University of BRISTOL

/PFRC

THE POVERTY PREMIUM IN 2022

April 2023

PROGRESS & PROBLEMS

QUICK READ SUMMARY

Supported by
FAIR BY DESIGN
Ending the extra costs of being poor

QUICK READ

Context

Since 2016, the UK has suffered a series of economic shocks, which have had a detrimental impact on household incomes, particularly those at the bottom of the income scale. Events such as the vote to leave the EU, the Covid pandemic and subsequent lockdown, and the current cost of living crisis have left lower-income households with static or decreased incomes and far higher costs. **The financial precarity of those on the lowest incomes, therefore, has markedly increased since the 2016 study was conducted**, and it is in this context that we analyse and understand changes to the level and nature of poverty premiums experienced, as well as consider how any financial support offered by the government may alter the effect of them. What remains unchanged, however, is the importance or reducing these premiums for those who can least afford it.

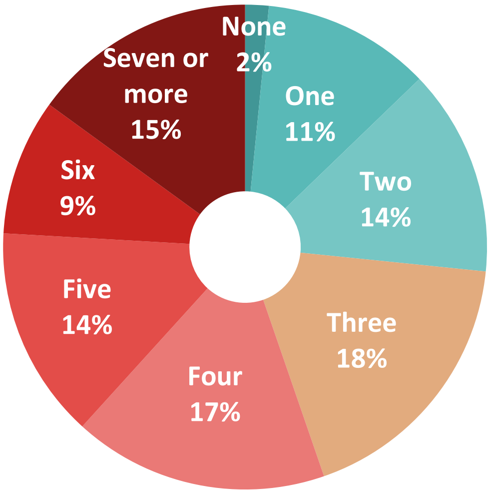
Methods

This study aims to build on and update the 2016 study,[1] while drawing on the similar 2019 study.[2] The findings are based on a representative survey conducted in 2022 of 741 respondents whose household income was below 70% median income equivalised for household size. Representative costs for each component of the poverty premium were then calculated using a desk-based costing exercise. These data were analysed to calculate the prevalence of each poverty premium, the costs that are therefore incurred, and to understand who is most at risk from which premiums. The majority of costs were calculated as of autumn 2022, but the costs for energy customers paying by prepayment or on receipt of bill were revised in April 2023 to reflect rapid changes in the energy market.

Findings

Almost all low-income households experience at least one type of poverty premium (98% – similar level as in 2016), and the average low-income UK

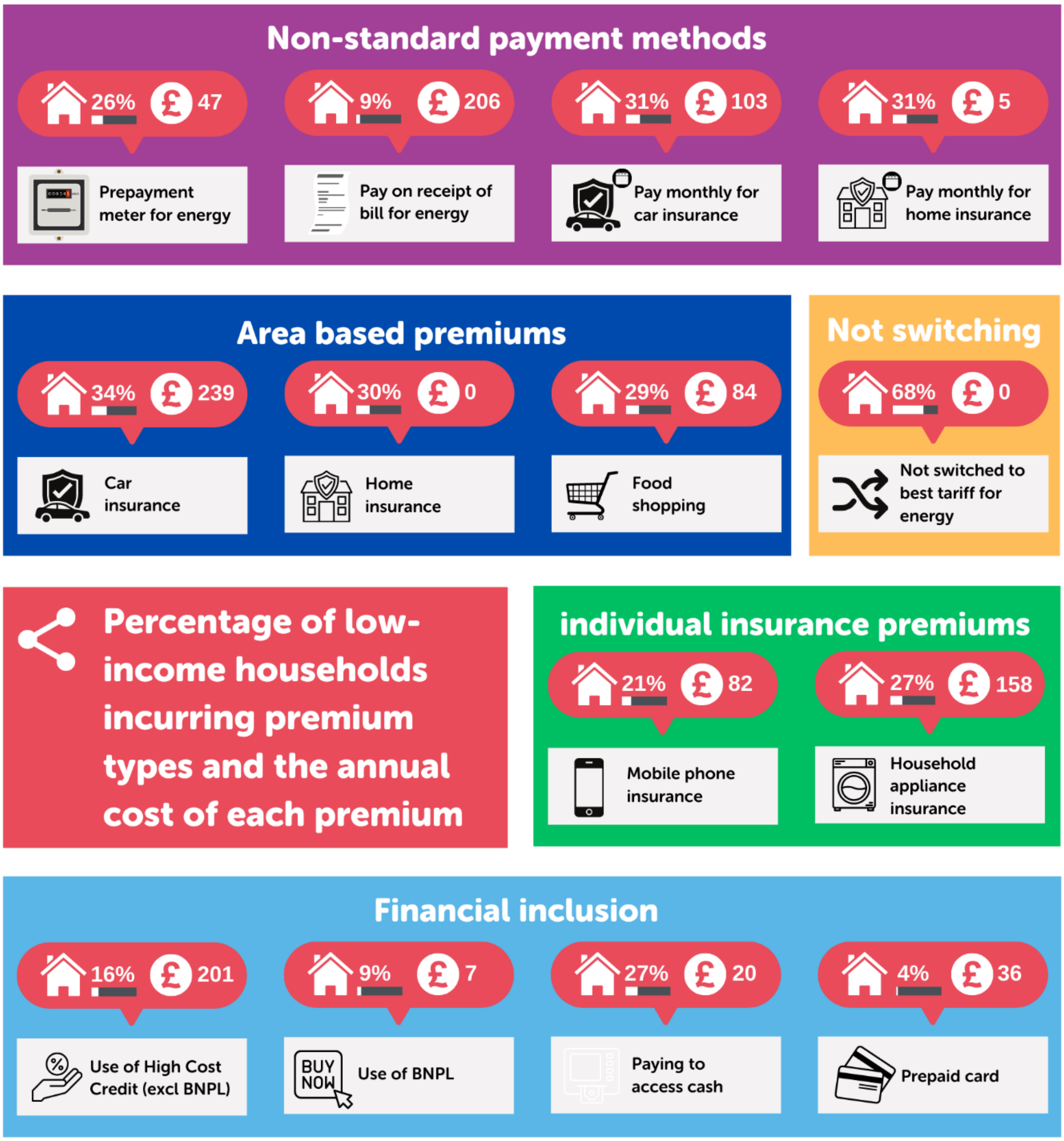
[1] Davies, Finney & Hartfree (2016) Paying to be poor: Uncovering the scale and nature of the poverty premium
[2] Davies & Trend (2020) The poverty premium: A customer perspective



household incurred 3.5 premiums. Nearly two-in-five (38%) low-income households incurred five or more different types of premium.

Left: Number of poverty premiums incurred by low-income households in 2022

Below: Infographic showing the proportion of low-income households incurring each individual type of premium and the cost attributed to each premium in our 2022 costing exercise.



The poverty premium and paying for energy

The domestic energy landscape has gone through major changes since the 2016 research was conducted. In 2017, a tariff cap for those on prepayment meters was introduced, before being expanded in 2018 to include all payment methods. By 2020, the average UK household on a standard variable tariff was paying a historic low of £1,042 – but the energy crisis of 2022 saw this accelerate up to £1,971 by April 2022 and more than £4,000 by January 2023.[3] The Government's Energy Price Guarantee limited what an average household would pay to £2,500 from October 2022, but by this point the energy market had changed significantly, with important ramifications for the poverty premium discussed below.

In the Spring Budget of 2023, the Government announced that it would be ending the premium paid by households using prepayment meters from July 2023. This announcement came too late for the majority of analysis in this report; however, in section 2.3 we have illustrated how this is likely to impact the average low-income household.

Switching to the best tariff

One key consequence of the increase in the tariff cap, as discussed above, has been the **almost complete disappearance of cheaper tariffs that would enable customers to switch to reduce their gas and electricity costs**. In September 2022, when the costings for this report were collated, there were no fixed rate tariffs that were lower than the Ofgem Tariff Cap, by any payment method. However, the actual cost to the customer has risen dramatically, so those in poverty will be struggling far more than they were back in 2016, even though the poverty premium has disappeared or been much reduced. While the implementation of the Energy Bills Support Scheme,[4] may be temporarily protecting lower-income households, the impact is still keen. We would expect the energy poverty premium to return once switching suppliers to gain better deals becomes possible, unless options such as a new energy social tariff are implemented ahead of time.

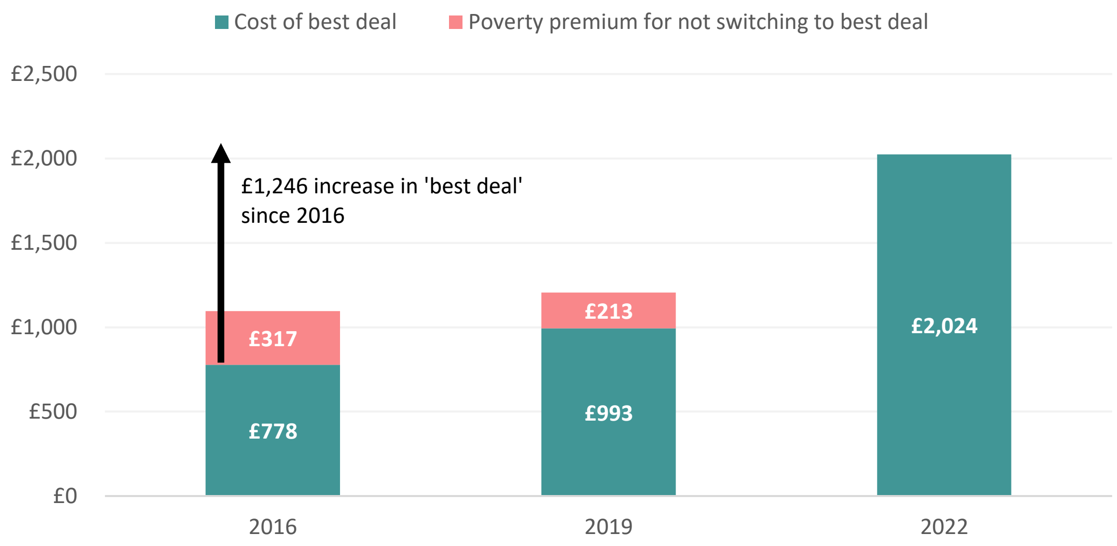
Prepayment meters

The cost of gas and electricity for those who have a prepayment meter (PPM) for gas or electricity has been higher than those who pay by Direct Debit, and this difference remained when this research was conducted in 2022 (though the Government has since announced an intention to remove this poverty premium from July 2023). The cost of this premium has been reducing since 2016, from £70 to £47 and from July 2023 this will fall to £0 – though issues related to lesser ability to 'smooth' expenditure throughout the year will remain (which are not accounted for in this research). The number of low-income households incurring this premium has also dropped, from 32% to 24% using PPMs for electricity and from 27% to 20% using PPMs for gas. This may be as a result of a policy to phase out PPMs and move households onto smart meters. However, given the large increase in energy bills and energy debts

[3] This is the tariff cap for standard tariff paid by Direct Debit.
[4] GOV.UK (N.D.) 'Help with your energy bills'

throughout the course of 2022[5] we may start to see this trend reversed. Use of PPMs is more common among those renting in both the private and social sector, and **it is the very poorest of households who are most likely to have prepayment meters.**

Below: The rise in energy costs in recent years far exceeds any reduction in the poverty premium



Paying on receipt of bill

The opposite has occurred among those who pay for electricity or gas on receipt of bill; these premiums have increased over the years, rising from £43 in 2016 to £132 in 2022 and £206 as of April 2023; **higher than those who pay by PPM**, through higher tariffs. However, there has been little change in the proportion of low-income households incurring any of the premiums between 2016 and 2022. Paying on receipt of bill appears more common among older households. Premiums for paying monthly for insurance, however, appear to be mainly incurred by a younger group of households, and there has been little change in the number who incur them. The cost of paying monthly for car insurance has risen from £81 in in 2016 to £103 in 2022.

Area-based poverty premiums

Insurance

Overall around a third of households incur these premiums. Among low-income households who have insurance, over half live in a deprived areas; 55% with contents insurance and 57% with car insurance. Comparatively, this shows a slight, significant increase in the proportion incurring each premium. The cost implication has disappeared for home contents insurance, from £14 in 2016, but the poverty premium for car insurance has increased dramatically; rising from £74 in 2016 to £239 in 2022.

[5] See, for example: Wilson (2022) '[Vulnerable smart meter customers could be forced onto prepayment as energy bills soar]'

Food shopping

Overall, just under a third of low-income households (30%) incur a poverty premium for doing at least a quarter of their food shopping at smaller, more expensive outlets – above the UK average of doing 17% of shopping in these establishments. Overall, this costs these households an average of £84.

Individual insurance poverty premiums

Overall, the cost of insuring appliances or mobile phones has remained broadly static since 2016, although the number of people doing this has risen considerably. In 2016, just 13% reported having insurance for specific household items like kitchen appliances, but in 2022 this has risen to 27%. The propensity to have mobile phone insurance also increased, albeit at a lesser level, rising from 16% of low-income households in 2016 to 21% in 2022. Those who had purchased mobile phone insurance were typically of working age and had a higher or average income for their age.

Financial inclusion poverty premiums

Access to money

While concerns over continued free access to cash have become increasingly prominent in recent years, and the number of fee-charging ATMs may have increased, there has been little change in the amount that consumers can expect to pay when withdrawing cash from a pay-to-use machine – £1.68 in 2022. A slightly higher proportion of low-income households reported having used a pay-to-use cash machine in the last 12 months in 2022 (29%) than in 2016 (27%). While students are most likely to have used a fee charging ATM in the last 12 months, it is people with health issues who do so most frequently, and those from a non-white ethnic background. There has been very little change in cost or number using prepaid cards in this time frame.

Higher Cost Credit

The higher-cost credit market has changed markedly since 2016, and even since 2019, and this has made comparisons difficult. For example, the cost of mail order catalogues has dropped over time – reflecting a shift from some providers to Buy Now Pay Later (BNPL) – and the fluctuation in the cost of buying rent-to-own goods may signify the contracted market of 2022.

Overall, a quarter of low-income households (25%) were found to have used one or more of the forms of credit that we asked about, but this falls to 16% if we exclude BNPL, matching the figure of 16% that we found in 2016.

Overall cost of the poverty premium in 2022

Overall, the average (mean) poverty premium incurred by a low-income household in 2022 is £217 (with one-in-four low-income households paying at least £317); a considerable drop in comparison with the £490 that the 2016 study found as the average poverty premium then. However, the majority of change we find in 2022 can be explained by one of two factors: **a change in the methodology for attributing costs,** or **the removal of the energy switching premium due to the 2022 energy crisis.** When accounting for both of these factors, **the equivalent premium in 2022 would be £499 per year**, little change from the cost calculated in 2016. On this measure, one-in-four low-income households would be incurring a poverty premium of more than £656 per year.

£217 **was the average poverty premium paid by low-income households in the UK in 2022**

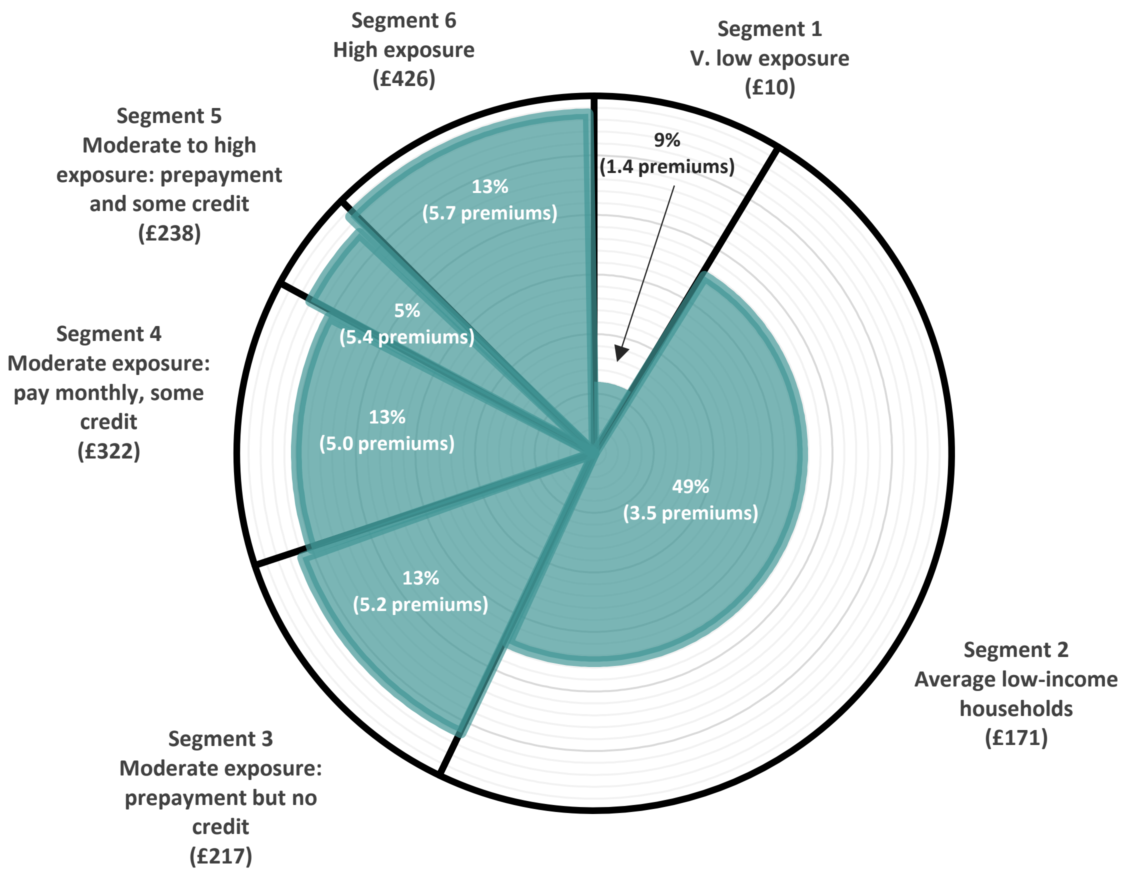
For one-in-four low-income households this rises to **£317**

£419 **would be the average premium paid by low-income households if we remove the (temporary) impacts of the energy crisis**

Meaning that if previous market conditions return one-in-four low-income household would pay **£656**

Segmentation based on level of exposure to different poverty premiums

Our segmentation (below) shows that the impact of the poverty premium is not felt equally among low-income households, with some households incurring many more different types of premium than others and incurring higher costs as a result. This analysis also confirms what we found in 2016: poverty premiums are often a consequence of the extent to which households are fully participating in society. The segments that had the highest exposure were more likely to be households with children and working part time. Both working and having children can mean extra costs, and expenses that have to be met, and doing this while on a low income appears to result in a higher propensity for higher-cost credit use.



Key industry learning

High-cost credit

Higher-cost credit remains a 'deep' premium,[6] one that is costly but infrequently incurred. We do see positive developments in the higher-cost credit market as a result of regulation: fewer people are borrowing with payday loans or home collected credit, perhaps reflecting the shrinking market for those products, but many more are using Buy Now Pay Later (BNPL), with some concerns over the sustainability of this. The rising costs of home collected credit should also raise concerns over the unintended impacts of regulation; the HCSTC market is continuing to shrink[7] and adequate alternative provision needs to be easily accessible to those who need it.

Energy

The particular and unusual circumstances of the energy market in the UK in 2022 have had a huge impact on the poverty premium. The change to the cost incurred (or not) through not switching to the best energy tariff cannot be understated; it was the biggest single contributor to the 2016 poverty premium, and was incurred by the greatest number of people then. If cheaper tariffs do return, then the poverty premium may end up being substantially higher again. Those on PPMs, generally the poorest households, and those who pay on receipt of bill are still being charged more. And even without a poverty premium, many on low incomes are struggling to manage their bills. Government and regulators need to give serious thought to how households can manage energy bills over the next few years.

Insurance

Car insurance, particularly the geographical element but also the extra cost of paying monthly, is the key concern in 2022, having demonstrated the biggest increase since 2016. Over half of the households who had a car were incurring substantial extra costs to insure their vehicles – a legal obligation. More clarity on how risk is spread across the population may help alleviate some of these extra costs, if it leads to the implementation of regulatory and/or social policy change.

Policy implications

The similarities in the profiles of poverty premium exposures between 2016 and 2022 indicates that certain patterns of payment are difficult to avoid. There is surprisingly little change in the number of households incurring each particular premium, which implies that relying on individuals to change their behaviour may not have the impact that wanted. Fundamentally, **the poverty**

[6] Finney & Davies (2017) Making the poverty premium history – a practical guide for business and policy makers
[7] Fair4all Finance (2022) Blog: illegal money lending and the changing credit market.

premium represents a mismatch between the needs of those on low incomes and the markets that serve them.

Conversely, it is evident that **regulation and social policy can make a real difference to reducing or even eliminating the poverty premium**; in both the energy market and the HCSTC market, regulation has changed the level and nature of the way in which the poverty premium occurs. However, as is also clear, this is not necessarily of benefit to those in poverty. The changes to the HCSTC market have resulted in higher prices for some forms of credit, and while the tariff caps did reduce the poverty premium initially, they have failed to protect low-income consumers from high energy prices. Therefore, a more nuanced approach to the development of regulation and social policy may decrease poverty premiums across of number of areas and **so regulatory bodies and government departments should consider regulations and policies that address the specific inequalities experienced by those on low incomes and with protected characteristics.**

Finally, the financial outlook for those in low-income households in the coming year is grave, and it seems unlikely that this will change for the better in the short term. Policymakers should consider longer-term, sustainable ways in which those who are financially vulnerable can be supported in managing their bills, ideally **introducing permanent social tariffs for essential services**.

Thanks go to Fair by Design, which is managed by Barrow Cadbury Trust, for supporting this research.

University of BRISTOL

/PFRC