are limited to those in poverty and may not be the consequence of poverty. But in all cases, low income increases the consequences and reduces the scope for mitigation. For example, 'food deserts', to the extent that they exist, are essentially a problem of mobility rather than low income. But low income means it is more difficult to, for example, hire private taxis to get around the problem.

Similarly, in the case of higher insurance costs, those with low incomes are more likely to live in deprived areas, but only 38% of those in the 10% most deprived areas are themselves income deprived (DCLG, 2011:3). The 62% of people who are not in low-income households are equally affected by these higher costs.

To reiterate, the poverty premium often results in people in poverty facing a greater risk of paying a higher price, often because of some other factor that correlates with poverty.

### Measuring and estimating the poverty premium

There are clear difficulties in estimating the poverty premium. It is contingent on household or personal characteristics such as income, tenure, household energy efficiency, internet connection, family size, consumption choices, and risk aversion, as well as market structures and the actions of relevant suppliers. Several studies have attempted to look at the potential size of the poverty premium, but not the numbers affected. Europe Economics and New Policy Institute (2010:23) note that the evidence for a poverty premium for food is inconclusive.

Hirsch (2013a) estimates the poverty premium related to utilities for different household types as a proportion of the income required to meet the minimum budget for MIS. He looks at two types of poverty premium,

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on the basis they are relatively widespread and clear cut: higher tariffs due to a failure to be on the best tariff, and the high cost of credit for durables (Hirsch, 2013a:23–27). As a result, the variation between household types to an extent depends on how much of the budget is spent on utilities and the energy efficiency of the dwelling. The result is that the premium can add between 5% and 10% to the minimum budget.

Alternative illustrations of the effect have been calculated by Save the Children (2007, 2010). In 2010, the illustration of a poverty premium given is almost £1,300, as a result of high-interest credit, charges for cashing cheques, inefficient energy payment and higher insurance premiums based on area. This appears to be a maximalist approach for calculation, for example, including the rather infrequent event of purchasing a new cooker. It cannot be taken as an average poverty premium, and the fact that this could not be done says a lot about how hard it is to pin down the poverty premium.

There is some limited international evidence on the poverty premium. The French equivalent is *la double peine* ('double penalty', where poverty itself is the first penalty, and the associated higher costs the second). A study by the Boston Consulting Group for the action tank *Entreprise et Pauvreté* found no evidence of a poverty premium for transport or food, but for other areas of consumption a penalty of around 2.5% of income (Dalsace et al, 2012). This rises to 8% for some family types. The research used expenditure data to calculate a median unit purchase price (including, for example, rent per square foot of accommodation), compared with the budget spent by customers in poverty. The poverty premium here includes rent and healthcare based on more restrictive insurance. Rent accounts for around just under one-third of the average effect.

There has also been research in the US, on what Fellowes dubs the 'poverty opportunity' (2006:10). There is evidence that those on low incomes in the US tend to pay more for food, housing (through mortgage interest rates), utilities, transport and financial services. No attempt is made to get a total for either the premium or the numbers affected, but Fellowes notes that they could add up to hundreds or thousands of dollars a year (*ibid.* 2006:4). A study by Broda et al (2009) found no evidence of the poor paying more for the same food products. This research had access to more detailed data than others as it enabled household characteristics to be matched with the precise goods bought. The poor generally paid less for the same products than those with higher incomes (the very poorest – those on US\$5,000 to US\$7,999 a year – paid slightly more than others with low incomes). The reasoning was that the poor are more likely to take advantage of offers and shop around, and shop costs such as rent are often lower in poor areas (Broda et al, 2009:85).

This selection of international evidence suggests that the poverty premium could potentially be a broader concept (with the application to living space in France, for example). However, the risk is that the concept becomes diluted and simply notes that the truism that the poor cannot afford the same standard of services as those with higher incomes. In general, whilst examples of the poverty premium are easy to devise, quantifying the extent of the average premium for a family in poverty is a more difficult task.

## How do low-income budgets differ from average budgets?

### Differences in budgets and their costs, by income quintile

Consumption patterns among low-income households differ from those of average income households in certain key respects. Table 6 shows expenditure shares across 10 different categories for a household in the bottom fifth and a household in the average fifth of incomes.

**Table 6: Expenditure in low-income and average-income households**

	Bottom income quintile	Middle income quintile
Food & non-alcoholic drinks	16%	13%
Alcoholic drink and tobacco	4%	3%
Clothing	5%	5%
Net rent	11%	7%
Water supply	3%	2%
Fuel	7%	5%
Mortgage	6%	9%
Other housing	1%	1%
Household goods & services (inc. communications)	10%	9%
Motoring	7%	11%
Transport fares	2%	2%
Recreation and culture	9%	13%
Restaurants and hotels	7%	8%
Miscellaneous goods and services (including education and health)	9%	10%
Other expenditures items	3%	4%

Source: Living Costs and Food Survey, 2013

Food and fuel take up a greater proportion of expenditure among low-income households (16% and 7% of the total respectively) than among the average-income household (13% and 5% respectively). They spend less on recreation (9% compared with 13%) and motoring (7% compared with 11%).

This different expenditure pattern also means that low-income and average-income households experience different rates of inflation. In recent years, this has been higher for low-income families than for families on average incomes. Hirsch et al (2011b:8) refer to this phenomenon as a 'new inflation environment' in contrast to the experience of the 1990s, where essential goods and services rose less quickly than average. Adams et al (2014:136) note that whilst CPI has increased by 20% between 2008 and 2013, categories that make up a larger share of the budget of those on low-income such as food and energy have increased faster, at 30% and 60% respectively.

There have also been compensating factors for higher income households in recent years, as the decline in mortgage interest repayments

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in 2009 reduced the average inflation rate for the highest income quintile by 0.6 percentage points, compared with 0.2 for the lowest income quintile (Adams et al, 2014:139).

This higher inflation rate for lower income groups applies over the last decade as well: Levell and Oldfield (2011:31) note that over the period between 2000-01 and 2010-11, the average annual inflation rate declines with income from the second decile to the top. However, a longer term view before this period, from 1976 to 2000, finds that those on lower incomes faced a below-average inflation rate in this period (Crawford & Smith, 2002:14).

These studies by various IFS researchers do not allow for any sort of poverty premium: they assume that all households face the same prices for the same goods, but that inflation differs for different groups simply because different households have different expenditure baskets. An alternative method for calculating inflation for low-income households is to consider how the cost of living has increased on the basis of the changing price of a basket of essential goods.

The use of the Minimum Income Standard (MIS) enables this analysis to be carried out. This has the advantage of providing a reference budget for what the general public consider essential, rather than what is spent: on sufficiently low incomes, not all that is essential may be afforded, thus underweighting the importance of that item of consumption. Hirsch (2013b:12) finds that the price of a minimum basket of goods for a single person rose 45% between 2003 and 2013, whilst consumer price inflation rose by 30%, thus making the minimum basket relatively more expensive by 12%. The largest increases above CPI were for lone parents and couples with one child, followed by lone parents with two children.

## Factors driving increases in the cost of living

Almost all economic decisions made by government have the potential to impact on the cost of living of people in the UK. Trade policies can raise or lower the price of imported goods. Planning policies can raise or lower the cost of land, and so the cost of housing, for example. Longer term policies such as investment in research and development and education could lower the costs of goods at some point in the future.

The focus of this research is the public policy decisions made by government or public bodies that have a direct and immediate influence over costs. In this context, public policy influences are those decisions made directly by the government (such as on taxation), or those made by public bodies with statutory obligations in a relevant areas (for example, the price-setting undertaken by Ofwat). Some of these are clearly quite significant in influencing the cost of living.

### National and local government uprating policies

#### *Public transport fares*

Government sets the legislation that determines the pricing of certain public transport fares. In the case of rail travel, regulated fares<sup>2</sup> since 2004 have been limited to RPI+1% (just RPI for 2014), though this is an average and they can be varied by up to 5% across services (2% in 2014) (Keep, 2013). The long-term trend has been to shift the costs of use from taxpayers to service users: the government had previously intended to increase fares from 2012 by RPI+3% (Butcher, 2014). In the case of bus travel, prices

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are set by the commercial operators who have won tenders from local authorities, although there are a series of different subsidies. Reductions to one of these subsidies, the Bus Services Operators' Grant, will see average fares increase by 1%, or 2% in rural and larger metropolitan areas (Butcher, 2013:10).

Hirsch et al (2011b: 8) note that non-car travel prices increased by around 50% in both the 1990s and the 2000s. In contrast, RPI rose by 31% in the 1990s and 25% in the 2000s. Transport is relatively less important in terms of expenditure for those in the bottom quintile of the income distribution: around 12%, compared to over 16% for the middle quintile (Adam et al, 2014:135). Public transport represents a smaller share of the MIS budget for families with children as they mostly use private transport, but is around 11% of the total budget for a single working-age adult (Hirsch, 2013b:15).

#### *Water charges*

Water charges are set either as a fixed charge based on the rateable value of the property or are metered. Water bills are uprated on a supplier-by-supplier basis according to the formula  $RPI + K$ , where K is an additional measure set by Ofwat on the basis of the business plans of water companies for investment, operating and return on capital considerations<sup>3</sup>. This K factor has previously been negative, with the former director general of Ofwat at the time noting that there is a case for this to take into account average living standards (Byatt, 2012). Water bills have increased by around 50% above RPI inflation since privatisation (Tinson & Kenway, 2013:9). On the CPI measure of inflation, they have increased by almost 30% since 2008. It is, however, a small share of MIS (around 3% for a single adult).

#### *Social rents*

From 2002 onwards, government policy has been to synchronise social rents between local authorities and registered social landlords. As such the guidance for this has been a maximum rent increase of  $RPI + 0.5\% + £2$  per week (Wilson, 2014). It is intended that rents will subsequently rise from 2015-16 at a rate of  $CPI + 1\%$  for the following 10 years, though some councils were counting on the previous price-setting continuing and there are concerns that construction of new homes might be hit (Wilson, 2013:21). Housing benefit insulates many low-income families from these rises, but will increasingly fall short of the total rent.

#### *Private rents*

The Local Housing Allowance (LHA) is a benefit paid to those with privately rented homes. There have been several changes that mean it covers less of total housing costs than before: in April 2011, LHA was capped at the 30th percentile rent of each Broad Rental Market Area, rather than the 50th percentile rent cap that preceded it. Since April 2013, it has no longer increased in line with local rents, but CPI inflation or 30th percentile rents, whichever is lowest. In 2014-15 and 2015-16, in most areas it increased only by 1%, although some of the savings from this are to be used to increase the cap in areas at risk of becoming unaffordable (DWP, 2013b:3).

#### *Council tax*

Council tax is based on rateable property value, and varies across local authorities. Council tax increased very little in the 1990s, but by over 60% in the 2000s (Hirsch et al, 2011b:8). Since 2010, government policy has been to encourage councils to freeze council tax (increases above 2% require a

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local referendum). The exception is that there has been an effective increase for some of those with low incomes, as the localisation of council tax means that 71% of councils now require all working-age households to pay at least some council tax (Bushe et al, 2013). Council tax is around 7% of the MIS budget for a single adult. In Scotland, council tax has been frozen in nominal terms since 2007-08, whilst in Wales council tax has increased above inflation. Domestic rates in Northern Ireland have increased only by inflation. The three devolved administrations have not made changes to their council tax support or rate relief schemes.

### Global market influences

In this section, we look at some examples of global influences on the cost of living. This section cannot be comprehensive. We look at food and energy costs to demonstrate that, for some essential goods, fluctuations in price are due to international effects.

Hirsch et al (2011a) note that there are four major MIS categories that are subject to global market influences: food, fuel, household goods and services, and clothing.

#### *Food*

The cost of food is affected not just by the cost of raw ingredients but by a range of factors in the supply process. Around 47% of the value of food consumed in the UK in 2012 was produced abroad (Defra, 2013:24). The importance of global commodity prices became apparent in August 2008, when UK food price inflation hit around 13%, with large increases in other countries (Ambler-Edwards et al, 2009:8). The long-term trend in global agricultural prices is expected to increase as a result of a number of factors such as growing demand and resource pressures, including energy prices (OECD-FAO, 2011:3). Hirsch et al (2011a:20) note that the prices of final products, such as bread, are less volatile than individual components, for example wheat, but the long-term pressure is still upwards on food.

#### *Energy*

Around 47% of the average household dual-fuel bill comes from wholesale costs, the part of the bill affected by global influences (DECC, 2013a). Hirsch et al (2011a:24) note that the long-term trend indicates an increase in domestic fuel prices with both global and domestic policy influences contributing. For example, DECC's central projection for gas prices is that they will increase by 20% between 2012 and 2018 (DECC, 2013b:6).

### Consumption taxes

Consumption taxes are taxes on spending on goods and services rather than income directly and are often termed 'indirect taxes'. One form of indirect tax is value added tax (VAT) which functions as a tax on the purchase price of a good or service. VAT was introduced in 1973 at a rate of 8%. It has since been increased to an all-time high of 20% in 2011. The increase in VAT in 2011 is thought to have added 0.7 to 1.4 percentage points to CPI inflation (Bank of England, 2011:31).

Indirect taxes can also take the form of excise taxes, for example, vehicle excise duty, air passenger duty, green taxes, betting taxes, and duty on tobacco, alcohol and motor fuels. Excise taxes are widely used by governments to discourage the consumption of specific commodities that may be deemed to be unhealthy or undesirable. Taxes on such commodities are sometimes referred to as 'sin' taxes. They are also used in situations

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where levying VAT is impractical or not legal (such as air travel and insurance products).

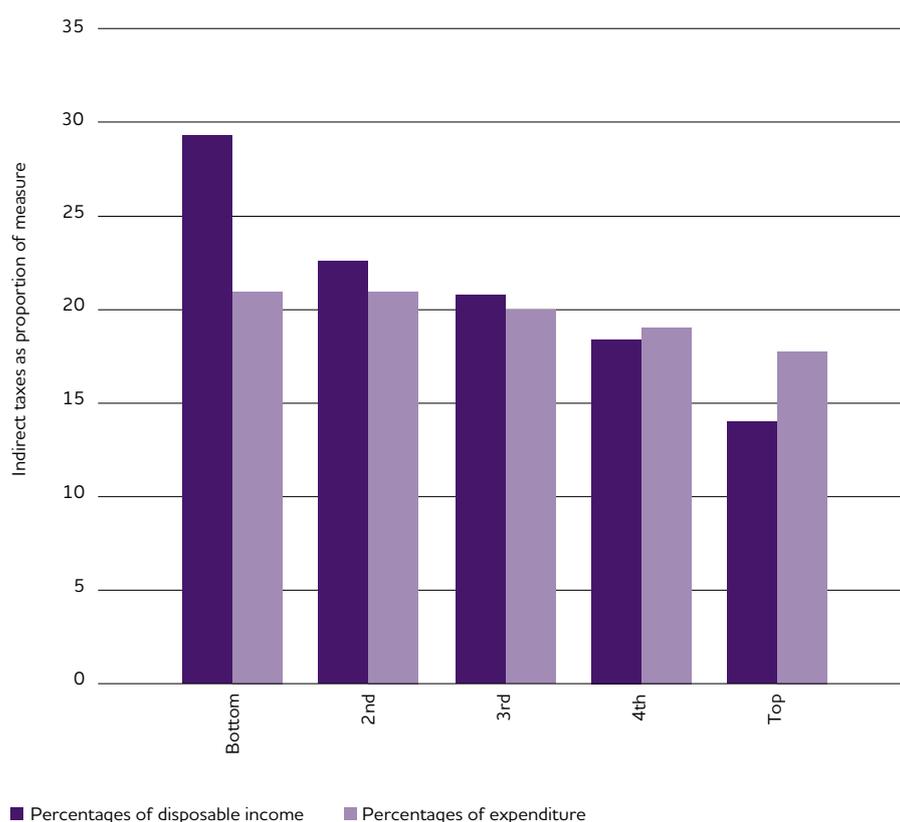
Consumption taxes are a key way in which government policy affects the disposable incomes of low-income consumers through the cost of living. Consumption taxes are considered by some to be regressive and have a disproportionate impact on those on low incomes as they do not account for the ability of the consumer to pay, meaning people on low incomes pay a greater proportion of their income as tax (Lyon & Schwab, 1995; Farrelly et al, 2012; Hoffer et al, 2013). However, detailed research into spending and incomes don't paint such a straightforward picture.

It has been estimated that the poorest 20% of households in Britain spend an average of £1,286 a year or 11.4% of their annual disposable income on 'sin taxes'. In addition, they also spend £1,165 (or 10.3%) on VAT (Snowdon, 2013). Snowdon also notes that the gap in the proportion of income spent on indirect taxes has widened since 1977. Among the poorest quintile the share of equivalised household income spent on indirect taxes has risen by 8 percentage points to 30.1% in 2012 while for the richest quintile this fell by 4.7 percentage points to 20% (Snowdon, 2013:13). This means the poor have gone from paying proportionally less than the rich (22% to around 25%) to paying more than the rich by half (30% to 20%).

Figure 1 provides estimates. It shows that around 28% of the disposable income of the bottom fifth of households is taken up by indirect taxation, double the 14% for the top quintile. However, by expenditure the difference is much less notable.

There is disagreement over whether consumption taxes are truly regressive or not. The IFS note that looking at a snapshot of consumption taxes as a share of income is misleading, as income fluctuates and people such as students and pensioners can be spending above their income, meaning a higher share of their income is taken up by consumption taxes (Crossley et al, 2009:197). Crossley et al find VAT to be progressive when considered as a share of expenditure (2009:198). The ONS find consumption taxes overall to still be slightly regressive as a share of expenditure, with 21% of the bottom income quintile's expenditure taken up by indirect taxes, compared with 20% for the median quintile and 19% overall (ONS, 2013:7). So whilst VAT itself is slightly progressive on an expenditure basis, other elements of indirect taxation, such as the duty on tobacco, make it regressive overall.

**Figure 1: Indirect taxes as a proportion of income and expenditure**



Source: ONS, 2013

Another way to look at the question is to consider the effects of these taxes on the ability of households to reach the income required for the MIS budget. Hirsch and Valadez (2014:24) find that for a couple with two children, indirect taxation is equivalent to around 14% of the MIS budget, less than the median 20% of expenditure in Figure 1. This is because much of the budget for MIS is not subject to VAT (for example, food, children's clothes), whilst the more regressive elements either do not feature (tobacco duty) or comprise only a small part of the budget (alcohol and fuel duty). As a result, changes to excise duties would have a relatively small impact on the income needed for a minimum socially acceptable standard of living. By contrast, VAT does have a bigger impact on the budgets of low-income households, and any analysis of the relationship between the cost of living and poverty needs to consider the impact of indirect taxes on the incomes of the poorest.

## Groups for whom the relationship between cost and low income is different

### 'Special' and 'enhanced' costs

This section considers how the relationship between the cost of living and income can differ for some groups in poverty compared with the average. Several groups have characteristics that can create additional costs and/or increase existing costs. One of the interviews conducted for this project,

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to do with food insecurity, brought out several of the issues. Thus food insecurity (where low income and job insecurity may be compounding factors) may afflict:

- those who find it difficult to make use of offers (e.g. if cooking only for one) or capitalise on economies of scale
- those without a car if that prevents them from using large supermarkets, meaning either higher food costs and/or more limited choice
- those in poorly insulated housing, who may have to choose between heating and eating)
- those who are homeless or are asylum seekers if reliant on a voucher system.

Tibble (2005) calls these costs 'special' costs and 'enhanced' costs. Tibble concluded that those with disabilities faced both kinds of extra cost. The special costs are those that are a result of impairment, such as a wheelchair or a stair lift. The enhanced costs are those faced by people without impairments and those with them but that tend to be higher for those with impairments (such as laundry costs or special diets). These costs can actually increase with income, so when people who previously could not afford to meet all their needs receive an increase in income, they can afford to meet more of their needs but face associated higher costs in doing so. This would also be the case for those without disabilities, but could persist over a greater range of income for people with disabilities.

A review by Baumberg et al (2014) of some of the studies on higher costs for disabled people finds that they can vary from around £16 a week to almost £2,000, depending on methodology and what is included (the highest figure includes significant costs from a personal assistant). On several methods of calculation, these additional costs for disabled people increase poverty rates. This is because some disability benefits (Disability Living Allowance and Attendance Allowance) are designed to meet some of the additional costs of disability, but are still counted as income for the purposes of calculating poverty statistics.

Turning to those in rural areas, their consumption basket is both different and likely to be more expensive. Lower population densities mean rural areas are harder to serve by transport networks relative to cities, and more expensive to extend gas lines to. As a result, people living in rural areas need to rely more on private transport, travel further for goods and services, and use more expensive forms of fuel for their homes. All of these increase the cost of attaining the same material standard of living as those in more urban areas, although housing may be cheaper. These topics are covered in greater depth in the transport and fuel reviews for the Anti-Poverty Strategy (Titheridge et al, 2014; Preston & White, 2014).

MIS for rural areas found that most of the difference between a rural and urban MIS budget was accounted for by higher transport costs (Smith et al, 2010:39). The difference in costs for both transport and heating increases for all family types with increasing rurality, i.e. when moving from rural towns to villages to hamlets.

On the income-based measure of poverty, rural areas tend to fare better than urban areas. For example, figures from HBAI show that in 2011-12, 15% of those in rural areas were in poverty after housing costs compared with 23% in urban areas (ONS, 2013). But as in the case for people with disabilities, this may be an underestimate of poverty, given the specific additional costs faced by those in rural areas. Those with the same low

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income in rural areas may well be in deeper poverty than those with an equivalent income in urban areas.

Note that people in large families are not one of these groups. The size of family is already accounted for in the way poverty is measured: it is recognised that larger families need more resources to avoid poverty than smaller families. In the official data sources, such as Households Below Average Income, incomes are adjusted via the process of equivalisation to make possible comparisons between large and small families.

### Those lacking 'enabling' products

'Enabling' products have been defined as goods and services that improve access in other markets (Europe Economics & NPI, 2010:7). Europe Economics and NPI identify three such products: a current bank account, a car and access to the internet. This report considered how possession of one or more of these enablers might benefit a consumer. It suggested (Europe Economics & NP, 2010: 57) the following benefits:

- A current bank account increases credit options, and presents opportunities to pay via direct debit, standing order and in some cases a debit card.
- Car ownership lends access to more remote stores and/or cheaper stores (e.g. bulk buy).
- An internet connection allows online banking, a greater range of savings and credit products, and access to price comparison sites and online deals.

In a similar vein, Bates (2008: iii) in a foreword to a study of how low-income consumers may be poorly served by competitive markets, refers to these products as 'entry requirements... required to navigate and take advantage of offers available in markets' without which 'choice is often little more than illusory'. Several of these products are themselves now considered essential for certain household types under MIS, notably a car for families with children.

Hirsch (2013a:8) notes that a lack of access to enabling products can exacerbate the poverty premium.

The argument here appeals to common sense. For example, it is easy to see that car ownership allows access to larger shopping centres: if their unit prices are lower, then that access confers advantage and the lack of it a disadvantage. Similarly, access to the internet may potentially offer benefits such as easier price comparisons between suppliers or the frequently available discounts for online billing. The idea that a current bank account conferred advantages (and that low-income households would be much less likely to possess them) has been a cornerstone of the concept of financial exclusion going back to the report of the Social Exclusion Unit's policy action team (HM Treasury, 1999).

Against this, acquiring the enabling products in the first place costs money and the benefits may not be felt at all below a certain income. For example, as mentioned above, those with low incomes tend to be more risk averse (e.g. Diaz-Serrano & O'Neill 2004; Dohmen et al, 2009). Given that cheaper direct debit payment methods involve some surrender of control to the company, which automatically withdraws a variable amount of money, the possibility of a higher than expected amount being withdrawn can discourage some consumers.

The evidence does suggest that low-income households were less likely than households on average to possess these enabling products – 17% of low-income households lacked a current account compared with 9% for

households as a whole, over half lacked a car (compared with 26% overall) and two-thirds lacked internet access compared with 39% overall (Europe Economics & NPI, 2010:5).

Moreover, Europe Economics and NPI (ibid.) showed that low-income households were indeed disadvantaged by the lack of the requisite enabling product. With the principal source being expenditure (rather than price) data, the report offered evidence in terms of the share of total household expenditure going on particular categories of spending. The examples chosen were the shares of expenditure by small, lone parent families going first on food and second on fuel. Expenditure on food was used to test the hypothesis about car ownership while expenditure on fuel was used to test the hypothesis about internet access. In both cases, the evidence presented favoured the hypothesis, although no formal statistical test was reported, the sample size was small and the data used was for one year (2007) only.

In short, although the hypothesis is appealing, and the evidence strong that a low-income household is less likely than average to possess almost any 'good', the additional evidence showing subsequent disadvantage is harder to find.

### Overview: a framework for identifying low-income groups facing higher costs

Table 7 summarises the above, using an extended version of the notion of 'enhanced cost', reflecting the fact that costs can be higher either because more of the good or service has to be consumed in order to achieve a particular standard of living, or because the unit price is higher. On the basis of this classification, low-income households containing people with disabilities face special costs and enhanced (quantity) costs; low-income households in rural areas face all three kinds of extra cost; and low-income households lacking the enabling goods face enhanced price and usually special costs too.

**Table 7: Summary of low-income groups facing special and enhanced costs**

	Special costs	Enhanced cost (quantity)	Enhanced cost (price)
Low income with disabilities	Extra equipment (e.g. stair lift) or care needs (e.g. daily home visits)	Washing, heating (e.g. if housebound), energy, more private transport	
Low income in rural area	A car (even one per adult) 'essential'	Fuel (further to travel)	Less choice (e.g. for food, energy)
Low income w/o a current bank account			No direct debit ('financial exclusion')
Low income w/o access to a car	Public transport fares		Less choice (e.g. for food)
Low income w/o internet access	Travel, postage		Less choice, less able to shop around
Low income in poor-quality accommodation		Higher energy use ('fuel poverty')	

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Table 7 includes two other groups defined by their housing. In the first case, their housing is low quality, and in particular is energy inefficient. Enhanced costs follow directly. This is the problem of fuel poverty by another name.

The other is households with high housing costs. When income for the purposes of measuring poverty is calculated on an 'after-housing costs' (AHC) basis, it may be thought that housing cost (like family size) does not need to be considered from the cost-of-living side. Besides the narrowness of 'housing cost' for the purposes of calculating AHC income (rent or mortgage interest, water charges, structural insurance, service charges but not, for example, maintenance costs in owner-occupied accommodation (DWP, 2013b), there are two reasons why it does.

First, if rent and mortgage interest (the two main components of housing cost) diverge sharply, tenure is a factor that can cause otherwise similar low-income households to face very different costs. Over recent years, especially within the private sector, this has indeed been the case. In 2011-12, average mortgage repayments for those with below-average household incomes were 25% below what they were five years earlier (before the financial crash), after taking account of inflation. By contrast, private sector rents for those with below-average incomes were unchanged, having risen more or less in line with inflation.

Second, many of the high-profile social security reforms since 2010 have in effect restricted the amount of housing benefit that will be paid (Aldridge & Maclnnes, 2014). In particular, various benefit caps mean that the risks associated with rising housing costs now fall on the low-income household rather than being absorbed by the state as was previously the case. Low-income households receiving less than full housing benefit, once a marginal problem, is now spreading beyond the traditional high housing cost areas of inner London (Aldridge & Kenway, 2014).

This also illustrates another point of more general relevance, namely that in some cases, the relationship between cost and low income is mediated by social security. If changes happen here – the restriction on Disability Living Allowance and its replacement by the Personal Independence Payment being examples – then the relationship between cost and low income is disturbed.

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# 4 POLICIES AND ACTORS FOR ADDRESSING THE COST OF LIVING

## Introduction and summary

This chapter reviews the way in which the cost of living, as it affects low-income households, is addressed by government and regulators both in the UK and abroad. It looks in turn at government, regulators, individuals and third-sector organisations. It also looks at approaches from other countries to tackling rises in the cost of living.

The main findings of this chapter are as follows:

- Interventions can be understood as taking three forms – cost compensation (usually through the tax and benefit systems), cost controls such as discounts and price regulation, and attempts to ensure smooth functioning of markets (competition).
- Pricing regulation has evolved since privatisation. Whilst it remains in place in much the same form in water and to a lesser extent rail, there are no longer price controls for retail customers in communications. In energy, a new form of price regulation applies.
- Universal service obligations (including telecoms and basic banking) are used to provide some minimum guarantee of service provision in some service areas.
- In liberalised markets the burden is on consumers to inform themselves. Initiatives, especially in the food area, remain the province of local and community actors.
- Consumer vulnerability – replacing an approach focused on disadvantaged groups – is now the central concept most sector regulators are using to assess how well the sector in question is serving customer needs.
- ‘Vulnerability’ is as much concerned with the circumstances in which a person finds themselves as with the person themselves: anyone can be vulnerable, given particular circumstances. One thing this offers is that the companies themselves may then mitigate those circumstances.

- This more fluid picture of vulnerability may cause companies some problems, as it risks being uncertain and therefore difficult to put into effect. It is, however, very much an evolving field with considerable activity by almost all sector regulators.
- Whether ‘vulnerability’ is really well-adapted to efforts to promote the interests of low-income households is uncertain, but given the prominence of the idea, the fact that any attempts to do so must relate to vulnerability is not in doubt.
- A key issue that is currently emerging is how far the approaches of the sector regulators, chiefly around vulnerability, are adopted by the general market regulators (in particular, the Competition and Markets Authority from April 2014). This hinges on whether regulators should intervene in the market only for the general consumer, or whether it should intervene for particular types of consumer too.

This chapter breaks down the types of intervention according to the main actors – government, regulators, individuals and third-sector organisations. We look in depth at the concept of ‘customer vulnerability’, an increasingly widespread idea of how markets could be shaped for consumers who are disadvantaged within the marketplace. This concept is important has implications for reducing costs among people in poverty, but it is yet not fully defined or operational.

## Government

While some sectors have their own specific economic regulators (e.g. Ofgem for the energy sector), all sectors are subject to the general economic regulators responsible for ensuring competition. Until April 2014, the two general economic regulators were the Office of Fair Trading and the Competition Commission. Since then, the powers of these two organisations have been taken over by the Competition and Markets Authority (CMA). We use the term ‘less regulated markets’ to refer to those sectors that do not have their own, sector-specific economic regulator.

Such less regulated markets in the UK include those in food, childcare, and to some extent transport, and telecommunications. They are defined as less regulated because economic policy interventions are more limited in these markets than in sectors such as energy and water. It should of course also be noted that many of these sectors are often subject to non-economic regulation around, for example, quality and safety (e.g. childcare, food). Ofcom, the telecommunications regulator, has a much smaller economic focus than it used to, and its remit extends to responding to audience complaints on issues of content.

Table 8 sets out the three key ways in which governments intervene to address issues of cost for consumers – redistribution and compensation, cost reduction and control, and market operation.

The first category, redistribution and compensation, refers to measures that operate through the tax and benefits system, for example, providing consumers with additional income in order to meet certain costs. In general this is how affordability is maintained in the childcare market (through an addition to tax credits equivalent to 70% of the cost up to a certain limit, due to be increased to 85% under Universal Credit); and in housing for those on low incomes through housing benefits.

There is also Disability Living Allowance (replaced by the Personal Independence Payment or PIP), which contributes towards the extra costs

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of disability. Other forms of government intervention have the effect of increasing the cost of living, such as consumption taxes like VAT and council tax. Unlike the childcare tax credit, PIP can be spent on whatever the recipient chooses, much like other benefits.

The second category, cost reduction and control, refers to instances where regulators or government intervene in order to reduce the costs faced. This is similar but broader than Hirsch's (2013b) category of regulators intervening in supply and price structures. These affordability measures differ by industry and category of essential good. Water charges are still subject to specific price controls set by the regulator Ofwat, though have had a tendency to increase in real terms. Further measures are generally voluntary (such as social tariffs), except where specific problems are identified such as large families and water metering (prompting the WaterSure tariff). Price controls are also exercised over regulated rail fares.

In energy, while there are price controls on parts of the industry, these do not include the final price paid by consumers. Instead, there are specific bill reductions for some pensioners and subsidised or free insulation to help reduce the amount of heating needed by low-income groups.

The third category, market operation, refers to measures aimed at increasing competition in markets to keep prices low. This is the approach taken in markets such as food, clothing, and household goods and services. It covers penalties for anti-competitive practices such as the Office of Fair Trading's 2011 decision to fine certain supermarkets for co-ordinating price increases (OFT, 2011) and measures designed to stimulate competition by making consumers more likely to switch utility providers such as one-day switching (DECC, 2013). Another example of this is the universal service obligation for telecoms, which represents an attempt to ensure that all customers have access to a basic service and so prevent a specific market failure.

**Table 8: Typology of cost of living interventions**

Category of intervention	Redistribution, taxation and compensation	Cost reduction and control	Market functioning
Category description	Measures such as compensation for costs incurred, usually parts of the social security or tax systems. Also includes taxes on consumption	Measures that reduce or control costs (through prices or quantities that need to be consumed)	Measures that ensure the competitiveness and smooth operation of various markets
Sectors dealt with through this category (non-exclusive)	<ul style="list-style-type: none"> <li>● Housing</li> <li>● Childcare</li> <li>● Council tax</li> <li>● Consumption taxes on general goods and services</li> </ul>	<ul style="list-style-type: none"> <li>● Water</li> <li>● Heating and electricity</li> <li>● Transport</li> </ul>	<ul style="list-style-type: none"> <li>● Heating and electricity</li> <li>● Food and drink</li> <li>● Communications</li> <li>● Transport</li> <li>● Financial services</li> </ul>
Agencies involved	<ul style="list-style-type: none"> <li>● Central government</li> <li>● Local government</li> </ul>	<ul style="list-style-type: none"> <li>● Ofgem</li> <li>● Ofwat</li> <li>● Ofcom</li> <li>● Private companies</li> <li>● Local government</li> <li>● Central government</li> </ul>	<ul style="list-style-type: none"> <li>● Competition and Markets Authority (formerly Office of Fair Trading and Competition Commission)</li> <li>● Financial Conduct Authority</li> <li>● Consumers</li> <li>● Central government</li> </ul>
Policy measures included	<ul style="list-style-type: none"> <li>● Childcare element of tax credits compensates for costs of childcare</li> <li>● Housing benefits compensate for rental costs for low-income households</li> <li>● PIP contributes towards extra costs of disability</li> <li>● VAT and consumption taxes and other measures that change costs of various goods and services</li> <li>● Council tax (levy on rateable value of property)</li> <li>● Council tax support, i.e. rebate for low-income households</li> </ul>	<ul style="list-style-type: none"> <li>● Voluntary social tariffs in water</li> <li>● Reduce water bills for those on certain benefits</li> <li>● WaterSure scheme caps bills for households with three children or households with occupants with certain medical conditions</li> <li>● Warm Home Discount of £135 electricity bill reduction for qualifying pensioners</li> <li>● Energy Companies Obligation, e.g. insulation and heating help such as boiler replacement for qualifying low-income households and those in the 15% of areas with lowest incomes. Schemes such as this increase costs for other consumers</li> <li>● Price controls limit increases imposed by suppliers, e.g. RPI + K (water), RPI (rail), and the new RPIO<sup>4</sup> formula (energy)</li> </ul>	<ul style="list-style-type: none"> <li>● Competition policy, e.g. investigating market power of supermarkets and deciding on takeovers</li> <li>● Complaints and redress to ensure consumers can be compensated for unfairly incurred costs</li> <li>● Consumer-switching policy designed to encourage individual or collective switching of suppliers to get better deals, e.g. allowing pre-payment customers to switch even with up to £500 of debt</li> <li>● Tariff simplification, e.g. Ofgem has limited energy suppliers to only four tariffs, and requires tariffs to be presented simply</li> </ul>

Note: Table 8 categorises government interventions in cost of living into three: redistribution and compensation, cost control; and market operation.

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## Regulators

All industries and sectors are regulated by government to some extent. There are general regulations, for example, on ensuring that goods and services sold meet their descriptions and that goods sold are not unsafe. There is also competition law to prevent practices that may be detrimental to consumers. General regulation on competition and consumer welfare is handled by the Competition and Markets Authority.

Some industries have specific economic regulators which have a greater responsibility to intervene in the market to manage the different demands of consumers and producers. This includes energy (Ofgem), water (Ofwat), and communications (Ofcom). These industries acquired their regulators at the time of privatisation. Beesley and Littlechild (1989:454) note that British Gas and British Telecom at the time had market share of 100% for their core activities. As a consequence, regulation was necessary to prevent market abuse by monopoly suppliers. While there are now multiple firms operating in these industries, they are still subject to the oversight of regulators. This is for various reasons – energy still has ‘natural monopoly’ components such as generation and transmission that require regulation, and the importance of energy magnifies any market failures.

In other words, while it is certainly possible to argue that defective regulation imposes costs (e.g. Institute for Economic Affairs, 2013), these industries are themselves regulated for fear of even higher costs if left unregulated.

The privatised industries are all regulated to different extents, at least in part reflecting their different natures. In communications, price controls have been relaxed as competition has increased and the role of the regulator goes beyond economics to protecting the public from offensive material.

The water industry has the characteristics of a natural monopoly, making product competition difficult, whilst the low value of water and sewerage itself relative to the costs of the infrastructure make other types of competition based on competing for network access more difficult (Bottasso & Conti, 2003:3). For instance, Ofwat (2013) note that for the 2009 price review, the final settlement meant water bills were 10% lower than the price that suppliers had wanted.

There is greater scope for competition in certain components of the energy industry (with concerns about how well this competition is working), although the monopoly elements (transmission and generation) remain subject to price control.

Pricing regimes following privatisation adopted what is known as revenue-cap regulation. The method used, with some variation across privatised utilities, is RPI minus some other figure, often below 5%. This was developed partially out of the 1983 Littlechild report for pricing BT services in order to protect against monopoly, encourage efficiency and competition, and minimise regulatory burden (Stearn, 2003:14).

How the price caps have evolved has varied between industries. Water and rail were both industries with historic underinvestment that needed to be addressed and so it was felt they should have revenue increases at or above inflation (Smith, 2003:94). For rail, this meant regulated fares were capped at RPI until 1999, before falling to RPI – 1, then RPI + 1 from 2003 onwards. In 2010, the coalition government announced they were to increase at RPI + 3% from 2011, but the risks of a passenger backlash led to increases of RPI + 1%; +2%; and RPI for 2012, 2013 and 2014 respectively (Butcher, 2014:11). The approach for water was more systematic and originally based on 10-year investment plans (Smith, 2003:94).

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In the telecoms industry, price caps applied only to a basket of services supplied by the original monopolist and were removed in 2006 as it was felt the extent of competition was sufficient to protect consumers (Ofcom, 2006a:1). This is the only regulated industry examined to have price controls removed.

In energy, price controls apply to the non-competitive parts of the industry: transmission and distribution (Ofgem, 2009:5). These were originally RPI –X, but from 2010 have moved to a new regulatory regime of Revenue = Incentives + Innovation + Outputs. This is designed to reward efficiency. Targets are set, with some efficiency savings accruing to firms whilst automatic penalties exist for those that miss targets (Ofgem, 2010:2).

Utility pricing may be more relevant to those on low incomes. Using data from the Living Costs and Food Survey 2013, the bottom disposable income quintile spends 13% of total expenditure on utilities, compared with 10% at the median and 8% in the top quintile.

Even in the absence of a sector-specific economic regulator, economic interventions to reduce costs for low-income groups do take place. There are several such interventions in the telecommunications sector. For example, universal service obligations (USOs) originating from the EC Universal Services Directive place obligations on companies to provide an affordable service for vulnerable consumers (e.g. BT Basic). Within this sector, there are also schemes that place requirements on companies to translate audio to text for those with hearing impairments and a reduced price scheme for customers on means-tested benefits.

Examples of economic interventions to promote food affordability include Defra's monitoring of food prices and the competition enquiries into groceries. A series of policy action teams that looked at a range of food affordability issues, including access to shops, were set up in the late 1990s but with little effect.

**Table 9: Pricing regimes and interventions since privatisation**

Sector	Date of privatisation	Current price	Changes since privatisation	Other affordability policies	Comments
Water	1989	Regulated (RPI + K)	Responsibility for price review handed to Ofwat from SoS	WaterSure introduced for certain families in 1999; voluntary social tariffs from 2012	Price rises frequently above inflation in order to pay for large investment programmes
Telecommunications	1984	Retail prices unregulated	Former monopoly supplier BT subject to regulated RPI – X price controls for a basket of services until 2006	BT required to offer basic low-cost services due to USO	Price controls on BT as the former monopolist fell over time as the extent of competition increased
Gas and electricity	1990	Partly regulated (RIIO* for transmission and distribution)	Transmission and distribution previously regulated by RPI – X until 2010	Energy Companies Obligation (ECO) provides cost-reducing measures such as subsidised insulation	Price controls remain on the non-competitive parts of the gas network: transmission and distribution
Rail travel	1996	RPI + 1% average for regulated fares (RPI in 2014)	Previously RPI, then RPI – 1, then RPI + 1	Rail cards for certain groups	

\* RIIO stands for Revenue = Incentives + Innovation + Outputs

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## Companies and third-sector organisations

The previous section showed how regulators work to influence the market as a whole. Recent developments have indicated a shift towards placing greater responsibilities on companies themselves. The Retail Market Review (RMR), launched in 2010 amid concerns that the energy market was not working effectively for consumers, aims to create a 'simpler, clearer and fairer' (Ofgem, 2014) energy market for British consumers.

There are three overarching aims to the RMR – to make the sector 'simpler, clearer and fairer'. The first aim is simplifying the energy market to make it easier for consumers to understand and compare energy tariffs offered by suppliers. This entails banning complex tiered tariffs, introducing four core tariffs for gas and electricity from each supplier, and simplifying cash discounts.

The 'clearer' element of the RMR seeks to make the information sent to consumers easier to understand. Finally, the 'fairer' section of the review seeks to rebuild consumer confidence in the energy sector by putting in place legally binding fairness obligations. These include placing requirements on companies to provide advance notice of an energy plan coming to an end so that consumers have the opportunity to switch without facing exit fees.

While the measures set out in the review are to some extent specific to the energy sector, the principles underpinning them – to present consumers with 'simpler choices, clearer information and fairer treatment' – are likely to have wider application in less regulated markets. There are obvious applications to the telecoms sector, where, for example, domestic internet users face a range of choices of products and tariffs.

Seeing that the RMR has only just reported, it is not clear how companies will enact the recommendations. What is clear is that while Ofgem still expect customers to educate themselves, there is now a responsibility on suppliers to provide the information to make that education easier.

There is some evidence of non-regulator stakeholders having an interest in tackling affordability and access issues amongst vulnerable consumers. These other stakeholders include the third sector, civil society, the private sector and local authorities.

The sector in which these stakeholders have had the greatest involvement is probably the food sector. Non-government interventions in this sector include locally based food-growing initiatives (e.g. Making Local Food Work, Local Food and Food for Life) and free meal provision (e.g. lunch clubs). Many such initiatives have been going on for some time, but because support for them from government has fallen away in recent years, they play a greater role than previously. There are examples of co-operative initiatives in other sectors as well, such as Repowering London, a not-for-profit organisation set up to co-produce community-owned renewable energy projects.

There is also some innovative price reduction work being carried out by supermarkets and local authorities, such as the CRUMBS initiative in Southampton, which aims to reduce waste by distributing within-date perishable food to disadvantaged residents that would otherwise go to landfill.

There are instances of third-sector organisations providing goods and services that better assist their clients. For example, Age UK started selling home and travel insurance to older people after noticing that products could be better tailored to their needs. These products now form an important part of Age UK's income stream.

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Where third-sector organisations step in to provide services or products, they can demonstrate the viability of a market. The examples above, though in many cases still quite new, have done so. These are, though, areas where potential activity far exceeds current activity.

Ofcom and the Financial Conduct Authority (FCA) play an important role in tackling consumer vulnerability. Seeking to move companies from a reactive to a strategic approach to dealing with issues of consumer vulnerability, their work involves working closely with individual firms, consumer groups and other bodies to empower those tasked with addressing consumer vulnerability issues and facilitating co-ordination across regulators and companies alike.

Another way in which the FCA have sought to tackle consumer vulnerability issues is to deal with these under the guise of competition rather than protection. This means identifying commercial reasons to address cost or access issues. For example, most insurance companies will move motorists to a higher risk category upon reaching the age of 70. A lack of alternative companies to switch to means that consumers often end up paying considerably more while they may not actually represent an increased risk (for instance, Which?, 2010:17). In identifying this gap in the market, regulators can improve competition and help to reduce prices for potentially vulnerable consumers.

## Consumers and switching suppliers

Increasing the ease with which consumers can compare and switch suppliers is an important component of government policy on cost of living. Suppliers can be switched in most utilities: energy (gas and electricity), communications (landlines, mobile phones, and the internet), and banking accounts, the only real exception being water. The ability to switch varies by geography – it is, for instance, very difficult to switch gas supplier in most parts of Northern Ireland. Indeed it was not possible anywhere in Northern Ireland until 2011.

Switching rates, having risen initially following privatisation, have generally declined over the last few years. Statistics on consumers switching between gas and electricity suppliers indicate an increasing number up until 2008, with a decline thereafter. The number of electricity supply transfers in 2008 was around 30% higher than in 2003 at 5.4 million compared with 4.2 million. In 2013, it stood at 3.4 million. The story is similar for gas, from 3.1 million in 2003 to 4.2 million in 2008, and then down to 2.3 million by 2013.

Consumer Focus (2013:13) note that switching rates have fallen in communications and for bank accounts in recent years as well.

In the market for gas and electricity, switching rates tend to be higher amongst the higher social groups: 17% of those in group AB report having switched in the last year, compared with 13% in group DE (Consumer Focus, 2013:11). Mummery and Cooper (2011:15) note that low-income social tenants in particular are unlikely to have compared the prices of different supply options.

Analysis of data from the Which? Consumer Insight Tracker shows that the proportion of consumers switching tends to increase as you move up the household income distribution. In the energy market, the proportion of those switching supplier is 40% higher than in the bottom quintile. For broadband connections, the proportion of households who have never switched providers is 50% higher in the bottom quintile than the top.

The motivation for switching suppliers also differs between social groups. Lower social groups are more likely to have switched as a result of being

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directly contacted by a supplier, whereas higher social grades tend to do so after using price comparison tools (Consumer Focus, 2013:16).

Low-income consumers are also the least likely to engage with the energy market or with their annual price statement (something designed to encourage switching). This may be as a result of these consumers being more unable or unwilling to switch (Mummery and Cooper, 2011:22–23).

## International approaches

The UK approach has been characterised by a combination of compensatory measures, measures to regulate prices and measures to increase competition, with different essential goods and services subject to different combinations of those approaches. This section concludes with a summary of some international approaches to managing the cost of living.

### Energy

Approaches to tackling the problem of energy affordability vary considerably from country to country. A report by the Florence School of Regulation (2008) on the affordability of basic public utilities provides a good overview of the variety of approaches taken by European countries. Some countries have neither defined which populations are at risk of being unable to afford utilities or implemented any policies to tackle this. This is the case in many Scandinavian countries where the social system makes up for any income shortfalls including those that might result from the inability to afford such utilities.

In other countries there are some policy measures in place to promote affordable energy for low-income consumers, but their implementation depends on the voluntary actions of operators. Such is the case in the UK.

A third approach is for governments to introduce policies to promote affordable utilities that are mandatory for operators. This has been the approach of the French government to regulating the main utilities provider in France. Most measures directed at vulnerable consumers were agreed contractually between the French government and Electricity of France (EDF), subsequently becoming law. These measures include a minimum service of energy supply; discounts on technical operations; and social tariffs (electricity tariffs introduced in 2005 and gas tariffs in 2008).

The measures are financed by a public services compensation tax, which is paid for by all energy consumers.

Italy is taking steps toward adopting a similar mandatory approach for all suppliers in energy markets. At present, the Italian solution to addressing price problems for low-income consumers has been to introduce social tariffs that give households a fixed discount of around 20% on their electricity and gas bills. Other measures include a ban on disconnection when unpaid bills remain below €30 or if electrical appliances are used for health reasons.

### Water

In his paper 'Social Protection in the Household Water Sector in Developed Countries' (2005), Smets presents a series of measures devised to encourage the provision of affordable water services for low-income consumers. These measures include ensuring that the cost of water services is reduced through good governance and efficiency; subsidising water operations through general or local taxation; cross-subsidising water charges between different user groups (households, industry and agriculture) and/

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or between rural and urban areas (this approach might include progressive pricing in the form of rising block tariffs (tariffs that increase at certain levels of consumption), which requires metering to be in place); providing general income support to low-income or vulnerable consumers; and providing special assistance to consumers who cannot afford to pay their bills.

### Credit

A report by the Personal Finance Research Centre for Consumer Focus (2011) into international approaches to the provision of affordable credit for people on low incomes identified a range of measures introduced in other major OECD countries that have been successful in ensuring access to affordable credit. Among these measures were a national credit reference database (e.g. the lending regime in Germany is underpinned by comprehensive and reliable documented credit histories); interest rate restrictions or 'caps' on credit access for people on low incomes (e.g. France and Germany); provision of clear and reliable information for consumers so that they might make informed decisions when deciding to take out a loan; social banking and third-sector lending (e.g. Australia); and collaboration between major banks, charities and government to provide affordable credit loans to low-income families (e.g. Australia).

In terms of financial inclusion, one stand-out example comes from France. The central bank in France allocates everyone who wants one a basic bank account.

### Looking ahead – consumer vulnerability

Consumer vulnerability has a range of definitions but essentially relates to consumers who are disadvantaged within the marketplace. Vulnerability manifests itself as receiving goods and services insufficient for needs, or receiving them at disproportionate cost. This could be for a range of reasons, low income being only one of them.

All of the industry-specific regulators have given thought to both the definition and operationalising of the concept, with Ofgem appearing to be most advanced in terms of policymaking. Ofgem recently published a consumer vulnerability strategy which built on the Social Action Strategy (2005). The earlier strategy reflected statutory duties and gave regard to vulnerable consumers, although it did not use the term. These statutory groups included the elderly, sick and disabled, people on low incomes, and people in rural areas.

The regulators' understanding of vulnerability has changed in recent years. Influenced by the work of Linda Leonard, what is known as a 'dynamic' understanding – where people are in vulnerable situations rather than simply belonging to vulnerable groups – is said to have come to the fore.

The government's consumer empowerment strategy (BIS, 2011:36) notes that:

**Government has traditionally avoided defining a 'vulnerable' consumer as we can all be vulnerable at different stages of our lives or depending on the type of goods and services we are purchasing.**

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Whether this first part is strictly accurate or not, it is an indication that the current government does not intend to define who is vulnerable. Instead, BIS asked Consumer Futures and Citizens Advice to identify the groups of people most at risk and types of transaction that put people in vulnerable positions. Describing a group as 'at risk' does not imply that everyone in the group is vulnerable; instead they are more likely to be in a situation that makes them vulnerable.

The theme that runs through the resulting report, Tackling Consumer Vulnerability (Stearn, 2012), is that it is difficult to divide the population into vulnerable and non-vulnerable consumers; instead there are consumers in vulnerable situations. Stearn (2012:5) notes:

People's circumstances change and anybody can become vulnerable at any time for example through job loss or bereavement.

The actual definition used of a consumer in a vulnerable situation is:

People who cannot choose or access essential products and services which are suitable for their needs or cannot do so without disproportionate effort/cost/time.

Stearn, 2012:11

Factors that can increase the risk of people becoming or being vulnerable include low literacy, numeracy and/or financial capability, low or insecure income, unemployment, caring responsibilities, disability, living in social rented accommodation, and living in a lone-parent household (Stearn, 2012:11). Clearly, these can cover a lot of the population.

An important point for the regulators is that markets can also put people in a vulnerable situation. The role of regulation is at least in part to identify where this happens and attempt to limit the effects. Vulnerability reflects imbalances between consumers and firms within a particular market context.

So vulnerability is about a difficulty of choice and access, and while insufficient resources can and do restrict choice and access, they are not the only things to do so. Vulnerability is therefore broader and captures more than just people in poverty. However, those in poverty – at 13 million – might well be the biggest of the groups 'at risk of being in a vulnerable position'.

Moreover, most of the other factors listed above are correlated with being in poverty. It is difficult to disentangle poverty from vulnerability – are lone parents and those in social rented housing vulnerable because they have low incomes? Or potentially related factors such as a lack of, for example, internet access? Furthermore, whilst various groups are 'at risk', that does not mean that the risk is identical between groups. The risk may be higher for a single adult losing their job than for one person in a family with other sources of income losing their job.

There is, however, a problem in operationalising vulnerability. Regulators used to see the solution as pumping out information to make consumers more informed, and so neglected firmer intervention. They are moving towards price support such as tariffs rather than price regulation. But when the idea of vulnerability was fed into the creation of energy social tariffs<sup>5</sup>, companies found it harder to use than a simple list of groups. A compromise

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was reached whereby the tariff applied to those receiving the Cold Weather Payment, meaning it was only available to those low-income families who lived in a postcode cold enough to qualify.

Vulnerability is to some extent replacing a previous conception of disadvantaged groups (TNS Opinion and Social, 2011:6). This approach was about personal characteristics resulting from socio-economic background. Vulnerability reflects imbalances between consumers and firms within a particular market context. Thus framed, the latter conception might be more useful as it reflects that firms are also 'responsible' to a certain extent.

One concern that might be expressed is that vulnerability is rather broad. What should matter is less the fact that anyone can become vulnerable, but rather how likely that is and how severe the consequences might be relative to their standard of living. Any financial detriment arising from being in a vulnerable position is more significant on a low income than for a family on a high income.

If properly shaped and if the research conducted by regulators confirms it, vulnerability might be more useful from a poverty perspective than the disadvantaged group approach it replaces. It has the potential to be more specific, avoiding the problems of defining people as disadvantaged just because they share a characteristic with other disadvantaged people – high-income pensioners being the obvious example. Additionally, poverty itself is dynamic, with substantial moves in and out. For example, DWP (2010:23) find that 7% of the population who are not in poverty one year enter poverty the next.

The problem is making the definition of vulnerable usable. An example of this might be the work conducted by the Centre for Sustainable Energy (CSE, 2012) for Ofgem, which identified 35 'nodes'. Through this, CSE was able to establish groups that were particularly at risk of being vulnerable with some specificity, such as 'Low income single adults in electrically-heated terraced houses in less urban areas' (2012:13). If this enables a better targeting of resources by regulators, government or firms, then it may be more useful than the categorical approach as it allows for overlapping disadvantage: for this example, low income and rurality and heating method.

If vulnerable groups were to be targeted for more specific interventions, then depending on the necessary level of private sector involvement, some form of data-sharing or data-matching would be required. A current example of this is the Warm Home Discount which uses a data-matching process between DWP and the suppliers for the 'core group' (Ofgem, 2013:9). The core group are people aged under 75 receiving the guarantee element of pension credit and those aged over 75 receiving pension credit. When the DWP records correspond to a supplier's records, the rebate is given automatically.

There have been suggestions that data-sharing provisions are extended to the 'broader group' (others who can benefit from the Warm Home Discount, defined at the discretion of the energy company), for example, Citizens Advice (2011:4). The application of data-matching is potentially broader: for example, the Consumer Council for Water (2012:3) has suggested it could be extended to the water industry with new legislation. However, Consumer Futures (2013:8) has noted that any extension of data-sharing needs to have 'guaranteed' benefits for the consumer to outweigh potential risks.

This sharing and matching of data could overcome the problems of low take-up of schemes targeted at vulnerable groups. Currently, consumers tend to contact companies to find out about schemes, rather than the other way around. Given the problems identified earlier around access to information, particularly online, this will always result in low take-up.

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# 5 CONCLUSION AND RECOMMENDATIONS FOR AN ANTI-POVERTY STRATEGY

## Understanding links and opportunities

The aim of this report is to provide a framework for thinking about the cost of living which those concerned with poverty can use to elaborate any proposals for action. The cost of living is a more complicated subject for an anti-poverty strategy than low income for two reasons. First, it takes many diverse forms: when the 'poor pay more' it is almost never just a matter of a higher price for the self-same identical product.

Second, even though government is still central, most of the key decisions on the cost of living are taken companies and regulators. Third-sector organisations also have a part to play. An anti-poverty strategy must treat these other bodies as a key part of its audience and look to engage with them.

Table 10 presents two types of household – low income and high cost – and whether the policies that could be applied are specific to the households in the group or whether they apply generally but with a greater impact on those in low income. To address costs for people in poverty, we need a way of thinking about and categorising both the costs and the people.

**Table 10: Policies and their impact on low-income and high-cost households**

	<b>Low income households</b>	<b>Households with specific higher costs</b>
Examples of costs specific to the group	<b>A</b> Cuts in public subsidies and discounts targeted at low-income families	<b>B</b> Costs associated with disability or living in rural areas
Examples of costs affecting whole population that affect the group disproportionately	<b>C</b> Uprating of transport and water costs, consumption taxes	<b>D</b> Costs associated with consumer vulnerability or lacking enabling goods

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Much activity and campaigning against poverty focuses on group A – for instance, campaigns against the ‘bedroom tax’ fit in this group. Recent work by Scope’s Extra Costs Commission highlighting the additional costs faced by disabled people fit into group B.

Public policies that determine prices can affect everyone but if the items in question take a larger share of low-income households’ budgets, they are affected to a greater extent (group C). This should be quite an easy shift of focus for an anti-poverty strategy as government (or a particular regulator) is still the target and the policy (e.g. to hold down a rate of increase) is still simple.

Actions taken by companies and regulators usually belong in group D. These are broadly issues around access to markets, where the ideas of consumer vulnerability and ‘enabling’ goods belong. At the moment, it appears that ‘vulnerability’ is to be a core idea for utility companies and others. This makes it a basis on which anti-poverty organisations could engage with both regulators and companies, provided a way can be found to adapt the idea for people in poverty.

## Recommendations

This review of the costs associated with poverty confirms that there are concerns, including, but not limited to the higher rate of inflation for many essential goods in recent years. ‘Cost’ and ‘cost reduction’ properly belong in an anti-poverty strategy but two questions must be answered before significant effort can sensibly be devoted to them. The first is how to measure poverty once cost is included as a component. The second is how large an issue cost really is: first order or second, of great importance to some in poverty but not others?

Focusing on subsidies, notably the cost of housing and perhaps childcare too, remains crucial but is not enough. It also needs to be rethought. Both government and its critics focus on these subsidies. In an age of austerity, government cuts them both to save money and in the belief that by so doing it can change behaviour, even driving down (or at least holding down) the underlying cost. Critics oppose them on the grounds that the behavioural change can’t or won’t happen – and that they just make the poor poorer. Neither side is without merit, and neither has a monopoly of it. An anti-poverty strategy needs to develop principles to create an intermediate position in which the concerns of both sides can be heard.

Besides subsidies targeted on low-income households, problems of cost require development of thinking in three directions. The first is through attention to groups facing special and/or enhanced costs, for example those arising from long-term sickness or disability or those incurred, say, by residents in rural areas. Such groups need to be identified and the special and/or enhanced costs they face documented, quantified, the reasons for them explained and responsibility for them identified. This will often require close attention to the interplay between private service providers, public subsidy (e.g. in the case of rural public transport) and regulators. In migrating away from an exclusive focus on low-income groups, ‘avoiding poverty’ or ‘an adequate safety net’ may not be a sufficient goal. For example, campaigners for the rights of disabled people stress the importance of achieving ‘independent living’.

The second development is to turn the focus on those general costs with a disproportionate impact on low-income households. It should not be forgotten that today’s attention to poverty is built on a long record of

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measurement, starting (arguably) with the Rowntree Income and Wealth Study in the early to mid-1990s. Progress will require evidence, both statistical but also relating to the institutional framework that drives these costs. While some of these will be to do with the operation of free markets (rising world demand), it will be necessary to identify the role of public policy (and private sector reactions to them), from planning to tax and including the rules by which certain administered costs (e.g. regulated rail fares, network energy costs) are allowed to rise.

The third development is towards costs that are higher due to some other disadvantage experienced by particular households (and perhaps at particular times). One way forward could be to investigate how far the regulators' emerging concept of the 'vulnerable household' could be shaped to serve anti-poverty purposes. Another could be to develop the concept of the enabling good – possession of a bank account, access to high-speed internet, access to a car. There is also the assumption that if consumers were more willing to switch providers, costs could reduce and quality could increase, yet switching is less common among low-income customers and quite rare for all customers in certain markets.

All these are ideas with potential not yet fully realised. But thinking more about how consumers, companies and regulators interact – quantifying the losses associated with lacking an enabling good, for instance, or not switching utilities – could help both identify candidates for 'modern' universal service obligations and develop a basis for challenging regulators (including, for example, planning authorities) over the way they conceive and evaluate customer needs.

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# NOTES

- 1 Life assurance differs from life insurance. Assurance refers to events that are certain to occur (such as death) and often have an investment component that increases their value. Insurance refers to things one wishes to protect against financially, such as death during a certain time period.
- 2 Around 45% of fares are regulated, and tend to be those on commuter routes with no alternative.
- 3 See Ofwat's Glossary of Terms (at [www.ofwat.gov.uk/aboutofwat/gud\\_pro\\_ofwatglossary.pdf](http://www.ofwat.gov.uk/aboutofwat/gud_pro_ofwatglossary.pdf)) for more information. 'The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula  $RPI \pm K + U$ . K is the number we determine at a price review every five years to reflect what each company needs above inflation each year, to finance the provision of services. It may be changed at an interim adjustment between price reviews. RPI is the percentage increase in the Retail Price Index in the year to the November before the charging year. U is the amount of unused K not taken up in previous years. Also known as "K factor".'
- 4 RIIO stands for Revenue = Incentives + Innovation + Outputs.
- 5 Social tariffs for fuel have been phased out as part of the introduction of the Warm Home Discount.

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