Poor Choices:

The limits of competitive markets in the provision of essential services to low-income consumers

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Foreword

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Energywatch has dedicated itself to tackling the issues that have impeded competition in the energy market and given consumers a raw deal. We have also been vocal on the consequences of market failings for low-income consumers and have led the debate over the role that both the market and the state have to play in the provision of affordable energy for this group. This research sees energywatch take a step back from that debate and invite independent analysis from sectoral experts on energy and across six other essential service sectors.

In many ways this is a timely report. The last twelve months have seen the mushrooming ‘Credit Crunch’ wreak havoc on the financial services and housing sectors; as well as unprecedented oil prices and spiralling fuel and food bills. These events have made all households much more attuned to the functioning, or in some cases, malfunctioning, of markets. As the findings of this report demonstrate, the impact will be most severe for those already struggling to make ends meet; and who in a number of instances will have already been paying premium prices.

The sectors analysed here are food, housing, water, telecommunications, public transport, financial services and energy. In twenty-first century Britain many of us take these goods and services for granted, rarely giving them a second thought. Low-income consumers do not have reason for such complacency. Budgeting for and securing adequate provision of these essential services can remain a daily challenge for this group. The purchase of these seven goods and services accounts for almost two thirds of household expenditure in the three lowest income deciles.

The research looks at each sector and asks whether there are limitations in the extent to which competitive markets can deliver adequate provision of these services to low-income consumers. It also records the range of support mechanisms that are in place to support low-income consumers when the market, of its own volition, does not deliver in this respect.

Anyone who has represented the interests of low-income consumers will be familiar with the roll call of barriers that low-income consumers are prone to facing when engaging with markets; and these were evident in a number of the sectors analysed here. For example:

- A budgetary need to ‘pay as they go’ too often sees low-income consumers pay a premium for a non-premium service.

- Low spending power renders low-income consumers commercially unattractive, with few, if any, providers seeing a business case to compete for their custom; and providers that do will often do so on punitive terms (home lending for example). The resultant lack of competitive pressures inevitably leaves low-income consumers exposed to higher prices.

- Low-income consumers frequently lack access to the ‘entry requirements’ (a direct debit facility, internet access, basic skills etc.) required to navigate and take advantage of offers available in markets; meaning that choice is often little more than illusory.

Where present, these discriminatory tendencies can be further compounded by the structural failings within a market. The way that vertical integration and market concentration choke competition and inflate prices in the energy market are cases in point. Other characteristics that are corrosive to healthy competition can be found in some of the other sectors discussed here (anti-competitive practices by supermarkets in the food chapter, for example). This is of course bad news for all consumers, but the resultant higher prices will disproportionately impact on low-income consumers.

It should also be remembered that, while the report outlines the problems low-income consumers experience on a sector by sector basis, low-income consumers themselves will experience the effects of these in concert.

A number of the chapters presented here question whether sector regulators have been effective in discharging their primary duties to protect consumers and to ensure their respective markets work in the interests of all consumers. In a number of the sectors examined we have seen a regulatory attitude that, in an often well intentioned bid to stimulate competitive pressures and innovation within markets, has walked a fine line between ‘light touch’ and indifference. The ‘time bomb’ nature of this approach is currently all too evident in the turmoil we are now witnessing in the financial services sector.

Of course, the seven sectors examined here are very different in a number of ways. Water stands out from the other sectors in that it remains a monopoly enterprise, in which Ofwat has sought to simulate competitive pressures and stimulate competitive behaviours through the use of price controls. The infrequent nature of consumer transactions in the housing sector mean it is somewhat at odds with the other six sectors examined. It is therefore very difficult to make like for like comparisons, and to identify the extent to which the support mechanisms that have developed to assist adequate provision for low-income consumers in other sectors could apply to energy. Nonetheless, it is useful to see the types of approaches that have been taken to bridge the gaps where markets do not ensure adequate provision for low-income consumers.

It is particularly interesting to see the way in which third sector and non-mainstream, sometimes not for profit, enterprises have entered certain markets covered here. Housing associations, community transport schemes and credit unions are perhaps the most prominent examples. The fact that some mainstream banks have conceded it is not commercially viable to service low value loans and are now supporting credit unions in this endeavour is an intriguing development. There are few equivalents in energy and it is questionable whether the market as currently structured would enable such approaches to succeed. However, there is no reason why a future energy market based on the energy services model and featuring more localised approaches to the provision of energy, should exclude non-mainstream providers. They key will be finding the best ways to nurture their development in the transition to this ‘new world’.

Despite a recognition that all these services are essential for social inclusion, the inconsistencies in government and regulatory approaches to providing direct support or subsidy to low-income consumers are also readily apparent. The up to 100% subsidy for ‘eligible rent’ in the form of Housing Benefit and the prominent role played by the Universal Service Obligation in telecoms clearly represent the best practice in these respects.

Poor Choices represents the final piece of energywatch research. In many ways it is a fitting note for energywatch to end on. During its lifetime energywatch has consistently pushed for an effective market that works for, rather than against consumers. We have also pushed to ensure meaningful support is in place for low-income consumers. This report performs an invaluable role in highlighting the work that remains to be done in the energy sector and in six other essential services. The baton now passes to Consumer Focus, with its cross-sector remit, to push forward on that transformation. The findings presented here will certainly assist in that respect.

I am grateful to Professor Thomas and his co-authors for the illuminating work they have produced. While the views expressed are very much the authors’ own, there is a great deal that reinforces energywatch’s own experience in working for low-income consumers and there is much here that we commend.

Richard Bates

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Introduction

"The seven sectors examined in this report represent the goods and services essential for, at the least, social inclusion and, in most instances, survival in a modern society. For the lowest three income deciles, they represent about 60 per cent of total household expenditure."

Stephen Thomas

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1. Introduction

The combination of rapidly rising food,[1] energy,[2] water[3] and transport[4] prices and the 'credit crunch' has thrown into sharp relief the difficulties that an increasing number of households, especially low-income households, are facing in making ends meet. If these issues are not addressed by government, there is a very real and immediate risk that low-income households will face the prospect of being unable to afford key essentials, such as energy and food, at the level required to maintain good health and an acceptable standard of living. Failure to gain sufficient access to these essentials will lead to real health consequences. A report by the World Health Organisation published in August 2008 found that life expectancy in the UK had fallen to 79 years. It blamed low incomes, poor education, bad housing and a failure to curb junk food and adopt healthy transport policies for this decline in health.[5] The 'credit crunch' is likely to exacerbate these problems. A survey published in September 2008 found that 56 per cent of the UK population are buying cheaper food to cut costs.

The market landscape for the provision of these essential goods and services has been transformed in the last 20-25 years. In particular, there is now a much greater reliance on markets than on government planning to ensure these goods and services are available at affordable prices. When these markets fail or become unreliable, as seems to be the case with the 'credit crunch' and to varying degrees with energy and food markets, the impact will be most keenly felt by those who were already facing the greatest difficulties in relation to these goods and services. This reliance on markets has significantly reduced the policy options available to government to act when social problems, such as those caused by the 'credit crunch' and rising energy prices, appear.

The primary features of the transformation in the provision of these good and services have been:

- Monopolies replaced by markets (energy and telecoms);
- Private ownership has replaced central government public ownership (water, energy, telecoms and rail);
- The role of local authorities has been cut back from owner of services and products to a more restricted regulatory role (buses and social housing);
- Internet price comparison sites have become a key tool for households in determining whether they are getting the best deal possible (financial services, energy, telecoms); and
- Independent sector regulators have been introduced to oversee the markets created (energy, telecoms, financial services, and rail).

It is only in the food and water sectors that the legacy market framework has remained largely intact. Food remains a free market with essentially no price controls, while the water sector is still constituted by regulated (albeit now privatised) monopolies.

The impetus for these changes has been a belief that free markets operated by private companies are invariably the most efficient way to bring goods and services to households. Implicitly, the price reductions and improved service, which it is assumed will flow from the operation of a free market, will far outweigh any negative consequences that could result from the workings of a free market, especially when compared to more restrictive forms of supplying a good or service. Any problems specific to low-income households - for example, that private companies will not have sufficient incentive to serve low-income households who, because of their low purchasing power, are unprofitable to serve - can be dealt with by imposing specific duties on regulators and by voluntary agreements or codes of practice with the private companies. With the market delivering better prices and better services the State will only have to step in to provide support as a last resort.

Where transformations in the markets for essential goods and services have taken place, these are mirrored in the ways that households have had to alter the way they relate to these markets and the ways in which they purchase goods and services from them. There is now a much greater onus on households to take responsibility for navigating and taking advantage of competitive markets in order to ensure they realise the promise of better value for money and improved service.

The barriers listed below, which low income households can encounter when engaging with a market, mean it remains unclear as to whether this is a reasonable expectation to make of low-income households.

- They may be commercially unattractive, meaning competing companies will not be motivated to try to win their custom;
- They may lack access to the facilities and competences needed to take maximum advantage of the markets, for example internet access, surplus capital to use direct debit with confidence and/or take advantage of discounted offers (2 for 1, season tickets etc);
- A budgetary need to pay up front in order to avoid the risk of unmanageable bills, for example with energy and mobile phones;
- Financial and social exclusion issues and basic skills deficit.

This research will focus on the experience of low-income consumers in relation to the purchase of seven key essential goods and services: energy, water, public transport, telecommunications, financial services and food. It will seek to ascertain:

- The extent to which free, competitive markets have been introduced in each sector;
- How far the theoretical benefits of markets have actually been realised;
- Whether these benefits are limited to more affluent households who possess the skills and resources to exploit the potential of the market;
- The extent to which the market in each sector has shown itself capable of (a) ensuring adequate provision for; and (b) serving the interests of low-income consumers.

Where the theoretical benefits of markets have not been realised, we ask:

- To what extent is this to the particular detriment of low-income consumers?
- Are the problems evident in the functioning of the energy market symptomatic of the problems that low-income households face in their procurement of essential services in other markets?
- What mechanisms and measures have been introduced to ensure adequate provisions to low-income consumers and how effective are these?
- Who has been responsible for implementing these protective mechanisms and measures?
- Are there lessons that can be learnt for the energy sector?

The aim is not to determine whether the advent of privatisation and/or liberalisation in these essential services has been beneficial: this would require the construction of highly contentious 'counterfactuals' (i.e. what would have happened if the old structure had not been changed?). This report will therefore limit itself to examining the extent to which free, competitive markets for essential goods and services ensure adequate provision to low-income consumers and to what extent the interests of this group are well served.

2. What purchases are essential?

The debate over what represents an essential good or service in a modern society is often contentious, particularly as the list of goods and purchases regarded as essential for social inclusion expands with growing prosperity and technological developments. Much as the framework for the delivery of essential goods and services has been transformed, and much as consumer behaviour has evolved in response, the product or service itself has also undergone changes in some sectors.

Services generally now regarded as essential, a land-line and/or mobile telephone for example, would, in the case of a land-line telephone, have been regarded as a luxury 50 years ago, while mobile telephones did not even exist 30 years ago. Now the ready availability of a telephone line is regarded as an essential for social inclusion and, for some vulnerable households with particular health conditions, essential for survival. Nevertheless, few would dispute that the seven service and product sectors examined in this report are essential. The rationale for the sectors chosen is set out in Section 6.

3. Changes in delivery of services

For many goods, notably food, free markets operated by privately-owned companies have long been the rule. However, in the past two decades, services such as energy, telecoms and public transport - previously supplied by publicly-owned companies under monopoly conditions - have been transformed into privatised businesses, operating wherever possible through competitive markets. Water services have also been privatised, but objectives to introduce competition in the domestic sector have so far come to nothing.

This report examines how well these changes have served low-income households, focussing particularly on energy and comparing it with the six other essential goods and services listed above. These seven sectors account for a significant proportion of household expenditure and access to them is a fundamental pre-requisite to households being able to participate fully in society: so-called social inclusion.

The energy sector provides a clear illustration of the tensions that are emerging due to the difficulties in reconciling the public service obligations that underpin the provision of such an 'essential to life' service, with the prevailing belief that fully competitive markets are the best vehicle by which to deliver both electricity and gas. Perhaps the most telling manifestation of this tension can be found in the government's efforts to eradicate fuel poverty. The UK Fuel Poverty Strategy (2001) stated the government's belief that 'the best way to ensure that fuel is affordable to consumers is through liberalising energy markets and promoting competition'.[6]

Yet, in 2008, we find a situation where the prices dictated by the competitive market are driving the level of fuel poverty upwards. The growing differential between the price paid by pre-payment meter (PPM) consumers, predominantly low-income households, and those that pay by direct debit and operate their account on-line, predominantly higher-income households poses further questions about the efficacy of the competitive market in the provision of gas and electricity to low-income households. The precise differential between prices PPM and direct debit consumers pay varies somewhat as prices fluctuate. In July 2008, energywatch estimated that PPM consumers are paying on average 23 per cent (£203 per year) more than a consumer who pays by direct debit through online tariffs.

Worst off are those consumers who have chosen not to move away from (or are unable to move because of debt) from their incumbent suppliers. In July 2008, a PPM consumer in Yorkshire who still bought their gas from British Gas and their electricity from npower (owner of Yorkshire Electric) would on average be paying 43 per cent (£361 per year) more than the cheapest deal.

4. Marketisation and liberalisation of public services

Prior to important UK public services being privatised and opened to competition, it was possible, at least in principle, to ensure that low-income households paid no more than a fair rate for these services; that is, a rate that reflected the actual, if not always efficient, costs incurred in providing the service. Companies with monopoly rights, especially publicly owned ones, could easily be required to meet social obligations, sometimes subsidised by taxpayers and sometimes cross-subsidised by other consumers. For example, following privatisation of the electricity industry and prior to the introduction of competition for household consumers, the regulator required that prepayment meter consumer rates were no more than 10 per cent higher than standard rates. In theory, the model of state ownership and monopoly powers had the potential to enable a good balance to be struck between social policy concerns and economic pressures, rather than the former being subjugated to the latter. In practice, these arrangements were far from perfect, but there were no structural barriers to prevent them being made to work other than the intrinsic difficulty of designing the mechanisms for such an arrangement/balance of interests to work efficiently. Liberalisation sees government surrender 'the levers' in this sense against a promise that the benefits of markets would more than outweigh their loss.

Since the 1980s, nationally-owned public services have been privatised and, where possible, opened to competition, starting with telecoms (1984), gas (1987), electricity (1990) and rail (1995). Buses, which up to 1986 were often publicly owned on a local basis, were also moved to the private sector and greater competition was promoted. The water industry, which was nationally-owned through a number of regional companies, was privatised in 1989. Although sporadic discussions about introducing competition have so far come to nothing, the sector regulator, Ofwat, is still examining ways of introducing consumer competition.[7]

The introduction of free markets has created tensions with the public service obligations that were previously enforced. The duty of private companies in competitive markets is to maximise profits for their shareholders. They are therefore motivated to charge as much as the market can bear and are inclined to gravitate towards the most profitable consumers. Whilst recognising that political expediency, reputation enhancement and commitments to socially responsible behaviour can all lead private companies to make concessions to some low-income households, schemes that have a significant cost and/or run contrary to competitive instinct will be seen as implausible, unless they are imposed on the companies, such as the Universal Service Obligation that is imposed on BT. Ironically, it is relatively easy to require BT to shoulder this responsibility because they retain the dominant share of the household market. If the market was much more competitive, it would be difficult to identify a single company to take on this responsibility and imposing such an obligation on the large number of competing companies needed for a truly competitive market would be difficult.

Reforms to public utilities have not been confined to the UK. For the past two decades, the European Union has passed a series of Directives[8] relating to public services aimed at opening them up to competition, but also formalising Public Service Obligations. Of the sectors examined, energy, public transport, telecoms and water are categorised as 'services of general economic interest'.[9] Under the Charter of Fundamental Rights:

> *the Union recognises and respects access to services of general economic interest as provided for in general law and practices, in accordance with the Treaty establishing the European Community, in order to promote the social and territorial cohesion of the Union.*

Electricity, telecoms and water are categorised by the European Commission as ‘Universal Services’. Under EU policy, this means that the service has to be made available to all consumers of a Member State with a specified quality and at an affordable price, including complete territorial coverage.

5. A longstanding concern

Consumer organisations have long been concerned by the problems that low-income groups can experience in securing adequate provision of essential goods and services and the various ways in which markets can leave this group disadvantaged. For example, the UK National Consumer Council (NCC) has campaigned on this issue for at least 30 years (NCC, 1977), even before the policies to transform provision from monopoly supply to competitive markets for many of these services were introduced. The findings of its most recent research on this subject (NCC, 2004) can be summarised under three main headings:

- **Understanding consumers’ needs.** The NCC found that ‘there is no consensus about which goods and services are essential to meet consumers’ basic needs, and therefore what policies are needed to ensure inclusion. More fundamentally, there is poor understanding of consumers’ real needs; often disadvantaged consumers are left to choose from services that are inappropriate.’

- **Changing nature of service provision.** NCC found that: ‘there is little consistency or focus in government policy towards the increasingly important role of the private sector – from water and telecommunications through to services such as transport.’

- **Barriers to access.** NCC found that: ‘disadvantaged consumers face many barriers gaining access to essentials, and contend with fewer resources (such as money and transport) and skills (such as numeracy).

While the aim of the NCC study was to generate debate and stimulate research into solutions to this problem, it offered three proposals for discussion:

- **Identification of essential needs:** An independent commission should identify the essential goods and services that all consumers should have access to.

- **Needs-based assessment of minimum income:** The commission should consult on appropriate minimum income standards required to purchase essentials and make recommendations to the DWP to adjust income support measures accordingly. These should then be revised annually.

- **Universal, equitable access to essentials:** Government, regulators and suppliers should work together to improve access to essentials, not least by tackling the higher costs of access experienced by disadvantaged consumers. This should include agreeing consistent standards on accessibility, affordability and appropriateness of services (the NCC did not call for off-the-peg solutions or simple subsidy).

6. Market characteristics of the sectors examined

Of the seven sectors examined, only food and drink comes remotely close to the characteristics of a free market envisaged in economic theory. In simple language, this is based on a vision of identical goods being sold from a large number of market stalls all prominently displaying their price (see Table 2). This requires that:

- There are many firms, each having an insubstantial share of the market;
- There is free exit and entry into the market; in other words, it is easy to set up a new company and there is no obligation on existing companies to stay in the market;
- There is a homogeneous product;
- There is perfect factor mobility; in other words, producers are free to sell their products and services to any market they choose;
- There is perfect information; in other words, all buyers and sellers have complete knowledge of all market information at all times.

In practice, economists acknowledge that no market that meets or largely meets all these criteria can ever exist. The assumption is that the benefits from an imperfect market will be greater than the costs that inevitably arise because of these imperfections.
Put simply, food consumers usually have a choice of supermarkets from which to buy, prices are displayed and it is possible to check which supermarket is cheapest. Few barriers/costs to exercising choice exist, e.g. you can walk out of Tesco and into Asda, or even purchase some items from both. In the longer term, if markets are not working well, new supermarkets will be opened where there seems to be a need. In practice, even for food and drink, as the chapter here demonstrates, the market is far from perfect.

- Companies use eye-catching offers on high profile purchases to lure in customers, but it is not easy to judge the cost of the full range of items required – information is far from perfect.
- The big four supermarket chains control about 75 per cent of the market. While it would be relatively easy to open a small grocery store, their buying power and control of prime sites etc. mean that it would be extremely difficult for a new company to rival the big four – there are not many firms each with an insubstantial market share and there is not free entry and exit from the market.
- Many products are dominated by strong brands, which are often preferred over ‘own brand’ and unknown brand goods of apparently similar quality – there is not a homogeneous product.

Nevertheless, despite the apparent dominance of the big four, the economic pressures on household budgets are leading some households to move towards low-price supermarkets, such as Lidl and Aldi.[10] The big four supermarket chains will have to respond by reducing (or appearing to reduce) their prices if they are to retain their market share. So markets could arguably be said to be working even in as concentrated a sector as food.

6.1 Energy

Energy is a fundamental necessity for human life. In a modern society, this means a connection to an electricity supply network and, in many cases, a natural gas connection, although bottled gas or fuel oil can serve as substitutes for the latter where economic reasons mean a network connection is not viable. Natural gas and electricity are entirely standard products, there is little opportunity to postpone demand and, for consumers, storage of natural gas and electricity is impossible, meaning energy has to be bought at the moment of need. The opportunity to purchase energy through a competitive market had become available to most consumers by 1998. Unlike most of the other sectors, energy is a major purchase for industrial consumers so, in a market, household consumers are competing in the market with industrial consumers. One particular problem associated with the introduction of competition is that retailers buy their energy from a market where the price is set every 30 minutes and there could be very wide variation during the day in the wholesale price. By contrast, meters for residential consumers are at best still only read quarterly, so there is no way for the retailer to know on what day and at what time an individual consumer has consumed their energy. This means there is no way to accurately pass on high wholesale prices to the consumers that actually consumed this energy at the peak time.

This is one of the problems that has led to pressure for 'smart meters' which record and transmit consumption data on a 30 minute basis. If smart meters were to be used to send price signals to consumers, for example, charging high prices in peak hours, this could, depending on the tariff/charging framework adopted make the choice of supplier very difficult because the consumer would not know in advance what price was going to be charged. It would also open the way to very high prices being charged on cold winter days when demand was high and when vulnerable consumers might choose not to consume on cost grounds.

One major difference compared to the other sectors (with the partial exception of water) is that energy demand is a derived demand. Consumers do not want a kWh of electricity or a therm of gas, they want the service this will provide and the amount of energy needed to provide will depend heavily on the efficiency of the equipment used and, for heating, the thermal properties of the dwelling. So energy consumption is not a reliable indicator of energy service received

6.2 Water and sewerage[11]

Like energy, water is a fundamental necessity for human life. It is also an entirely standard product: there is relatively little opportunity to postpone demand and it is a major purchase for many large industrial consumers as well as residential consumers. It is clear that water supply for residential consumers in England and Wales will, for the foreseeable future, remain a fully regulated business, operated by regional monopoly companies with prices set by the regulator. There are substantial variations in prices between suppliers. But rural consumers do not pay systematically more than urban consumers and disconnection of occupied houses is banned by law.

There are statutory requirements on the companies to include special provision for assistance for metered consumers with above average consumption, but on the basis of narrow and inflexible criteria. The take-up rate of this assistance is extremely low and as the chapter on water shows, this low take-up is due to rigid eligibility criteria and low awareness rather than a lack of need for such a service.
There is a particular problem of assessing consumption. The majority of residential consumers are not metered and their charges are based on the size of the premises. For some consumers, those living in flats for example, individual meters might not be viable. The issue of metering raises complex questions of reconciling economic efficiency and responsible use of resources with the need to ensure that all consumers are able to access an affordable supply of this essential commodity. It seems reasonable to assume that if consumer charges were based on actual consumption, consumers would use less, but the risk would be that low-income households, particularly large families, would be forced to use less than would be desirable on health grounds.

6.3 Financial services

This is a complex sector that, for our purposes, can be divided into two main streams: banking services and insurance services. Both of these can be subdivided further with mortgage provision, access to other credit needs and current accounts being important parts of banking services.

While access to financial services is not a fundamental necessity, it is highly desirable that all citizens should have good access to these services from the point of view of social and financial inclusion. Access to a good range of financial services is often necessary for unlocking the best deals in a number of the sectors covered here, such as the best energy and mobile telephone tariffs.

People with poor credit records or have hitherto survived in a cash economy do have difficulty getting bank accounts and 'basic' bank accounts have been introduced, following government pressure on the banking industry. Whilst this enables low income consumers to access accounts with modern electronic capabilities, it also allows government to save money by facilitating the payment of benefits by electronic transfer. Some, but not all, basic bank accounts allow users to set up direct debits, although those who are restricted to basic accounts may not have stable enough finances to allow this. Overdrafts are not allowed and so users do not address the issue of access to credit. This may mean that poorer consumers may have little alternative but to use more expensive forms of credit than would be offered through the normal commercial channels. Mortgages would also be harder to get, or at least more expensive, for consumers with poor credit records or whose choice of property is restricted. The mortgage sector is not examined in detail in this chapter.

For banking, there are also issues of access to branches as the number of banks outside major conurbations declines.

In the insurance field, premiums paid depend heavily on 'post codes' and citizens living in problematic areas face severe additional costs. This may lead to some citizens having to forego insurance cover for things where cover would be very desirable, such as home contents insurance for example.

However, there has been a considerable change in the willingness of citizens to switch supplier of financial services regularly, although identifying the best deal is much easier for those with easy access to a computer and who are comfortable using the internet to search price comparison sites, which can often make it easier to make product comparisons.

6.4 Communications

Twenty-five years ago, the communications sector was a simple sector with a lot in common with energy and water as a regulated monopoly with a limited product range. Now, the widespread availability and adoption of broadband and mobile telephones means that the sector is much more complex and diverse. The landline network is still a monopoly activity, but the availability of mobile phones and new cable networks means the scope for abusing the monopoly power is much reduced. For some analysts, this is a demonstration that, in the long-term, no activity should be regarded as a 'natural monopoly' as markets will, if allowed, find ways to break a monopoly.

The monopoly element is now restricted to the network connection for both fixed landline and mobile telephony. Competition in the fixed line market has been driven by regulatory pressure and by new entrants. In mobile telephony, competition has always occurred at the retail end and focuses increasingly on multi-functionality and bundling of products and services. Nevertheless, a high proportion of fixed line domestic consumers have chosen to stay with the former monopoly provider even though for many consumers it would not necessarily be the cheapest option. This may be due in part to inertia, lack of confidence in new, untested suppliers and the increasing complexity of tariffs which make it difficult to determine the relative prices that different competing companies would charge for a given pattern of calls.

One of the most important aspects of the fixed line market is the continued existence of legal requirements on British Telecom (BT) to provide a universal service nationally (under the universal service obligation or USO). Amongst other things, this means that BT's prices have to be geographically averaged and that BT has to meet all reasonable requests for connection to the telephone network. There is an overt recognition in the legal requirements concerning affordability of basic fixed telephony services, and BT has some albeit limited schemes to help low users and those on low incomes, according to defined criteria.

For consumers outside major conurbations, provision of broadband is not always available and mobile phone networks are less reliable in more remote districts. Communication technology is also increasingly seen as an essential element of social inclusion, but there are few policy measures to ensure access for all consumers.

6.5 Public transport

Public transport can be divided into local public transport, mainly buses, and regional and national services, such as rail and long distance buses. For social and economic cohesion, access to these services is important. There are also generally significant environmental benefits in measures that encourage citizens to travel by public transport rather than private cars. As a result, there are a range of public subsidies provided, such as subsidies for rail routes that provide important links and free bus passes for senior citizens.

In terms of structure and pricing, there were attempts to introduce market competition in local buses with different companies competing over similar routes, but there has been a process of concentration so that most areas are again served essentially by a monopoly, owned by one of only a handful of large companies. The long-distance bus sector is also now very concentrated.

The rail sector was essentially privatised as a series of regional monopolies that were allocated on a franchise basis after a bidding process. There has been concentration here as well and a number of regions have been combined to gain scale economies. As with telecoms, pricing has become complex and consumers have little confidence that they can readily identify the cheapest option. It remains to be seen how successful the simplification of fare structures announced in May 2008 will be.[12]

6.6 Food & drink

Like water and energy, food and drink is a fundamental necessity to human life. However, in the UK the system of supply has always been very different from these services, as it has always been based on a free market. The sector is highly diverse and, even within the same basic product, there is usually scope for significant product differentiation, for example on quality or between brands (including 'own brands'). While the big four supermarkets - Tesco, Sainsburys, Asda/Walmart and Morrisons/Safeway - have between them 75 per cent of the grocery market, there are niche low-price suppliers, for example Lidl and Aldi, as well as small local outlets. However, those living outside major conurbations may be much less able to take advantage of a competitive market if the local population is not large enough to support a sufficient number of competing retailers. One issue is to what extent the viability of small local outlets is threatened by the large supermarkets. The loss of these local, albeit higher-price, shops may pose a particular threat to low-income consumers if the large supermarkets are not easily accessible to them.

6.7 Housing

Adequate housing has long been recognised as a necessity in a modern developed society and, as a result, a very extensive system of support exists to try to ensure that all citizens have adequate housing. The sector can be divided into at least three main forms of provision: owner-occupier, private rental and social rental including council housing and housing association properties. In addition, there are a significant number of people who are homeless, either sleeping rough or in hostel accommodation, who must also be considered.

Housing provision has an important impact on energy purchases as a major determinant of the type and amount of energy required, particularly for space and water heating. Housing is also likely to determine water bills. As a result, the amount a comparable household has to spend to receive the same energy service could vary considerably, and it is widely recognised that 'fuel poverty' can only be effectively tackled by policies that include measures aimed at improving the thermal properties of the housing stock.

7. Household expenditure on the essential goods and services examined here

A study commissioned by the Joseph Rowntree Foundation and published in July 2008 (Bradshaw, 2008) aimed to establish a Minimum Income Standard (MIS) for households. It was based on group discussions and workshops with members of the public in which groups negotiated what items were essential for this standard, focusing on *needs*, not *wants*. The MIS budgets are based on detailed lists of what is required by different household types, including: food; clothes; accommodation; utilities; fuel; household goods; personal goods and services; transport; and social and cultural activities. The study[13] found that in order to maintain a minimum, socially acceptable quality of life in 2008:

- a single working-age adult needs a budget of £158 per week;
- a pensioner couple needs £201;
- a couple with two children needs £370; and
- a lone parent with one child needs £210.

Most people relying on basic out-of-work benefits do not reach this standard. A single person on Income Support gets less than half of the MIS figure. Out-of-work families with children typically get two thirds. However, pensioners receiving Pension Credit do reach the minimum income standard:

- A single adult, working full time, needs to earn £6.88 an hour to reach this weekly standard, compared to the minimum wage of £5.52.
- For almost all household types considered in the JRF study, the minimum income standard is above the threshold used to measure relative poverty – 60 per cent of average (median) income. The great majority of households below this poverty line cannot afford a standard of living that members of the public participating in the study considered to be the minimum acceptable in Britain today.

If we look at Family Spending statistics (see Table 1), we can see that a family with two children would have to earn in the top 40 per cent bracket of household income to achieve this 'basic but acceptable standard of living', while even a single person living alone would have to earn enough to place them at the top of the second decile to meet this standard. So if the Rowntree study is correct, it would seem likely that around 40 per cent of households in Britain do not earn enough to meet this standard.

However, while the Rowntree study led to debates about whether a bird feeder, a bottle of wine or film tickets should be on the list of goods people need to participate in society, generally, the necessity to have access to goods and services in the sectors we are examining is much less debateable.

Table 1 Weekly (£) spending excluding rent and mortgage

	Lowest 10%	Second decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Top 10%	Average
Average spend	123.20	136.50	186.10	265.90	290.00	293.90	370.80	432.50	523.90	674.00	333.00

Source: *National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London*

The Rowntree study attempted to identify how much households would need to spend for a 'socially acceptable quality of life'. The following examines what low-income households, many of which do not earn enough to meet Rowntree's Minimum Income Standard, actually do spend on the essentials.

Using the government's Family Spending statistics[14] we can examine how households, and in particular low-income households (those in the lowest three income deciles), apportion their expenditure between different essential goods and services (see tables 3 and 4). Education and health are crucial services for all income groups. However, the availability of state provision that is largely free at the point of delivery means that these items represent a very low proportion of household expenditure, although expenditure on these items tends to increase a little in percentage terms as the highest income groups opt to pay for private provision.

We can see that some of the 13 main classifications of expenditure follow a pattern of the higher the income, the higher the expenditure, but the percentage it represents of total household expenditure remains fairly constant. For example, expenditure on clothing and footwear represents about 5 per cent of household expenditure for all income categories. The percentage of income spent on alcohol, drinks and tobacco, household goods and services and recreation and culture is also fairly constant for all income groups.

However, for essential requirements, such as food and non-alcoholic drink, housing, fuel and power and, to a lesser extent, communication expenditure as a proportion of total expenditure decreases as income increases. For example, expenditure on food and non-alcoholic drink accounts for 16 per cent of the expenditure of the lowest income decile but only 7 per cent of the highest income decile.
The proportion of income spent on the transport, 'miscellaneous' and 'other' categories increases significantly with income. For example, the highest income decile spends 16 per cent of the expenditure on transport compared to 9 per cent for the lowest decile. The highest income decile spends more on transport than the entire expenditure of the lowest income decile.

Table 3	2006 expenditure by category for low-income households		
(£ per week/percentage of total household expenditure)			
	Lowest 10%	**Second decile**	**Third decile**
Food & non-alcoholic drink	24.50 16	31.40 16	36.60 13
Alcoholic drinks, tobacco	5.30 3	6.00 3	8.30 3
Clothing & footwear	6.60 4	9.10 5	12.80 5
Housing, fuel & power	32.30 21	35.20 18	42.50 16
Household goods & services	11.20 7	14.70 7	17.60 6
Health	1.80 1	2.80 1	4.40 2
Transport	13.90 9	16.90 8	33.20 12
Communication	5.70 4	6.80 3	8.50 3
Recreation & culture	17.10 11	25.20 13	34.70 13
Education	1.70 1	1.50 1	2.70 1
Restaurants & hotels	10.10 6	13.60 7	17.50 6
Miscellaneous	9.80 6	14.30 7	22.20 8
Other	15.60 10	22.40 11	30.50 11
Total	**155.60** **100**	**199.80** **100**	**271.40** **100**

Source: *National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London*

Expenditure on food and drink is very diverse and disaggregating further does not shed much light on expenditure patterns. However, to examine the other six sectors we are studying in depth, we need to go down to the next level of disaggregation. These simple statistics can give only a snap-shot of expenditure; they do not explain why patterns are as they are.

7.1 Energy

Expenditure on energy in percentage terms falls sharply with increased income, and the highest decile devotes only about one third as much percentage-wise of their income to energy as the lowest decile (see Table 9).

7.2 Water

Like energy, expenditure on water is much more significant for the lowest income group, which spends 4.2 per cent of income on water compared to the highest income group, which spends less than 1 per cent (see Table 10). The government has adopted as a sustainability indicator the number of households paying more than three per cent of their disposable income on water supply and sanitation services.

7.3 Financial services

Financial services is, along with housing, perhaps the most complex and diverse of the sectors (see Table 5). Some elements, such as vehicle insurance, are legal requirements (for vehicle owners) and have a high cost. Others, although not legal requirements, are also high cost and not having them could be seen as risky, for example household insurance and pension contributions. Banking services have a very low cost and are voluntary, but could be seen as an essential for social and financial inclusion. Their availability also may provide a key to securing best value in the purchasing of other goods and services.

7.4 Communications

Expenditure on communications as a percentage of total expenditure falls rapidly with increasing income and the highest decile spend only half as much in percentage terms as the lowest decile (see Table 7).

7.5 Transport

Transport expenditure is very much in two parts: public transport and personal transportation (see Table 6). Public transport makes up a much higher proportion of low-income expenditure on transport and, within that, buses are the largest element. For higher income groups, rail fares are more important, probably reflecting commuting. Expenditure on personal transportation as a percentage of total expenditure rises rapidly with increased income, with the percentage spent by the highest decile almost double that of the lowest decile.

7.6 Food & drink

It is not useful to split expenditure on food and drink further than is shown in Table 4. This does show that expenditure on food and drink makes up the highest proportion of total expenditure for the lowest two income groups, accounting for a sixth of total expenditure. Expenditure, as a percentage of total expenditure, falls sharply with increased income and is only half that for the highest income decile (who spend most on transport) as it is for the lowest two deciles.

7.7 Housing and mortgages

This, along with financial services, is the most complex sector to analyse (see Table 8). As might be expected, rent dominates lower income groups' expenditure while mortgage payments dominate higher income groups' payments. The impact of Housing Benefit on the lowest income groups is dramatic and the lowest decile pays only a quarter on average of their gross rent, the rest being met by Housing Benefit.

8. Summary

The seven sectors examined in this report represent the goods and services essential for, at the least, social inclusion and, in most instances, survival in a modern society. For the lowest three income deciles, they represent about 60 per cent of total household expenditure. Because of their essential nature, water, energy, food and communications tend to represent a much higher proportion of expenditure for low income households than they do for high income households. Transport and housing represent an increasing proportion of expenditure for higher income households, reflecting decisions by these households to choose to use their additional income to purchase more expensive houses and cars. For financial services, purchases of insurance increases significantly as a percentage of expenditure, presumably partly because richer households tend to have more or higher value items that require insuring and partly because lower income households may not have enough money to insure all their possessions as fully as they might.

References

Bradshaw J., et al. (2008) 'A minimum income standard for Britain: what people think' Joseph Rowntree Foundation, York. http://www.jrf.org.uk/bookshop/eBooks/2226-income-poverty-standards.pdf

National Consumer Council (1977) 'Why the poor pay more', National Consumer Council, London.

National Consumer Council (2004) 'Paying more, getting less', National Consumer Council, London. http://www.ncc.org.uk/nccpdf/poldocs/NCC068_poor_pay_more.pdf

Notes

1. In September 2008, it was reported that food prices had risen by 8.3 per cent since January 2008. http://news.bbc.co.uk/go/pr/fr/-/1/hi/business/7597703.stm
2. energywatch analysis shows that between January 2003 and September 2008 the average energy bill for a medium user paying by Standard Credit has risen by 141 per cent.
3. In February 2008, it was reported that water prices would rise on average by 5.8 per cent. http://news.bbc.co.uk/1/hi/business/7264594.stm
4. In April 2008, it was reported that commuters faced an increase of 14 per cent in their rail fares. http://www.telegraph.co.uk/news/uknews/1570755/Commuters-facing-14pc-rail-fares-rise.html
5. http://www.guardian.co.uk/society/2008/aug/29/un.life.expectancy and http://www.who.int/social_determinants/final_report/csdh_finalreport_2008.pdf
6. See: http://www.berr.gov.uk/files/file16495.pdf
7. http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/prs_pn1308_openmktcomp
8. Directives are measures passed by the European Parliament that member states are required to incorporate in national law within a specified period of the Directive being ratified, typically about a year.
9. The European Commission states that 'services of general services of general economic interest are services that public authorities consider should be provided in all cases, whether or not there is an incentive for the private sector to do so. It has also stated that EU Member States are free to determine those services which they consider to be in the general interest.' http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft421.pdf
10. In the 12 week period to 13 July 2008, Aldi increased its sales by 19.5 per cent and Lidl increased its sales by 14.3 per cent. The Grocer, 'Discounters bag record market share' 26 July 2008.
11. This report will focus on water services in England and Wales. Ownership and regulation in Northern Ireland and Scotland are different.
12. http://news.bbc.co.uk/1/hi/business/7404514.stm
13. http://www.jrf.org.uk/knowledge/findings/socialpolicy/2244.asp
14. http://www.statistics.gov.uk/downloads/theme_social/Family_Spending_2006/FamilySpending2007_web.pdf

Table 2 **Characteristics of products and services to be studied**

	Energy	**Water**	**Financial services**	**Communications**	**Public transport**	**Food & drink**	**Housing**
Product variety	Standard product	Standard product	Wide variety	Expanding, especially for mobile phones	Limited	Wide variety	Wide variety
Scope for product differentiation	Little	None	Wide variety	Variety	Little	Wide variety	Wide variety
Is the product an essent	Basic necessity	Basic necessity	Necessary for social inclusion	Necessary for social inclusion	Necessary for social inclusion	Basic necessity	Basic necessity
Can demand be postponed?	No	No	Yes	Some flexibility	No	No	No
Do residential consumers compete with large consumers?	Yes	Yes	Not directly, but probably indirectly	Yes	No	No	No
Pricing mechanism	Market + regulation	Regulated	Market with significant regulatory oversight	Mainly market but some regulated prices	Regulation + market	Market	Part market, part regulated
Market structure	6 national competitors	Regional monopoly	Generally fragmented	4-5 main infrastructure companies but wide range of retail companies	Regional or local monopolies	Range of suppliers but 4 main supermarket chains	Range of suppliers
Specific assistance for poor?	Limited voluntary social tariffs	Limited	None	Limited assistance for landli	Some concessions	None	Yes
Accessibility/pricing issues for rural consumers?	Limited	Limited	Banking	Broadband	Yes	Yes	Limited

Table 4 **Total 2006 household expenditure by main commodity or service**

(£ per week / percentage of total household expenditure)

	Lowest 10%	**Second decile**	**Third decile**	**Fourth decile**	**Fifth decile**	**Sixth decile**	**Seventh decile**	**Eighth decile**	**Ninth decile**	**Highest 10%**	**All households**
Food & non-alcoholic drink	24.50 16	31.40 16	36.60 13	40.10 12	44.60 12	47.40 11	51.90 10	57.80 10	62.70 9	71.90 7	46.90 10
Alcoholic drinks, tobacco	5.30 3	6.00 3	8.30 3	9.20 3	11.60 3	11.70 3	13.60 3	14.90 3	15.30 2	15.20 2	11.10 2
Clothing & Footwear	6.60 4	9.10 5	12.80 5	15.70 5	18.10 5	20.70 5	26.00 5	33.50 6	39.40 6	50.50 5	23.20 5
Housing, fuel & Power	32.30 21	35.20 18	42.50 16	43.30 13	45.40 12	49.90 11	48.90 10	52.60 9	51.10 7	74.30 8	47.60 10
H'hold goods & services	11.20 7	14.70 7	17.60 6	24.80 7	23.90 6	29.50 7	33.60 7	36.90 6	46.10 6	64.40 7	30.30 7
Health	1.80 1	2.80 1	4.40 2	4.40 1	5.60 1	5.50 1	5.00 1	6.90 1	6.40 1	15.90 2	5.90 1
Transport	13.90 9	16.90 8	33.20 12	40.50 12	46.60 12	55.40 13	65.40 13	84.70 14	107.50 15	156.20 16	62.00 14
Communication	5.70 4	6.80 3	8.50 3	9.40 3	12.10 3	12.00 3	13.80 3	14.80 2	16.70 2	17.80 2	11.70 3
Recreation & Culture	17.10 11	25.20 13	34.70 13	39.40 12	51.50 14	58.20 13	67.40 13	83.70 14	92.10 13	115.40 12	58.50 13
Education	1.70 1	1.50 1	2.70 1	2.10 1	2.40 1	2.80 1	3.30 1	8.20 1	15.00 2	32.60 3	7.20 2
Restaurants & Hotels	10.10 6	13.60 7	17.50 6	23.40 7	29.00 8	36.30 8	44.80 9	53.30 9	66.00 9	84.80 9	37.90 8
Miscellaneous	9.80 6	14.30 7	22.20 8	26.00 8	28.80 8	35.80 8	44.10 9	48.00 8	57.40 8	73.80 8	36.00 8
Other	15.60 10	22.40 11	30.50 11	54.60 16	60.60 16	72.90 17	89.00 18	99.00 17	139.70 20	191.60 20	77.60 17
Total	**155.60 100**	**199.80 100**	**271.40 100**	**333.00 100**	**380.20 100**	**438.10 100**	**506.9 100**	**594.10 100**	**715.50 100**	**964.40 100**	**455.90 100**

Source: National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London

Table 5 2006 household expenditure on financial services

(£ per week / percentage of total household expenditure)

	Lowest 10%	Second decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Highest 10%	All households
Household Insurance	1.90	2.80	3.60	4.00	4.90	5.40	6.10	6.10	7.50	8.90	5.10
Vehicle Insurance	2.10	3.00	4.60	5.80	7.20	8.10	10.10	11.40	12.20	15.20	8.00
Life assurance & pension	1.00	1.70	3.20	5.30	10.20	14.80	21.10	28.70	54.40	76.80	21.70
Other Insurance	0.50	0.70	1.10	2.20	2.30	3.00	3.30	4.00	6.40	8.40	3.30
Total Insurance	**5.50**	**8.20**	**12.50**	**17.30**	**24.60**	**31.30**	**40.60**	**50.20**	**80.50**	**109.30**	**38.10**
Bank, credit Card etc charge	0.30	0.10	0.30	0.30	0.30	0.30	0.30	0.40	0.50	0.70	0.40
Savings & investments	0.20	0.70	4.40	3.80	1.90	4.10	5.20	6.40	13.70	22.50	6.30
Paying off loan to clear debt	0.60	0.40	0.90	1.70	2.40	3.00	3.30	4.30	5.90	3.50	2.60
Windfall from Gambling etc	1.00	0.70	2.80	1.70	1.70	2.40	2.20	5.50	2.00	1.50	2.20
Total	**7.60** **5**	**10.10** **5**	**20.90** **8**	**24.80** **7**	**30.90** **8**	**40.90** **9**	**51.60** **10**	**66.80** **11**	**102.60** **14**	**137.50** **14**	**49.50** **11**

Source: National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London

Notes

1. Other insurance includes medical insurance premiums, non-package holiday travel insurance and other insurance including friendly societies.
2. Vehicle insurance is also included in the financial services table.

Table 6 2006 household expenditure on transport

(£ per week / percentage of total household expenditure)

	Lowest 10%	Second decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Highest 10%	All households
Purchase of Vehicles	4.60	4.00	12.00	12.30	14.10	19.30	21.60	32.80	44.90	68.70	23.40
Operation of Personal Transport	6.40	9.10	15.60	18.80	25.00	28.30	33.60	40.80	47.60	61.10	28.60
Vehicle Insurance	2.10	3.00	4.60	5.80	7.20	8.10	10.10	11.40	12.20	15.20	8.00
Total personal Transport	**13.10 8**	**16.10 8**	**32.20 12**	**36.90 11**	**46.30 12**	**55.70 13**	**65.30 13**	**85.00 14**	**104.70 15**	**145.00 15**	**60.00 13**
Rail & tube Fares	0.60	0.30	0.70	0.60	0.70	1.30	2.30	2.80	4.00	8.20	2.20
Bus & coach Fares	1.00	1.00	1.20	0.80	1.50	1.80	1.90	1.30	1.40	1.20	1.30
Total public Transport	**1.70 1**	**1.50 1**	**2.30 1**	**1.50 -**	**2.60 1**	**3.90 1**	**5.00 1**	**6.00 1**	**7.20 1**	**13.70 1**	**4.50 1**
Other travel & Transport	**1.30**	**2.30**	**3.20**	**7.80**	**4.90**	**4.00**	**5.10**	**5.10**	**7.70**	**13.60**	**5.50**
Total Transport	**16.10 10**	**19.90 10**	**37.70 14**	**46.20 14**	**53.80 14**	**63.60 15**	**75.40 15**	**96.10 16**	**119.60 17**	**162.30 17**	**70.00 15**

Source: National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London

Notes

1. Total public transport includes combined fares.
2. Vehicle insurance is also included in the financial services table.

Table 7 Household expenditure on communications

(£ per week / percentage of total household expenditure)

	Lowest 10%	Second Decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Highest 10%	All households
Postal services	0.20	0.40	0.50	0.40	0.50	0.30	0.60	0.50	0.70	0.80	0.50
Telephone equipment	0.10	0.40	0.40	0.60	0.50	0.70	0.70	1.50	1.00	1.30	0.70
Telephone Services	5.40	6.10	7.50	8.40	11.00	11.00	12.50	12.70	15.00	15.70	10.50
TV, video, cable Internet	3.40	3.60	4.20	4.80	5.70	6.20	6.80	7.10	7.90	8.70	5.80
Total	**9.10 6**	**10.40 5**	**12.70 5**	**14.20 4**	**17.80 5**	**18.20 4**	**20.60 4**	**21.90 4**	**24.60 3**	**26.50 3**	**17.50 4**

Source: National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London

Table 8 Household expenditure on housing and mortgages

(£ per week / percentage of total household expenditure)

	Lowest 10%	Second Decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Highest 10%	All households
Gross rent	59.90	47.10	32.80	26.40	21.20	21.50	18.00	17.70	12.60	21.00	27.90
Net rent	14.70	14.50	16.80	16.90	17.30	19.80	16.40	17.10	12.40	20.60	11.20
Mortgage intere council tax	11.20	13.60	20.40	30.90	41.30	54.00	63.70	72.50	94.40	117.80	52.00
Purchase of Dwellings	5.00	42.60	42.60	23.80	25.40	63.00	46.80	62.50	73.00	132.50	51.70
Maintenance & Repair	1.60	2.60	5.50	5.50	6.20	7.40	9.20	9.50	11.80	20.50	8.00
Total gross Housing	**77.70**	**105.9**	**101.3**	**86.60**	**94.10**	**145.90**	**137.70**	**162.20**	**191.80**	**290.80**	**139.60**
Total net Housing	**32.50 21**	**63.30 32**	**85.30 31**	**67.10 20**	**90.20 24**	**144.20 33**	**136.10 27**	**161.60 27**	**191.60 27**	**290.40 30**	**122.90 27**

Source: National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London

Table 9 2006 household expenditure on energy

(£ per week / percentage of total household expenditure)

	Lowest 10%	Second decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Highest 10%	All households
Electricity	4.90	5.80	6.60	6.80	7.30	7.70	7.80	8.70	9.30	10.60	7.50
Gas	4.50	5.60	6.30	6.40	7.00	7.20	7.50	7.90	9.10	10.20	7.20
Other fuels	0.80	1.00	1.10	0.80	1.10	1.00	1.10	1.50	1.30	2.20	1.20
Total	**10.20** **7**	**12.50** **6**	**14.00** **5**	**14.00** **4**	**15.40** **4**	**15.90** **4**	**16.40** **3**	**18.00** **3**	**19.70** **3**	**22.90** **2**	**15.90** **3**

Source: National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London

Table 10 Expenditure on water

(£ per week / percentage of total household expenditure)

	Lowest 10%	Second decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Highest 10%	All households
Water	**5.80** **4**	**5.70** **3**	**6.20** **2**	**6.90** **2**	**6.50** **2**	**6.80** **2**	**7.00** **1**	**7.70** **1**	**7.20** **1**	**9.60** **1**	**6.90** **2**

Source: National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London

Note: Includes also 'miscellaneous services relating to the dwelling', e.g. refuse collection and skip hire.

Food

"The need to spend £31 on food for a week for a single person is unlikely to be met when the single person's Income Support allowance for people aged 18-24 is just £45. It would leave just £2 per day to find all other necessities. The situation is even more extreme for those single people aged 16-18 for whom the single person's allowance is just £36."

Dr. Tim Lobstein

Director, Childhood Obesity Programme, IASO-IOTF, London.
Visiting Research Fellow, SPRU
- Science and Technology Research,
University of Sussex, Brighton

Access to an adequate supply of food is essential for life. Food consists of multiple components required to a greater or lesser degree (e.g. food energy, protein, essential oils, vitamins, minerals) but food may also contain threats to health through excess supplies of certain ingredients (e.g. saturated fats) or through toxic components or contaminants, including microbiological contaminants.

This chapter will focus on the ability to gain access to the types of foods that are able to supply a nutritious and well-balanced diet for those members of the population living in low-income private households. Except in passing, this chapter will not consider toxic or microbiological food-borne threats to health, nor the problems of gaining access to adequate food supplies faced by people living in institutions.

Characteristics of food and diet

Several authoritative sets of recommendations have been issued by international, European and British governmental bodies outlining the essentials of a nutritious diet. It is not necessary to repeat the specific recommendations here, as they are largely in agreement with each other and well accepted among professionals (although there is some scope for ‘spinning’ the emphasis on different components of a healthy diet which, when used in product promotion, can be a source of confusion among consumers). As a generality, healthier diets are those containing a greater variety of foods, and containing more fresh, perishable types of food (including fresh fruits and vegetables, oily fish and lean meats), as well as wholegrain foods. Less healthy diets are those containing more highly processed foods, and foods with relatively high levels of fats (especially animal fats), added sugar and added salt.

Secure food supplies have been a focus of attention in overseas development for many years, and definitions of food security are available, but these tend to focus on quantitative aspects of a few essential characteristics of food – such as adequate food energy and protein – and not on the adequacy and quality of the total diet. In modern economies where food security is not a major problem it is more useful to consider *nutrition security* and to use the term nutrition *in*security – akin to the concept of food poverty – to describe situations in which population groups are failing to meet the recommended dietary guidelines for nutritional health.

Nutrition insecurity underpins current concerns about the need for action to improve nutrition and reduce obesity and diet-related disease for the population generally and for low-income groups in particular, as discussed in the present paper. The causes of nutrition insecurity can be attributed to problems in food supply, availability and accessibility, and pricing differentials. The causes may also be attributed to inappropriate choices which, in turn, may be determined by the available information, the consumers’ education, knowledge and motivation, and the commercial strategies being used to promote and market different products.

It should not be forgotten that food purchases may be made on behalf of other people: typically one member of a household will shop for others in the household. When eating out, the composition of the meals and foods available (the recipes and formulations) are determined by the caterer and the caterer’s suppliers.

Nutrition insecurity is not directly measurable. Dietary surveys give the clearest indication of people’s regular intake patterns but these normally rely on self-reported consumption data and are prone to errors of recall. The degree of under-reporting is not uniform, and can vary according to the type of food (e.g. snacks, confectionery, sweetened hot drinks and soft drinks are often forgotten) and can vary across income groups, age groups and household types. Other indicators of nutrition insecurity may use food supply data and food supply trends, market trends, price information and measures of availability of food types. Nutrition insecurity is also indicated by the health outcomes: primarily, the incidence and prevalence of diet-related diseases. These show clear socio-economic gradients across the income spectrum. It should be noted, though, that these diseases may be the result of multiple determinants, including nutrition insecurity, but also low physical activity, and tobacco and alcohol use.

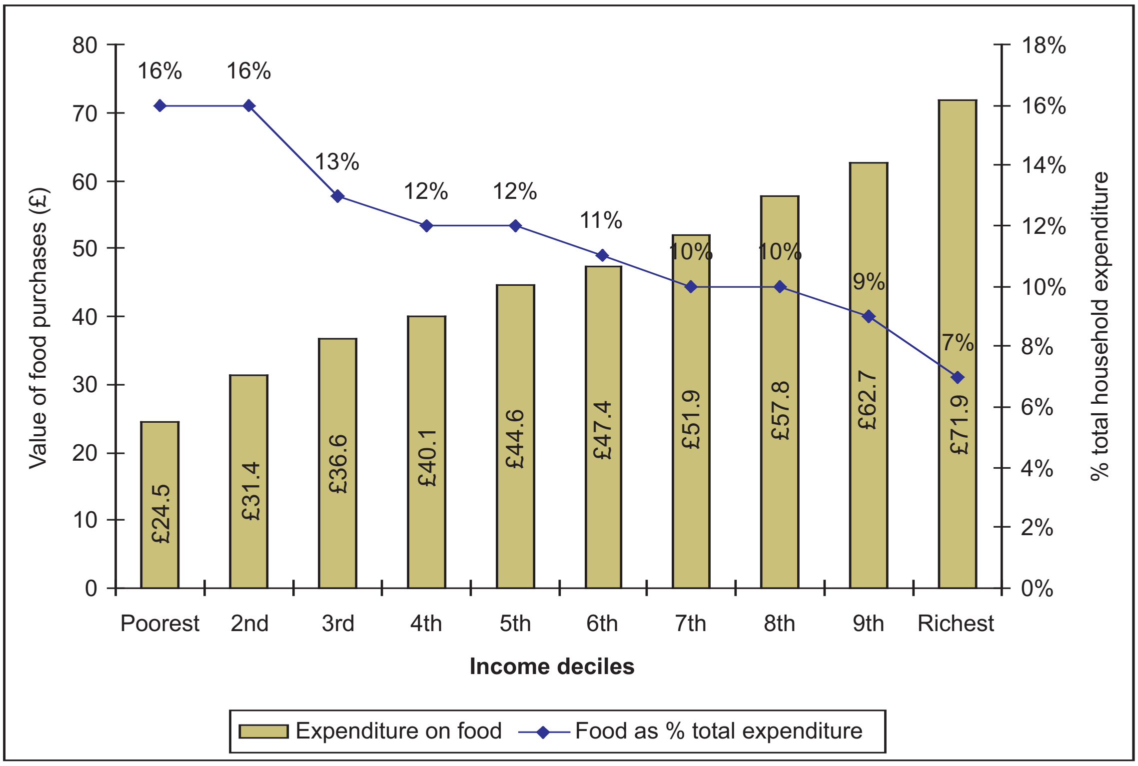
Table 1:	**Examples of raised levels of diet-related disease among lower-income populations, UK**
Disease	**Dietary contribution**
Anaemia of pregnancy	Lack of iron-rich foods, fruit and vegetables
Low birthweight	Poor maternal diet
Anaemia in children and adults	(as for Anaemia in pregnancy)
Dental disease	Sugary foods, snacks, soft drinks
Childhood eczema/asthma	Low breastfeeding rates
Obesity in childhood and adults	Energy dense foods
Hypertension	Salt and salty processed foods
High cholesterol	*Trans* and saturated fatty foods
Low high density lipoprotein or high triglycerides	Energy dense foods, lack of fish
Non-insulin dependent diabetes	Energy dense foods, lack of fruit, vegetables and fish
Coronary artery disease	Salty and energy dense foods
Peripheral vascular disease	Lack of fruit, vegetables and fish
Cerebrovascular disease	Energy dense foods, lack of fruit, vegetables and fish
Cancers of the lung, stomach, oropharyngeal, oesophagus	Lack of fruit, vegetables and fish
Cataracts	Lack of fruit, vegetables and fish

Source: *adapted from James et al, 1997*[1]

Food in the household budget

Expenditure on food has always been a core element in household expenditure. With rising food prices in the UK reported in 2008, the previous decades' decline in the average proportion of household budget spent on food looks set to reverse and show a significant increase in the next few years. The figures below show the most recent pattern of spending, with the value and the proportion of total household expenditure spent on food (eaten in and outside the home) by income group. It can be seen that higher income groups spend more, but that this represents a smaller proportion of their total expenditure.

Figure 1: Expenditure on food in value and as proportion of all expenditure, by income decile



Source: Family Spending: 2007 edition tables 3.2 and 3.3, ONS, 2008.

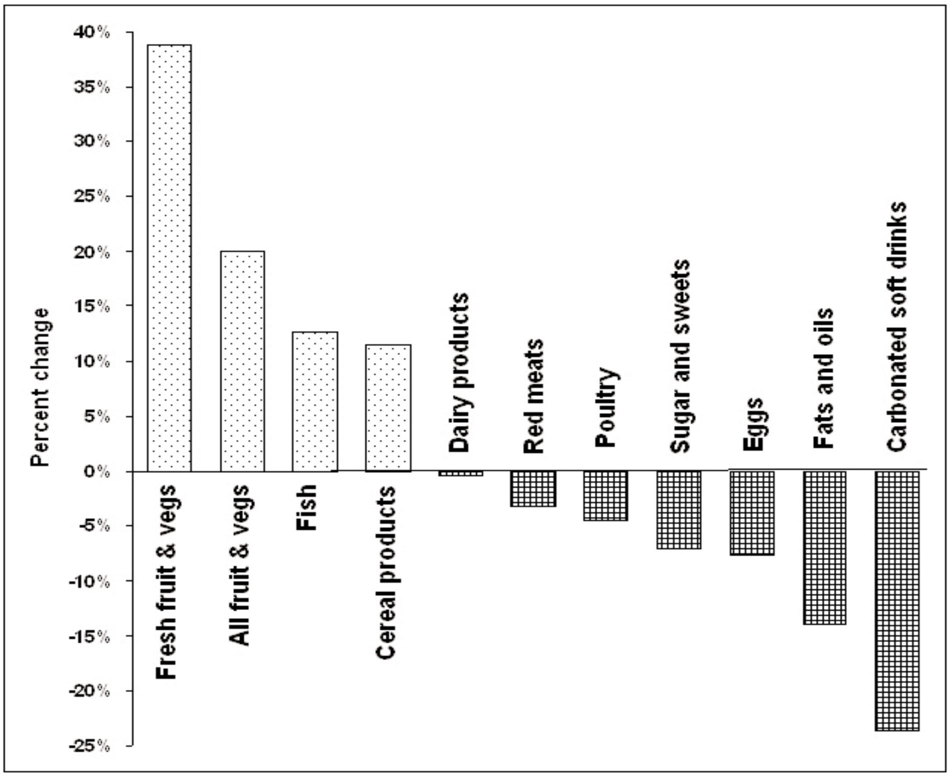
The relative costs of food are of high significance, as these may determine the pattern of food bought, especially among those on lower incomes. Prices and price trends indicate that generally the prices of certain commodities have decreased substantially, with the prices for fats, oils, sugar and starch falling over the long term, while the prices for fresh, perishable and healthier foods have tended to fall less, or to rise. Examples of the costs of different foods are given in the table below. Food costs are given per 100 kcal of food energy rather than per unit of weight, as food weight may be easily distorted by the inclusion of significant amounts of water, either naturally as in milk and fruit juice, or deceptively as in bacon or frozen prawns. Furthermore, using per 100 kcal indicates the degree to which the foods can ‘fill you up’ and not leave you feeling hungry. (For reference, an adult typically needs 2000–2500 kcal per day.)

Table 2: Costs of food (per 100 kilocalories) showing the cheaper sources of calories tend to be the least healthy		
Item	Typical cost per kg or litre	Typical cost per 100 kcal
'Healthy Living' pork sausages (11% fat) Bulk-buy frozen pork sausages (29% fat)	£2.56 £1.34	21,5p 3.8p
'Healthy Living' burgers (7% fat) Economy burgers (14% fat)	£5.48 £1.75	39.4p 6.8p
Lean mince (12% fat) Regular mince (20% fat) 'Value' mince (28% fat)	£4.99 £4.50 £2.48	38.3p 17,5p 7.8p
Basics frozen whole white fish (0.3% fat) Basics fish fingers (11% fat)	£2.44 £1.96	29.0p 12.3p
Carrots Broccoli Tomatoes Potatoes Frozen chips	45p £1.38 £1.33 35p 28p	21.8p 50.8p 88.5p 7.6 2.0
Vegetable oil Lard	£1.19 £1,00	1.3p 1.1p
Value wholemeal bread Value white bread	46p 46p	2.1p 2.0p
Whole milk 1% skimmed milk	70p 70p	10.9p 20.6p
Value ice cream Chocolate Value digestive biscuits Value Custard Cream biscuits Basics ready salted crisps	38p £3.26 55p 65p £3.71	2.7p 5.3p 1.3p 2.2p 4.0p
Bananas Apples Oranges	77p 65p 68p	9.8p 12.5p 11.5p
Fresh orange juice UHT orange juice Hi-fruit squash (50% fruit) (as diluted)	£2.15 58p 23p	38.4p 11.5p 5.0p
Granulated sugar	77p	2.2p
Sweetened tea (home made)	10p	4.8p

Source: *www.mysupermaket.co.uk Tesco and Sainsbury prices, 27July 2008.*

Trends in food supply show that the cheaper forms of calories have remained cheap or become relatively cheaper still, compared with healthier foods. The clearest trends are from the USA (see figure below), but with food prices largely set by world commodity markets, the trends are likely to be similar in the UK. An analysis comparing fruit and soft drink price trends in the UK showed a 33% price increase for fruit and a 20% price fall for soft drinks, relative to the food RPI, over the period 1980-2000.[2]

Figure 2: changing relative price of different foodstuffs, USA



Source: *reproduced in Food without Thought: How U.S. Farm Policy Contributes to Obesity Institute for Agriculture and Trade Policy, 2006.*

Recent increases in some food commodity prices (due to a variety of factors, including diversion of crops to biofuels, higher urbanisation of large populations and the transition of large populations from 'peasant' to 'western' diets) may alter this pattern, but it is unlikely that the prices of fresh and perishable foods will fall relative to processed, long-shelf-life foods. Rather, it is anticipated that price rises will further exacerbate the problems faced by low-income households and potentially lead to a worsening of their experience of diet-related ill-health.

Food on a low income

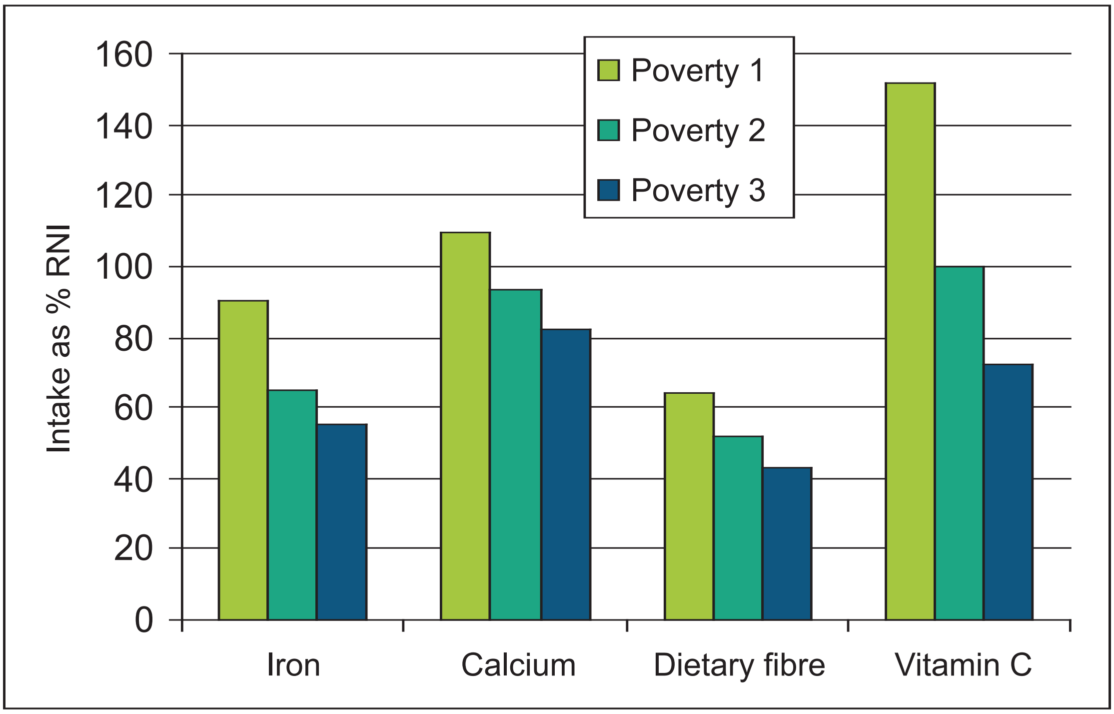
Studies in the 1980s and 1990s confirmed earlier research showing that lower-income households were likely to be suffering nutrition insecurity. Trends in the period 1980-1995 indicated a widening of the nutrient intake gap, so that even where lower-income households increased intake (e.g. of total fruit and fruit products) this was a smaller rise than that enjoyed in higher income households.

Other surveys indicated that low-income families in the 1990s were attempting to manage their budgets using a variety of strategies, although at some cost in terms of self-denial and family stress. Within their budgets, the evidence suggested that families spent efficiently in terms of the quantities of food and the avoidance of hunger, but that their dietary variety was often limited. Food has some elasticity, and spending on food may be temporarily sacrificed when other essential items – such as heating for children – are required.

A tight budget is also a barrier to making dietary changes or experimenting with unfamiliar or perishable fresh foods. There is no room for wastage. Furthermore, in order to preserve self-esteem and avoid stigmatisation, branded goods are sometimes preferred to cheaper options, children are given snacks and drinks to match their peers, and available free school meals are sometimes not taken up.[3]

In a detailed study of single-parent families living on low incomes, Dowler and Calvert showed clear evidence for a strong gradient in nutrient intake within three levels of deprivation.[4] Using a series of indicators to generate a poverty index (based on unemployment history and whether benefits were subject to deductions for rent and fuel arrears) the intake of key nutrients such as iron, calcium and vitamin C were strongly associated with the degree of poverty.

Figure 3: The gradient in nutrient intake according to degree of poverty



[1 = Not long-term unemployed, not having deductions to benefits; 2 = long-term unemployed or having deductions to benefits; 3 = both long-term unemployed and having deductions to benefits]
Source: *Dowler and Calvert, op cit.*

Continuing concerns over possible nutrition insecurity arose following the National Diet and Nutrition Survey (NDNS) series showing social class gradients in the intake of nutrients for adults, elderly people and children. One of the headline results for the adult survey was that consumption of fruit and vegetables is lower in households in receipt of benefit than in others, with 35% of men and 30% of women in this group eating no fruit during the survey week.

Food expenditure patterns also reflected the concerns expressed in the 1990s, with lower-income households spending more of their income, though less overall, on food purchases.[6] Eating out of the home became more popular, but again this was found more among those on higher incomes (the richest 20% spent 34% of their total food expenditure on eating out) than those on lower incomes (the poorest 20% spent under 17%).

Additional evidence of nutrition insecurity has been shown in terms of infant feeding practices and infants' access to breastmilk. Defining social class by partner's occupation, 40% of mothers in social class V (lowest class) did not initiate breastfeeding in a 2000 survey, compared with 10% in social class 1 (highest class).[7] This had improved somewhat by 2005, but even in the later survey the social gradient remained well-defined, and was also reflected in breast-feeding duration: at 6 months old, only 16% of infants in lower-income households were receiving any breast milk, while 35% of infants in higher income households continued to benefit from breast milk.[8]

The most recent UK government survey of dietary patterns among lower-income households indicated that many were failing to eat an adequately nutritious diet. Although the Food Standards Agency emphasised the similarities between lower-income and other UK households (the FSA's press release, stated *"The findings suggest that the dietary pattern of people on low incomes is the same as that of the general population, although in some aspects it is slightly less healthy"*), it acknowledged that the diets eaten by lower-income families were falling well short of the diets recommended for health. As a Canadian columnist described the UK survey's findings, *"low income adults eat about half the bare minimum of fruits and veg, while their kids eat one-third. Processed and salty meats, high-fat spreads, white bread and empty-carb treats are staples, all low-cost and easily hoovered."*[9] He added *"Not surprisingly, the subjects' iron levels are low, the likely explanation for almost epidemic levels of anaemia and exhaustion, what the privileged observe as laziness and lassitude."*

The survey included a self-reported assessment of food security, and the results indicated that 39% of respondents said they had been worried they would run out of food before more money came in, and 36% said they could not afford to eat balanced meals. It also noted that 22% of respondents reported reducing or skipping meals and 5% reported not eating for a whole day because they did not have enough money to buy food.

Food support services

There are a number of food elements provided within the social support services, including support during pregnancy and early childhood, in the school meals services, and in meals services for elderly adults. Meals and food may also be provided to some adults through catering services in the workplace.

There are several statutory food-related benefits. For pregnant women and new mothers, the Welfare Food Scheme was replaced in 2006 by the Healthy Start Scheme. This provides pregnant women and women with children under the age of 4 with a £3.00 voucher per week (per child, with a second voucher for children aged between 0 and 1 year) to buy food within a set range of products (fresh milk, fresh fruit and vegetables, formula milk). The scheme is only available to those with low earnings or on Child Credit and not on Working Tax Credit. The vouchers are available to all pregnant women aged less than 18 years regardless of income.

Vitamin supplements are also available to pregnant women through local antenatal and midwifery services.

School meals are provided free to children from eligible households. To be eligible, households should be in receipt of:

- Income Support
- Income Based Job Seeker's Allowance
- The Guaranteed element of State Pension Credit
- Child Tax Credit and have an annual gross income below £15,575
- And <u>not</u> in receipt of Working Tax Credit.

Children who receive Income Support or Income Based Job Seekers Allowance in their own right are also entitled to receive free school meals.

There is also a government-funded scheme to provide a piece of fruit or vegetable at no cost to all children aged 4 to 6 years, every school day. This is not designed to deal with income inequalities, but may increase consumption among those with the lowest prior consumption levels, especially if the same children are also taking free school lunches.[10]

Food-related elements within social support payments are not defined. It has long been government policy not to ascribe any specific amounts of income support or other support payments to the purchase of particular goods or services. Only one indication was made available when individuals with specified dietary needs (e.g. those with kidney disease) would receive a supplement, and this was admitted to be based on an assumed amount being spent on food from the standard payment. The assumed amounts being spent on food by those receiving standard benefits were £11.30 for an adult, £5.50 for a person aged 16 or 17, £4.40 for a child aged 11-15, and £3.00 for a younger child.[11] This was in the mid-1980s, and no subsequent estimates have been made available. The discrepancy between the rates for adults and those for older children aged 16-17 is noteworthy, given the similar – and arguably greater – need for a healthy diet among 16-17 year olds. At the time it was assumed that these older children were living at home and benefiting from the economies of shared food purchase and preparation, but the argument has weakened with greater use of pre-prepared foods, more eating outside the home, and greater independence of young people.

Inadequacy of food support benefits

Several attempts have been made to estimate the minimum cost needed to provide a 'modest but adequate' range of foods to ensure dietary health. The amounts determined as necessary for health are invariably higher than those typically being spent and, in some cases where income is especially low, would require a very high proportion being spent on food.

For example, in 2002 the Family Budget Unit, York University, calculated the modest-but-adequate (MBA) weekly food needs (excluding alcohol) for older people aged 65-74 years to be £31 for a single man, £29 for a single woman, and £55 for a couple. (A more stringent 'poverty threshold' standard, referred to as Low Cost Acceptable, sets the value at around £25 for an individual and £46 for a couple.) At this time the state pension scheme provided a basic weekly income of £75.50 for category A (full contributions from one adult) and £45.20 for category B (widow or divorcee of a full contributor) pensioners. If this was all the individual received as income then the food costs would absorb a substantial part of this. For those with no other income, Pension Credits were introduced in 2003, replacing previous supplementary benefits and income support payments as a means of topping-up older people's incomes to a basic minimum. This value is currently about £109 weekly for a single person and £167 for a couple. Assuming 10% food inflation spread over the period 2002-2008 is applied to the MBA basket of foods, then the MBA food costs would absorb some 30-35% of total income

For younger people the situation may be even more serious, and this is of special concern if the individual is likely to become pregnant, is already pregnant or is attempting to breastfeed, because nutritional status during these crucial reproductive phases may affect the long-term health of the child as well as the parent (men's preconceptual nutritional status is also linked to their offspring's health).

Using the most stringent Low Cost Acceptable standards (an amount necessary to protect health but with no flexibility and which expects the individual to seek out the lowest prices available) the York Family Budget Unit estimated the weekly foods needs for a single person to cost about £31, while for a lone parent with two children it was £42 and for a couple with two children it was £65. These figures provide some £2-£4 per day to find around 2000 kcalories of food, i.e. between 10p and 25p per 100 kcal – which should be compared with table 2 above on the price of different foods per 100 kcal.

The need to spend £31 on food for a week for a single person is unlikely to be met when the single person's Income Support allowance for people aged 18-24 is just £45. It would leave just £2 per day to find all other necessities. The situation is even more extreme for those single people aged 16-18 for whom the single person's allowance is just £36.

Compared with some other items, such as fuel, transport, essential clothing and personal care, food purchases tend to be more elastic. This is especially true for women, who may put the needs of their children or their partner ahead of their own needs, and consequently either eat insufficiently or have very poor diets. Several surveys in the 1980s and 1990s showed that women in low-income households gave their partners and their children priority in the types of food purchased, and would restrict their own consumption – to the point of missing meals or eating only left-over food – to ensure there was enough for the other family members.[12 13 14 15] Similar findings were reported in the recent government survey of low-income household food patterns, which showed nutritionally poorer diets among women, but not children, in households with higher food insecurity.[16]

Local initiatives to ameliorate nutrition insecurity

The UK government's strategy for tackling health inequalities has acknowledged the need for cross-departmental collaboration, with a lead taken in public health. Initial targets related to life expectancy and infant mortality have led to disparities. Health sector strategies to increase life expectancy included reductions in smoking and road accidents and improvements in housing, along with "prevention and effective management of other risk factors in primary care, e.g. through early identification and intervention on poor diet, physical inactivity, obesity and hypertension through lifestyle and therapeutic interventions, including use of statins and anti-hypertensives according to need" (page 4). The emphasis on lifestyle and therapeutic interventions hints at the ideological issues at stake: the government's preferred avoidance of market interventions or regulatory approaches to improving diet, and its dependence on local delivery of health education, best practice example and exhortation.

The burden of improving health and reducing inequalities has largely fallen to NHS Primary Care Trusts, local authorities and voluntary services, with some support from central government. In particular, the Food Standards Agency has taken a significant lead in promoting local initiatives (over 300 local food initiatives are identified in the Food Access Network database at *http://www.sustainweb.org/fandb.php)*.

The implementation of healthy eating and food access strategies through community and voluntary schemes has long been frustrated by short-term funding, a lack of long-term evaluation and a lack of feed-up and feed-forward mechanisms to allow local initiatives to influence national policy or subsequent programme development. This lack of integrated linkage between local actors, their authorities and their successors has led to poor strategic policy development, highlighted in a report to the FSA in 2003.[18] The report also criticised the tendency for local projects – especially those run as statutory initiatives in the health sector – to focus on individual behaviour change, which were rarely achieving actual changes and were widely deemed to be 'tickling the edges' when more structural factors affecting food access needed addressing.

The Food Standards Agency has worked on several initiatives in this area, working with the Local Authority Coordinators of Regulatory Services to document these initiatives on the FSA's Food Vision website (see http://www.foodvision.gov.uk/); funding the UK Liaison project of the Food Access Network to disseminate advice and information (see http://www.sustainweb.org/page.php?id=50); and appointing an Advisory Committee on Consumer Engagement (ACCE) to monitor and evaluate the FSA's continuing involvement.

This work acknowledges the role community food projects play in addressing health and income inequalities and ensuring better access to healthy food. The FSA has also undertaken several activities which potentially reduce social inequalities in nutrition security on a population-wide basis. These include the moves to provide ‘traffic light’ front-of-pack nutrition signalling which has already led some manufacturers to re-formulate their products to achieve better traffic light signals, and which has been praised by consumer groups for being easier to use and not requiring numeracy skills, compared with some industry-promoted alternative labelling schemes.[19]

Further, the FSA’s moves to persuade manufacturers to reduce the salt content of a wide range of products may have beneficial effects for all sections of the population, especially in its potential impact on those who are less conscious of the amounts of salt they routinely consume. This has run alongside a series of consumer awareness campaigns aimed in particular at socio-economic classes C1, C2, and D households. The salt programme is to be followed by a similar programme on reducing saturated fat levels.

Note on food safety

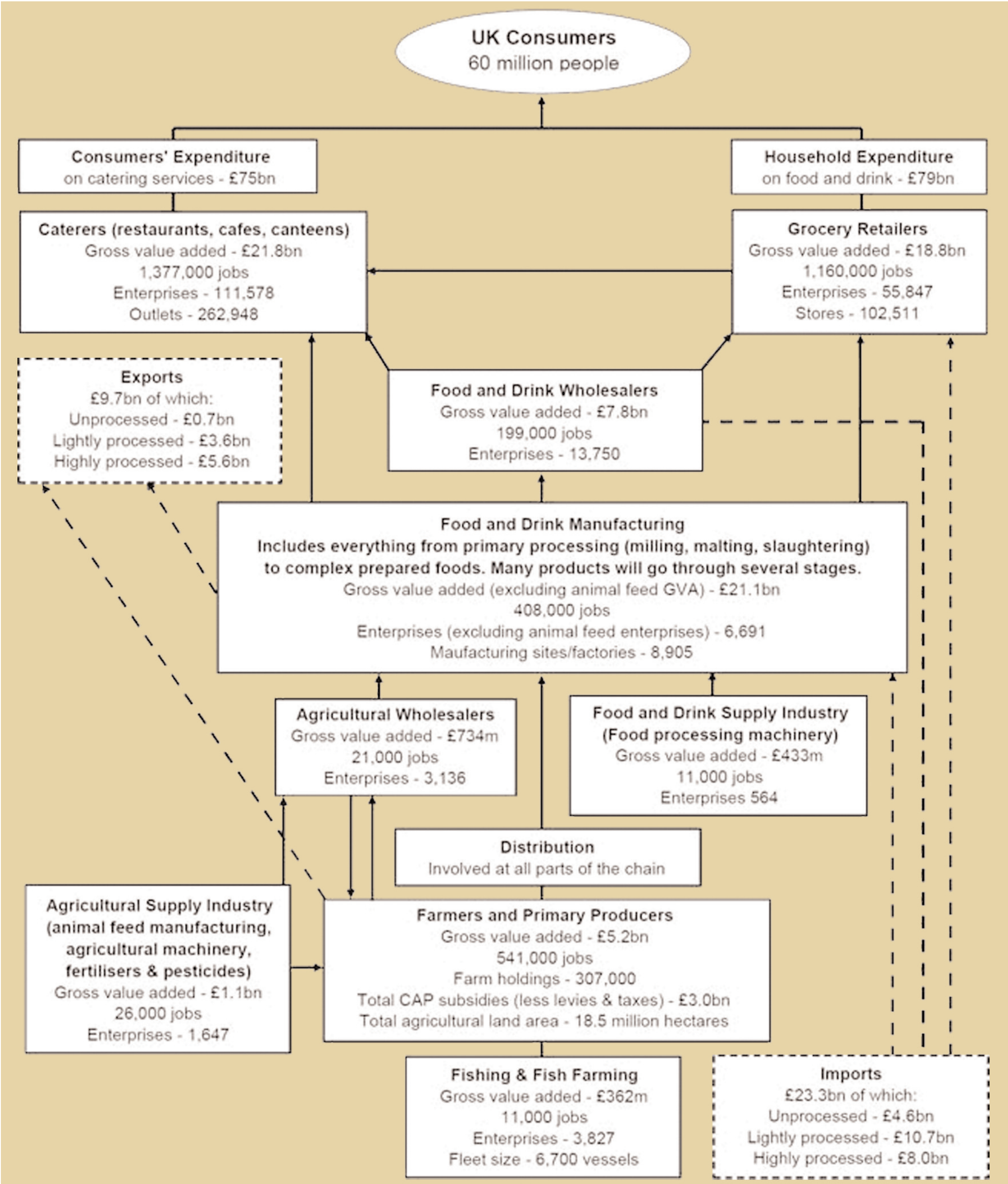
Little attention has been paid to the unequal distribution of food safety risks across socio-economic groups. In the absence of empirical evidence, there are strong a priori reasons to suspect that lower-income groups may be more exposed to the risk of consuming contaminated foods, including:

- Food of poorer quality, or handled by untrained staff, is more likely to be on sale at lower prices, attracting consumers with small budgets;
- People without easy access to good transport may be unable to maintain chilled foods at the proper temperature while bringing them home;
- Low-income families may not be able to afford to own or maintain certain hygiene aids and food storage and processing equipment, including food containers, fridges and clean microwave ovens.
- Lower-income families may be more motivated to keep left-over food for later consumption, or eat food that has passed its consume-before date;
- Poorly educated or non-English-speaking consumers may not fully understand the food storage, food preparation and heating instructions on products.

Private sector: the nature of the food market

The UK food supply chain can be summarised in the following Figure, showing the principal links in the chain from primary production at the bottom of the figure through to consumer. Note the major split between the retail and the catering markets. There is also a missing line connecting primary producers through to the sellers of fresh, unprocessed foods, especially through unconventional retailers such as street market sellers.

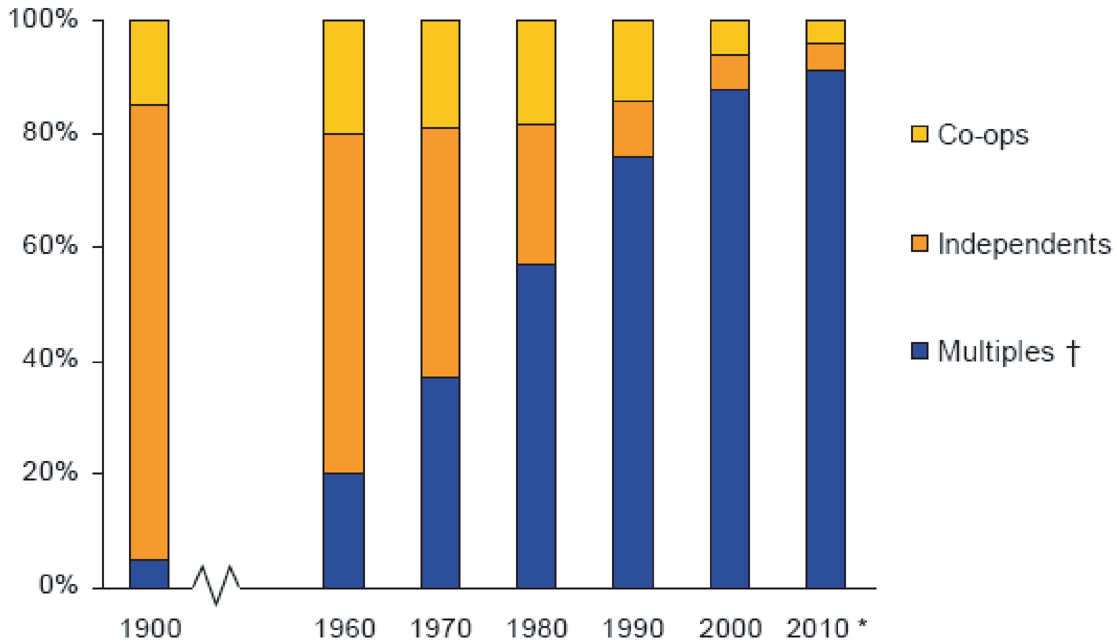
Figure 4: The UK food chain



Source: *Department for Environment, Food and Rural Affairs -Food Chain Analysis Group.2006.* [20]

One of the elements that is not clearly shown in the food chain schematic above is the degree of capital concentration in the various sectors. In particular the grocery retail chain has undergone a major revolution in the last four decades, with the multiple supermarket chains dominating the sale of food to the consumer. Within those chains, just four companies – Tesco, Sainsbury, Asda (owned by Walmart) and Morrisons (includes Safeway) – account for around 70-75% of food sales.[21 22]

Figure 5: Increased concentration of food supplies into supermarket chains (multiples)



Source: *IGD, Grocery Retailing 2004.* [23]

** 2010 is an industry forecast.*

† 'Multiples' category includes symbol-group convenience stores e.g. Spar.

The effect of this remarkable change in a key industry is to raise substantial concerns over the impact on choice, price and access to foods. The decline of small independent shops may increase nutrition insecurity by reducing the availability of healthier foods (particularly hard hit have been fishmongers, but also substantially affected are greengrocers, butchers and bakers) distributed through localised distribution systems. Such specialist independents are increasingly relying on higher-income shoppers, while the remaining small shops in lower-income communities cannot risk stocking more perishable items and instead rely on sales of processed, long-shelf-life foods, especially confectionery, snacks and soft drinks. Some exceptions can be found among suppliers of minority ethnic foods (see below).

Supermarket competition has led to further changes, with supermarkets seeking particular sub-sections of the market, so that some will aim for upper-income customers and others lower-income customers, and in locations where only one supermarket is within reasonable reach this may result in loss of diversity and greater risk of nutrition insecurity.

In these conditions, access to retailers becomes a further well-recognised problem. Households without access to a car or the resources to use one frequently face considerable problems in shopping at larger, more distant supermarkets which may offer better variety and availability and lower prices. Public transport may not adequately replace the car in such circumstances, especially if young children must accompany the shopper. The amount purchased and carried home may be limited by physical constraints, leading to repeated visits and potentially high transport costs.

For some families, the easy alternative may be to use ready-prepared, ready cooked food provided by local caterers, either by collection or delivery. The price may be greater than home-prepared equivalent meals, but there is a considerable saving in labour time as well as savings in fuel, kitchen equipment, storage and – if different members of the household have different preferences – savings in potentially wasted food. Fast food take-away services offer considerable social benefits, but unfortunately the nutritional quality of most of the product ranges is poor and the frequent use of this source of food may increase the risk of nutrition insecurity.

The supermarket 'offer' and income issues

As noted above, retailers have differentiated themselves in terms of the target section of the population, with some (e.g. Waitrose, Marks & Spencers) aiming primarily towards better-off households and others (notably Asda, Iceland, Somerfield, Lidl, Netto and Aldi) targeting more price-conscious lower-income shoppers. Three of the largest, Tesco, Morrisons and Sainsbury, remain in the middle with attempts to offer both premium quality goods and economy lines. None of the supermarkets have found a way of matching the variety and low prices of specialist foods demanded by ethnic minority groups and available in specialist shops in some urban areas. The reasons for the success of specialist shops for minority groups are unclear, but may depend on supplier and distribution networks within the same community, and links to family and business networks in the countries of origin. This form of social capital embedded in the community for ensuring supplies of specialist foods would benefit from further analysis for its potential to support lower-income households in non-minority communities, and its potential to improve nutrition security.

In the last decade, the mainstream supermarkets have increased their range of goods sold specifically to those on tight budgets, with 'saver' and 'economy' lines, usually wrapped in less decorative packaging and possibly lacking the degree of detail, such as nutritional quality, that the standard products carry. Compared with standard lines, the quality of the 'economy' goods may be lower (e.g. starch-thickened yogurts, grade 2 fruit), it may be as good but less attractive (e.g. smaller apples), it may be more variable (e.g. odd shaped), or it may be identical but packaged in lower-cost materials. A survey by the National Consumer Council found that the nutritional quality tended to be less healthy for the economy lines, for example having higher salt or fat content.[24]

The range and variety of economy line products had previously been criticised for failing to include healthier foods such as fruit and vegetables,[25] but this has subsequently improved. Although primarily of economic benefit to lower-income shoppers able to access the larger supermarkets where economy lines are offered, there is some evidence that it is better-off shoppers that make more use of these lines, while lower-income shoppers continue to buy familiar and more widely advertised brands – perhaps not liking to have their poverty on display or else believing the quality too bad.[26]

Within the supermarket offer, however, the greatest difficulty faced by consumers on a very tight budget is the inability to make use of the special offers that require larger outlay: thus milk prices per litre decline with the larger sizes, basic sliced bread is typically more expensive in the smaller loaves, as are many other staple foods (see table below). Furthermore, many special offers are made to reduce the cost per item when several are bought: thus 'buy two get a third free', or 'two for the price of…' offer require additional expenditure at the time of purchase. The benefit can be gained only if the food can be transported, can be properly stored and will be used before it deteriorates, and also if there is no cost to the shopper of advancing the capital at the time of purchase. For lower-income families, the advantages of bulk purchase may apply to larger families with the capital, resources and equipment to match, but for smaller low-income families there is unlikely to be sufficient capacity to take bulk purchases. The question of access to capital also affects home-delivered supermarket orders – again it is necessary to be able to pay in advance, and to afford the extra delivery costs unless these are offered free (normally only applicable if a minimum value of goods is ordered).

Table 3: Examples of differential pricing per unit of food in different sizes				
Food item	**Weight or volume**	**Price (pence)**	**Price per unit (pence)**	**Bulk discount**
Milk	1 pint 6 pint	42 212	42 35.3	16%
Eggs 'Basics'	6 15	88 150	14.7 10	32%
Rice basmati	500g 4kg	90 549	18 13.7	24%
Pasta	500g 1kg	79 124	15.8 12.4	21%
Canned sweetcorn	157gdr 272g dr	31 41	19.7 15.1	23%
Chopped tomatoes	230g 400g	39 42	17 10.5	38%
Baked beans	200g 4x400	45 199	22.5 12.4	45%
Nescafe	50g 2x400	158 600	3.16 75	79%
Sugar	500g 5kg	45 359	9 7.2	20%
White sliced bread	400g 800g	69 114	17.3 14.3	17%
Tea bags	40 480	69 5.95	69 49.6	28%
Lean mince meat	C 210g C 710g		492 421	14%
Vegetable oil	1l 3l	119 349	119 116.3	2%
Cheddar mature	C 250g C 450g		691 634	8%
Onions	Loose 'Basics' 2kg	78	72 39	46%
Carrots	Loose 'Basics' 2kg	73	74 36.5	51%
Grapefruit	1 3	46 100	46 33	28%
Oranges	1 12	26 200	26 16.7	36%
Apples	Loose 'Basics' 1kg	99	1.28 99	23%

Source: *Sainsbury supermarket Wandsworth 25 May 2008.*

Supermarkets aiming at lower-income groups typically promote a wider range of processed foods and a narrower range of fresh perishable foods compared with stores aiming to attract higher income shoppers, making it harder to choose a healthy diet. Surveys of shelf-space allocation, comparing for example the space allocated to soft drinks compared to that allocated to fruit, show a marked difference according to target market, with greater promotion of soft drinks in the lower-income-targeting stores. These promotional patterns compound the lack of availability of certain healthier foods – such as skimmed milk, wholemeal bread, low fat meat products, low sugar canned fruit etc – in stores aimed at lower-income shoppers.

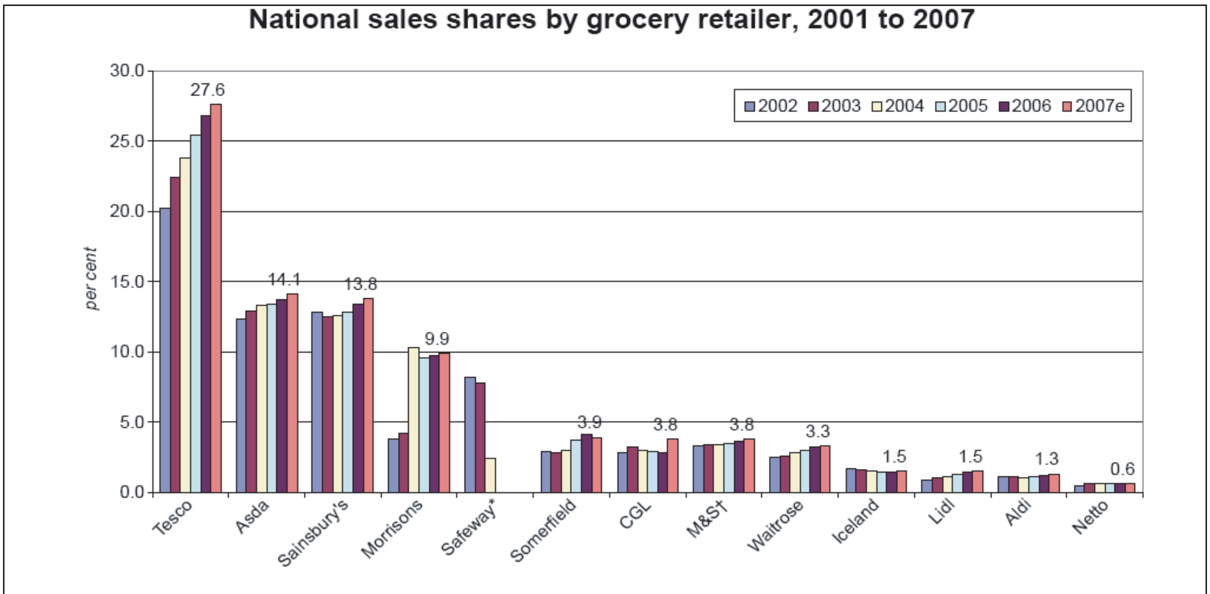
There is also evidence of red zoning, or price flexing, in which prices vary across stores within the same supermarket chain. Local smaller outlets in busy areas may charge more than their peri-urban sister stores, or may stock only higher-margin products. Those without transport are disadvantaged by this practice.

Supermarkets are also fiercely competitive in their development and expansion plans, with some accused of purchasing land in a spoiling manoeuvre to prevent rivals opening new stores. This may restrict choice and variety to shoppers in the immediate neighbourhood, and in smaller towns may effectively lead to a one or two company monopoly of the retail environment. These and other anti-competitive supermarket practices have been considered in the recent enquiry into monopoly in grocery retailing (next section).

Recent Competition Commission enquiry

As noted earlier, just four supermarket chains control some 70% of total grocery sales (see figure below) and this concentration led to the supermarkets being the subject of an investigation by the Competition Commission.

Figure 6: Proportion of grocery sales by the main supermarket chains



Source: Verdict, *UK Grocery Retailers 2008*, February 2008.
*Safeway was purchased by Morrisons in 2004.
†M&S sales relate to grocery only.

Source: *Competition Commission 2008*

The Commission's final report was published in April 2008.[27] *Its principal findings address planning issues and the relationship to suppliers, namely:*

- a recommendation for the inclusion of a 'competition test' in planning decisions on larger grocery stores. Applications would pass the test if within the area bounded by a 10-minute drive-time of the development site: the grocery retailer that would operate the new store was a new entrant to that area; or the total number of fascias in that area was four or more; or the total number of fascias in that area was three or fewer and the relevant grocery retailer would operate less than 60 per cent of groceries sales area (including the new store)

- action to prevent land agreements which can restrict entry by competitors;
- the creation of a new strengthened and extended Groceries Supply Code of Practice; and a recommendation to establish an independent Ombudsman to oversee and enforce the Code.

The Commission reported that it believed that local concentration hampered effective competition:

We concluded that consumers are adversely affected by local markets being highly concentrated rather than more competitive. Weak competition in local markets allows a grocery retailer to worsen the store-specific retail offer at its stores in those markets and earn higher profit margins at those stores. We estimated that the effect of weak local competition on store-level profit margins allows large grocery retailers to earn an additional £105–£125 million in profits per year at their larger grocery stores. This represents around 3 per cent of annual profits for the four largest grocery retailers. The additional store-level profits at mid-sized grocery stores as a result of weak local competition may be of a similar order. (p 12)

Concern was shown in a number of submissions to the Commission about the fixing of prices and, in particular, of two practices: the sales of goods at 'below cost' price which put significant stress on local competitors, especially smaller independent stores, and the sale of goods at different prices in different stores ('price flexing') unrelated to the actual cost, which exploits monopolistic situations. One estimate suggested that between 5 and 20% of the big chains' cheapest lines were being sold at below cost, although prices on other items compensated for the lost profit (cross subsidy). Small independents may not be able to match the cross-subsidy arrangements, particularly if the below cost products were their main sales items – such as bread, milk or alcohol.

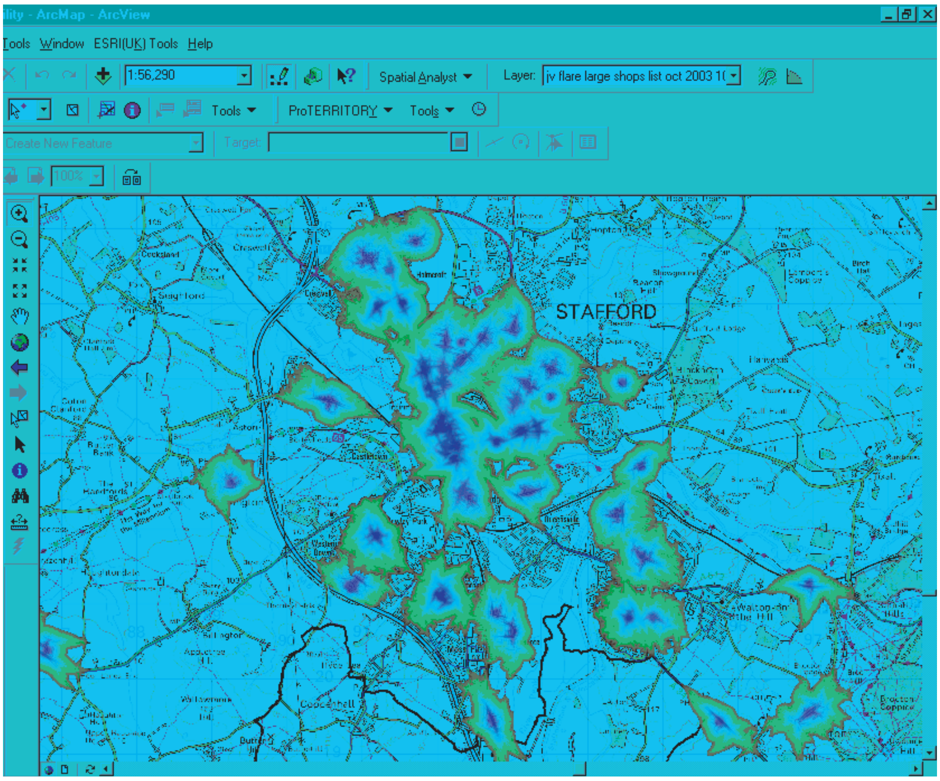
Points raised in evidence included:

- The loss of local shops in the high street and in villages, the resulting loss of 'social glue' and removal of trade from the local economy;
- Low-cost alcohol sold in supermarkets encouraged excess consumption, including by those under the legal age limit;
- Concern over excess packaging and transportation of foods to supply the large chains;
- Exploitative contracts with farm suppliers increased the pressure to recruit labour at below minimum wage levels, increasing rural poverty;
- Problems of access to supermarkets in low-income communities: this is highlighted when retailers are unwilling to open in high-crime areas or in areas with low population density (mainly rural), giving rise to food 'deserts'

Food deserts

The term 'food desert' refers to a locality with poor availability of an adequate supply and range of foods necessary for good health. There have been some arguments about the actual existence of such deserts, and the terms and definitions used to measure them. A food desert describes an area in which food retailers have moved away and shops have closed, and remaining shops offer only a very limited range of foods, so that access to a varied diet at low cost may require use of a car. Food deserts may be more apparent to those without access to a car and in need of a supply of a full range of foods within walking distance, and this may include older residents and low-income mothers with young children. Community mapping methods can help expose such issues: a mapping exercise conducted in Stafford using GIS technology[28] showed significant patches of the community did not have local access to a variety of fresh fruit or vegetables and other healthier foods (see below).

Figure 7: Staffordshire community mapping of food stores, showing ten-minute walking distances from larger food stores



Source: *National Consumer Council 2006*

In a study of Sandwell, an urban area in the West Midlands, the majority of the community lived more than 500m from a store selling eight or more types of fresh fruit and vegetables.[29] The area is the seventh most deprived in Britain, and a third of households have no access to a car. Similarly, the Staffordshire analysis, and comparable studies in Oxford and the London Borough of Brent, have indicated that the communities most poorly-served in terms of availability of healthier foods tend to be those that have higher indices of multiple deprivation. Even greater difficulty in gaining access to larger shops applies to car-less households in more scattered communities, where a third of all low-income households are located, including a third of low-income pensioners' households.[30]

Smaller shops may be available, but the cost of food from these sites is likely to be higher, and the range of healthy options available may be severely limited. Basic foodstuffs have been calculated to cost 24% more in small stores than in supermarkets and, taking supermarket own brands into account, the differences in costs were 60%.[31] In the recently published government survey of lower-income household food intake patterns, some 50% did not use a car for food purchases and 20% were not able to use larger supermarkets on a regular basis.[32] The survey noted that women in households that shopped at a large supermarket consumed significantly more fruit and more vegetables than other women.

It should also be noted that some planners measure physical access to shops 'as the crow flies' – a fixed measure of, for instance, 400m to the nearest basic services, or to the nearest outlet selling food. A direct measure like this does not account for physical access problems, such as difficult road crossings, steps and other barriers that may be difficult to negotiate with a pushchair, a wheelchair or a walking stick. More sophisticated measurement methods, using GIS software for example, are needed to ensure that the reality of food accessibility is reflected in the mapping process. Participatory approaches to consultation (such as community mapping) can be used to reveal the detailed experience of people living in deprived areas, and people who have problems with physical access and everyday food shopping.

Legislative context

Most of the legislation relating to food concerns the safety of food supplies. There is legislation regarding the packaging, labelling and description of foods, which has a bearing on the present topic (see below on labelling) that grew out of the historic 'weights and measures' concerns with fraudulent trading. Greater use of labelling and promotion legislation to ensure consistent information is given to consumers could be a step towards improving nutrition security.

Planning controls on the provision of food outlets, the development of supermarkets, the licensing of street traders and consent for street markets, and consent for take-away food stores, also have a bearing on the present topic. Greater use of these planning controls to improve access and availability of types of foods may provide an opportunity to improve nutrition security at local level.

Certain foods are subject to Value Added Tax. These were originally meant to reflect 'luxury' food products, and include foods bought when dining out of the home, unless taken away for consumption off the premises. Adjustments to the VAT regime to raise the cost of energy-dense, nutrient-poor foods and reduce the cost of healthier foods could be considered a tax-neutral form of intervention designed to assist those who are most sensitive to food prices.

Relation to fuel and other services

Both food and fuel are essentials to support life and prevent ill-health. Unlike fuel, the quality of the food provided makes a significant difference, so that substitution of, for example, food energy from fruits and vegetables with food energy from fats and oils, will make a considerable difference in the risk of ill-health. Food may also suffer considerably from contamination and as a result there are regulations on food safety and hygiene.

The food sector has a long tradition of being a market-driven sector – indeed, the term 'market' summons to mind the tradition of displaying food products for sale in the community – and has remained relatively free of regulation compared with water, energy and telecommunications. There are no requirements for minimal universal service provision, and in theory there are relatively low entry thresholds, allowing opportunities for new enterprises to compete with established ones. Government support is seen most clearly at times of stress, such as during the Second World War, but has continued to be provided through support of scientific research for food processing and for crop and animal health, and direct support for farm production and market protection, now largely organised at European Union level.

Where the market has failed low-income groups, there have been various, largely short-term and poorly financed, initiatives to assist communities in developing their own alternatives to the market. Allotment schemes, shopping clubs, breakfast bars in schools, along with advice centres and Sure Start and similar support schemes are offered, although they do not always find those in the community that are the hardest to reach. State benefits, including free school meals and meals on wheels, also supplement the market.

Rather than compare different sectors, however, it may be instructive to consider how they interact. The experience of living on a low income is dominated by the multiple interactions with all services, and the multiple disadvantages that can follow from these interactions.[33] As we have shown, many food products are 10-30% cheaper per unit volume if bought in larger quantities but their acquisition may require access to a car. Home deliveries require credit card payment. Bulk purchases require storage, which assumes there is sufficient space and sufficient technology such as freezers and fridges, to ensure the food does not perish. Furthermore:

- Lack of bank credit references and lack of bank account mean that credit cards may not be available, restricting access to advance purchase supermarket delivery and bulk-buy food products.

- Dependence on cash purchases for foods may be hampered by availability of cash outlets, with no banks and few ATM machines in lower-income estates.

- Fuel costs are a significant element in food preparation.

- Ordering and arranging deliveries requires computer and internet access which, in turn, assumes landline or more expensive ranging broadband services.

- Purchases of household equipment such as fridges, freezers, cookers, microwave ovens, etc requires credit or cash payment to get better deals, and access to the internet or at least a phone to 'let the fingers do the walking' and find the best deals, or to buy secondhand from e.g. E-bay.

- Theft losses of household equipment, including food preparation equipment such as microwave ovens, may not be easily replaced, especially if insurance has been neglected or is prohibitively costly.

- Access to welfare benefits, including those for food, requires dealing with Benefit offices, which in turn assumes telephone access as well as sufficient time to attend appointments.

Concluding remarks

It does not appear that the market as currently organised can deliver the necessary security of nutritious food to lower-income households. The major supermarkets have shown remarkable creativity in providing an enormous variety of foods to the population in general, but, as this chapter has shown, there remain significant structural factors which make access to a nutritious and healthy diet more difficult for those on lower-incomes. This chapter has also identified specific problems faced by low-income households which may increase their nutrition insecurity: namely accessibility and availability of nutritious foods, cost and differential cost of bulk purchases, as well as concerns over the availability of related resources, such as food storage and preparation equipment. It has also noted the need for adequate education and skills to ensure that appropriate food choices are made and can be put into effect.

Welfare resources may be improved to ensure incomes can cover the cost of a healthier diet, but even these gains may not be adequate to compensate for some of the structural disadvantages experienced by low-income households, given the way they are compounded by disadvantages in other sectors, with the result being that low-income households are excluded from a number of services at the same time.

An integrated approach to improving service availability and family support, beyond the purely financial, may be needed to ensure that the poor are not facing multiple disadvantage.

Lastly, it should not be forgotten that food is more than a means of 'fuelling' the physical body. Food also has strong social and psychological meaning. Well-meant attempts to identify recipes for poor families, which allow them to eat healthily on very tight budgets (the classic examples are fish-head soup and lentil bake), only serve to increase the potential social exclusion of being unable to invite people to share one's meals, let alone to dine out.

Food is also a comforter and a reassurance in times of low self-esteem. As George Orwell noted in *Road to Wigan Pier* in response to suggestions that poor people should eat brown bread and raw carrots, “when you are underfed, harassed, bored, and miserable, you don’t want to eat dull wholesome food. You want something a little bit ‘tasty’… Let’s have three pennorth of chips! Run out and buy us a twopenny ice-cream!”

Improving the health and wellbeing of people on low incomes requires a multiple, and multi-disciplinary, approach that takes structural, social and psychological needs into account. Resolving the structural issues – the focus of this chapter – can be the most important step towards improving the social and psychological impact of social exclusion.

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Housing

"Housing is seen as archetypal, appropriate for provision and allocation through a mixed economy - ranging from market provision for those who are reasonably well off, subsidy to enable others to obtain adequate housing, and the direct provision and allocation of publicly owned housing."

Professor Christine Whitehead
with **K.A. Martindale** and **F.M. Jones**

Cambridge Centre for Housing and Planning Research,
University of Cambridge

1. Introduction

1.1 Government involvement in housing

Historically, while the vast majority of housing has been provided by the market, there has always been a strong involvement by non-profit providers and later by employers and government. Almshouses go back many centuries. In the nineteenth century a number of larger employers provided accommodation for their workers. Government's role at this stage was mainly in setting physical standards but, by the end of the nineteenth century, local authorities had the right to provide accommodation. In the twentieth century rent regulation was introduced in 1915 affecting the vast majority of the population. The policy of 'Homes Fit for Heroes' in the inter war period involved government providing tenure neutral capital subsidies for the provision of new housing.

After 1945, government started to play a much larger role in the provision of housing because housing was seen as a major pillar of the welfare state. The policy of 'a separate house for every family who wishes to have them' was identified as early as 1945 (Ministry of Reconstruction, 1945) and one version or another of this commitment has remained in place into the twenty-first century. For thirty years from 1945 the main instrument of this policy involved the production of new housing by local authorities. For much of this period, public sector output by local authorities and new towns ran at about 50 per cent of total new investment. As a result, by 1979 the public sector directly provided over 30 per cent of all housing in England at heavily subsidised rents based on historic costs (Table 1.1). Rents for the vast majority of those in the private rented sector were also controlled. The market on its own, therefore, provided only for owner-occupation and for a small part of the private rented sector, mainly for mobile households. Housing finance was also still heavily regulated while the Town and Country Planning Act of 1947 had introduced tight regulation on the allocation of land for housing. Finally, in the early 1970s, rent rebates and allowances were introduced and made available to low income tenants, including those in employment, in both the private and public sectors to ensure affordability.

Since 1979 there has been considerable privatisation and deregulation not only through the Right to Buy, introduced in 1980, and rent deregulation in 1988, but also through the liberalisation of housing finance and the restructuring of the social sector transferring a significant proportion of local authority stock to housing associations (HAs or, more formally, Registered Social Landlords – RSLs). Even so, there are still large scale subsidies available for new build in the social sector; social sector rents are controlled well below market levels in most parts of the country, and income related subsidies remain available to all lower income households who are able to access the rented sector, either private or social.

Thus even the general housing system is quite tightly regulated through the planning system and through financial regulation. The reasons for this government involvement are not in the main specifically about competition. They are about the nature of the good housing, the attitudes of society to ensuring adequate housing for all and particularly about the distribution of income.

Housing for lower income households remains, and is expected to remain, subsidised through direct funding, rent policies and income related benefits. Housing, therefore, differs from other necessities, such as energy and food, in that government takes a strong pro-active role in ensuring access and affordability.

In organisational terms, housing is in many ways a microcosm of the mixed economy approach, with some parts being very much market oriented and mainly serving relatively better off households; while at the other extreme, the social sector provides subsidised housing and allocates it on the basis of need. In between, large scale subsidies, taxes and a wide range of regulations modify prices, output and allocation.

Table 1.1 Housing stock by tenure					
	Owner occupation %	Private rent %	Housing Association %	Local Authority %	Total stock 000s
1961	44	32	24		13,828
1971	52	20	28		16,065
1981	59	11	2	27	17,912
1991	67	10	3	20	19,671
2001	70	10	7	13	21,207
2006	70	12	8	9	21,989

Source: *Census 1961 – 2001, DCLG 2006*

Table 1.2 provides a summary of the broad categories of regulation and assistance by tenure, drawing out the major changes over the last thirty years. The actuality is far more complex than this, but it does give a 'feel' for the main government interventions that frame the current picture (Stephens et al., 2004).

Table 1.2 Broad Categories of Regulation and Assistance	
1. Land regulation	Tenure neutral controls on change of use. Since 1990 affordable housing has been a material consideration in granting planning permission.
2. Housing finance regulation	Heavily regulated flows of funds and interest rates below market rates. Liberalisation from early 1970s, particularly after 1980s as housing finance became part of the global market. Increased regulation of the industry and products in1990s. Important innovations: Mortgage Backed Securities in 1980s, particularly from late 1990s; Buy to Let mortgages late 1990s.
3. Rent regulation	Rent control in the private rented sector from 1915; deregulation from 1960s, full decontrol for all new lettings from 1988. Rents based on costs in the social sector, but rent control based on property attributes across sector introduced in 2000.
4. Housing taxation and subsidy	
All tenures:	Property taxation through local rates, now Council Tax, based in part on property values.
Owner-occupation:	Mortgage tax relief increasingly constrained from 1970s and especially in the 1990s; finally removed in 2000; no capital gains tax on principal home; no tax on imputed income since 1960s; stamp duty on purchase; particular groups of low income households eligible for income support for Mortgage interest (ISMI).

Private renting:	Fundamentally treated as an investment good with net income and capital gains taxed; mortgage interest allowed as a cost; stamp duty; low income tenants eligible for housing benefit (HB) now local housing allowance (LHA).
Local authority:	Heavy constraints on building since 1970s; revenue based subsidies to support rent policy; subsidies to bring housing up to the Decent Homes standard. Rent rebates on actual rents available to all eligible tenants.
HA sector:	Capital grants for new building and regeneration. Rent allowances available based on actual rents available to all eligible tenants.

1.2 Why Government Intervention?

Housing has many of the characteristics likely to generate market failure. On the one hand it is clearly a 'private' good in that benefits go mainly to the owner and/or occupier and choice is immensely important in ensuring the maximum value. On the other hand there are significant externalities arising from poor housing and neighbourhoods; there are imperfections in the housing finance market; housing supply can only be adjusted very slowly while demand responds rapidly to changes in incomes and the number of households; housing decisions are risky and costly to change; there is considerable asymmetry in information and power between landlords and tenants and more general problems of the market power, especially in the land market.

Even so, probably the most important efficiency reason for government intervention since 1945 has been that housing is seen as a 'social' or 'merit' good. In other words, society as a whole regards it as important that everyone is adequately housed and able to afford their housing. Moreover, to a significant extent government has been prepared to support this rhetoric with policy and finance. This, taken together with concerns about affordability and the capacity of lower income households to compete in the market and the argument that re-distribution in kind through prices subsidies and housing specific income subsidies is likely to be more effective in achieving minimum standards, has led to massive and continuing government intervention in the housing system.

In economic terms, there are a number of reasons why lower income households can be expected to pay higher than average costs or receive lower value for money. In particular:

(i) economies of scale mean that larger amounts of a good can sometimes be cheaper to produce and provide than smaller units. This certainly applies to housing, in that providing an additional square metre of housing costs very much less than the average cost per square metre. So if households require smaller units because their low incomes constrain their consumption, the cost per square metre will be higher and they will thus pay more per unit of consumption;

(ii) the government may impose building, maintenance and occupancy standards which are higher than poorer households would otherwise purchase. If these standards are adhered to the poor will pay more but, as a result, they will also consume more housing (but would rather consume less given their other requirements);

(iii) poorer households have less market power and choice than those further up the income scale so may not be able to achieve as good a bargain with suppliers as the average household. As a result they pay more and get worse value for money; and

(iv) there may be reasons why poorer households would choose a different mix of products than the average which would include more on housing. In particular, if the family is going to spend a high proportion of their time in the home (e.g. because they are unemployed, out of the workforce or have a large family) they may choose to spend more on housing. In this case they are both paying more and achieving higher benefits.

It is necessary to identify which of these reasons applies in any given situation in order to ensure the appropriate response. In particular:

(i) is it simply a matter of real resources costs? If so, to the extent that low levels of consumption of the physical product – housing – are related to poverty the problems can only be alleviated by disproportionate subsidy as real costs are necessarily higher e.g. by relating subsidy to actual costs;

(ii) is it that standards are higher than lower income households feel able to afford? Setting standards above market levels has been at the core of housing policy since the nineteenth century when it was recognised that poor housing generated external costs in terms of public health (including epidemics), fire and low productivity of the workforce. Increasing standards necessarily increased the resource cost per unit and therefore worsened both problems of affordability on the one hand and led to avoidance and evasion on the other. This led directly to the need for subsidy, initially in the form of a subsidy per unit built and much later, in the 1970s, to income related demand side subsidies. Initially, subsidies to construction were available to private as well as social suppliers. However, in the inter-war period, and especially after 1945, supply subsidies became concentrated in the local authority sector and then, after 1974, were extended to RSLs. As a result there is a strong and continuing distinction between the positions of social tenants as compared to other households (Holmans, 1987; Stephens et al., 2005);

(iii) is it not being able to negotiate effectively? Problems of relative power and prices above costs concentrated among poorer households show up in a number of different ways, not just in terms of the price per square metre, but also through lower quality of provision, poorer management and maintenance and, particularly, through less security of tenure. Most such problems are concentrated in the private rented sector, although there is also evidence of difficulties in the mortgage market. They are also reflected in housing market segregation. Issues in the social rented sector are again very different because of rent subsidies, lifelong security of tenure, and social ownership. Mechanisms to address these issues range from rent controls and security legislation through social ownership as opposed to profit maximising in the private sector, to personal subsidies to increase the household's capacity to compete in the market; and

(iv) is it that poorer households need more? The possibility that certain groups of poorer households will require more housing is recognised in terms of the physical standards of social housing and the allocation rules applied to that social housing. It is also incorporated in the regulatory framework for Housing Benefit, although those across the rented sector maximum occupancy standard are also incorporated into the formula for calculating rent rebates and allowances.

There are also more general characteristics of housing which make markets work badly. In particular, housing expenditure is indivisible (lumpy), while that on, say, food or leisure is made up of many different elements, making it easier to adjust expenditure. This problem is compounded by the high transactions costs involved in changing housing decisions, which is again quite different to most other expenditures where decisions are made on a much more regular basis. Most importantly, basic housing is an essential good. As such it is difficult for those on low incomes to adjust their consumption in the face of worsening conditions without it impacting adversely in their overall wellbeing and capacity to purchase the other necessities of life.

All of these factors mean that markets alone cannot work to provide adequate housing for all. They also suggest that a wide range of instruments will be necessary to address the different issues.

One of the outcomes has been the complex 'cat's cradle' of policy that has been built up over the generations (Hills, 1991; Stephens et al., 2005). Successive governments have attempted to simplify and codify these policies but have generally ended up adding to rather than subtracting from this complexity (Department of Environment, 1977; DETR, 2000; Stephens et al., 2004).

It is clear from the above analysis that no policy maker, whether from the right or the left, regards housing as suitable for wholly market provision. The specific question of how poorer households are able to compete for housing must be addressed through an analysis of the extent to which government policy has been effective in ensuring that poorer households both achieve adequate housing and are able to pay for that housing while still able to afford other basic necessities (Whitehead, 1983; Hancock, 1984).

However, the nature of housing – particularly its heterogeneity and the fact that it serves so many different purposes (effectively minimum shelter requirements at one extreme and a capital asset to increase wealth at the other) - makes it extremely difficult to evidence these apparently simple questions. In particular, there are no straightforward measures of quantity, prices and rents that make it possible to separate out the elements of expenditure which relate to occupation as compared to asset accumulation. The property rights purchased with the rent or house price also differ enormously from three months, or at the limit of lodgings no security to tenure at one extreme, to full rights of alienation through freehold ownership without a mortgage at the other. The ways in which assistance is provided also varies between tenures and, to a lesser extent, between household groups, making it difficult to make direct comparisons. Even what makes up housing expenditure is unclear – should it simply cover rent or mortgage payments, or be defined more broadly to include everything that varies with the housing decision (such as Council Tax or utilities)? Much of the evidence is therefore either rather general or difficult to interpret. The rest of this paper can of necessity provide only indicative evidence on the extent to which households suffer from market insufficiencies and whether these are effectively alleviated by government policy. Before turning to the detail, we first give an overview of the outcomes of policy in terms of incomes and housing expenditure by tenure.

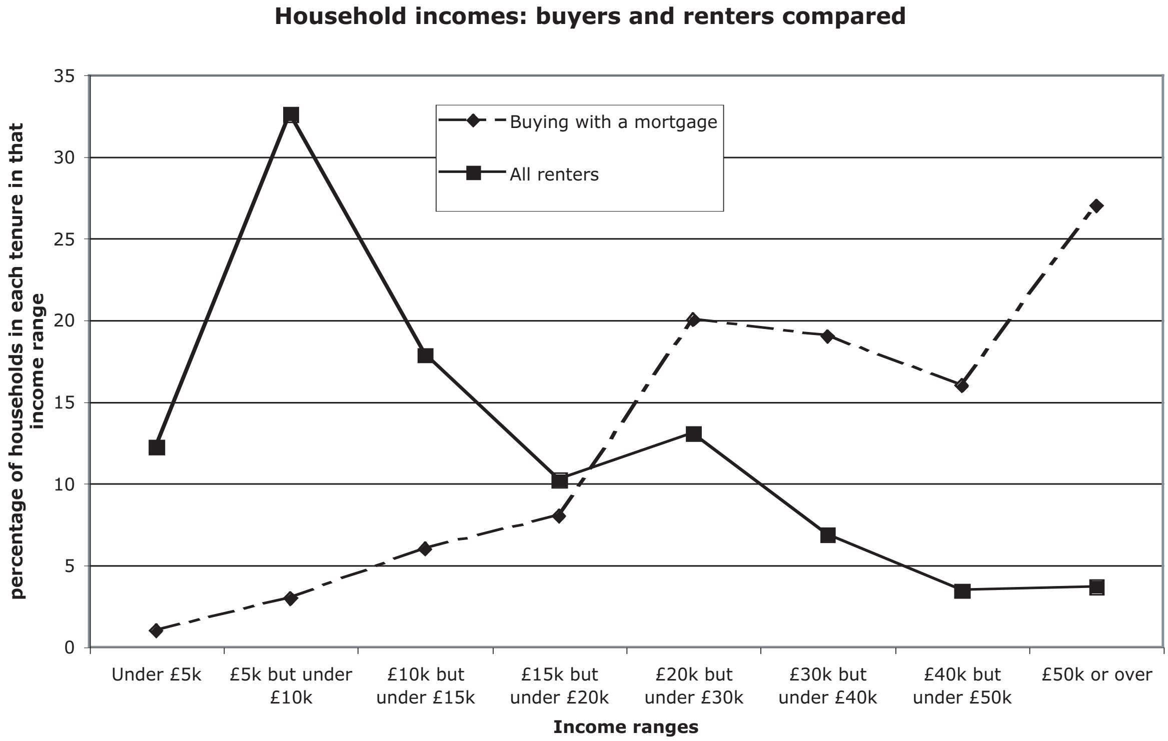
1.3 Housing Expenditure

Using a comprehensive definition of housing expenditure suggests that, on average, households paid £145 per week on housing and related costs in 2006 against a total expenditure of £456 per week. Therefore, housing accounted for almost a third of all expenditure. This compares to less than 9 per cent (although on a considerably narrower definition) fifty years ago (Family Spending, 2007 edition, 2008). The same publication notes that three of the four more narrowly defined expenditure items in 2007 – mortgage interest, gross rent and Council Tax/domestic rates – are housing related.[1] It is hardly surprising, therefore, that there is very considerable concern about the impact of housing costs on the well-being of households and of poor households in particular.

As already noted, there is generally a strong relationship between incomes and housing tenure, with lower income households concentrated in the rented sectors, particularly the social rented sector. Figure 1.1 compares the household incomes of owner-occupiers with a mortgage (who are generally better off than older owners who own outright) and those who rent. It shows that the vast majority of renters earn less than £20,000, while most households with a mortgage have incomes of more than £30,000. Table 1.3 shows how these figures break down between those in work and those where the head of household is not in the labour force. It confirms that the vast majority of lower income households are tenants and that incomes for those out of the labour force are generally below £10,000 per annum.

[1] It should be noted when interpreting these figures that the general figures in Family Spending simply average across all households. Individual households, especially poor households, do not usually pay both mortgage interest and rent.

Figure 1.1 Household incomes of buyers and renters by income range



Source: *Survey of English Housing Preliminary Results 2006/07*

Table 1.3 Gross income by tenure 2005/06 (%)				
	Under £10,000	**£10,000-£20,000**	**£20,000-£40,000**	**£40,000**
In work				
Owner-occupiers	3	14	21	40
Social renters	15	39	11	5
Private renters	9	27	17	20
All tenures	5	19	19	34
Not in work				
Owner-occupiers	31	43	6	5
Social renters	63	34	1	0
Private renters	67	28	1	1
All tenures	44	38	4	3

Source: *Department of Work and Pension, Family Resources Survey*

Turning next to housing expenditure, Table 1.4 gives the median percentage of income spent by households in each sector, with the highest percentage in private renting and those buying with a mortgage, while social tenants spend relatively low proportions of income, as do those owing outright. Absolute levels of expenditure range from £28 per week for social tenants to £160 per week for those with a mortgage.

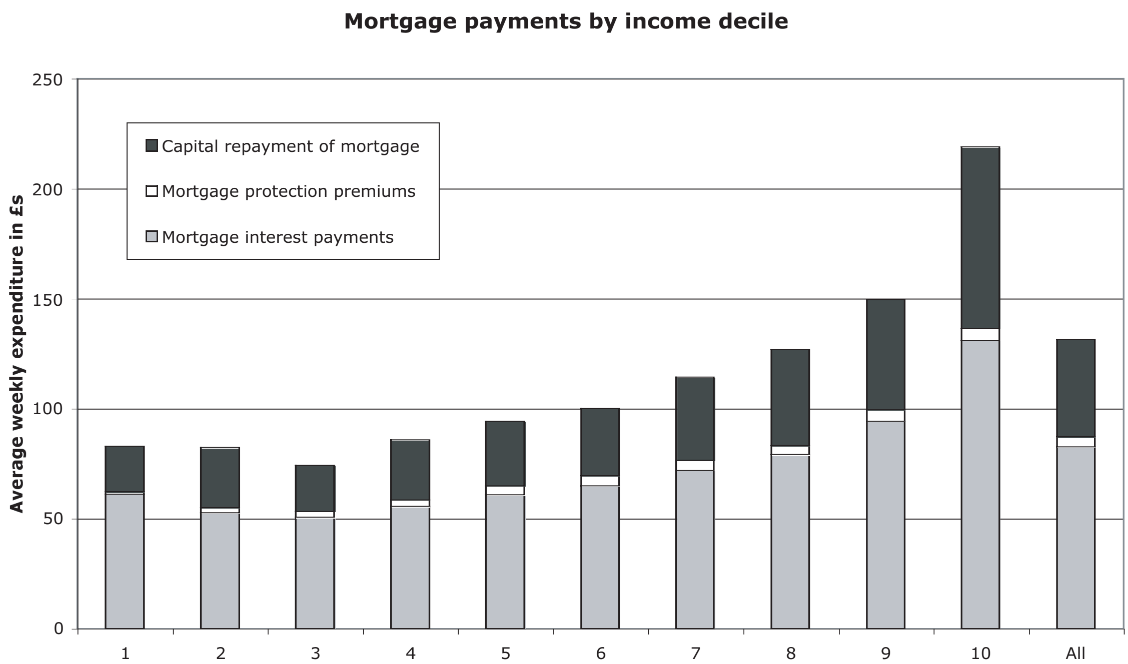
Table 1.4 Household expenditure in housing 2005/05

	Owned outright	Buying with mortgage	Private renting	Social		All tenures
				General	HA	
Median percentage of incomes (%)	10	27	28	14	17	19
Median expenditure £ per week	37	160	125	28	53	79

Source: *DCLG Live Tables 901*

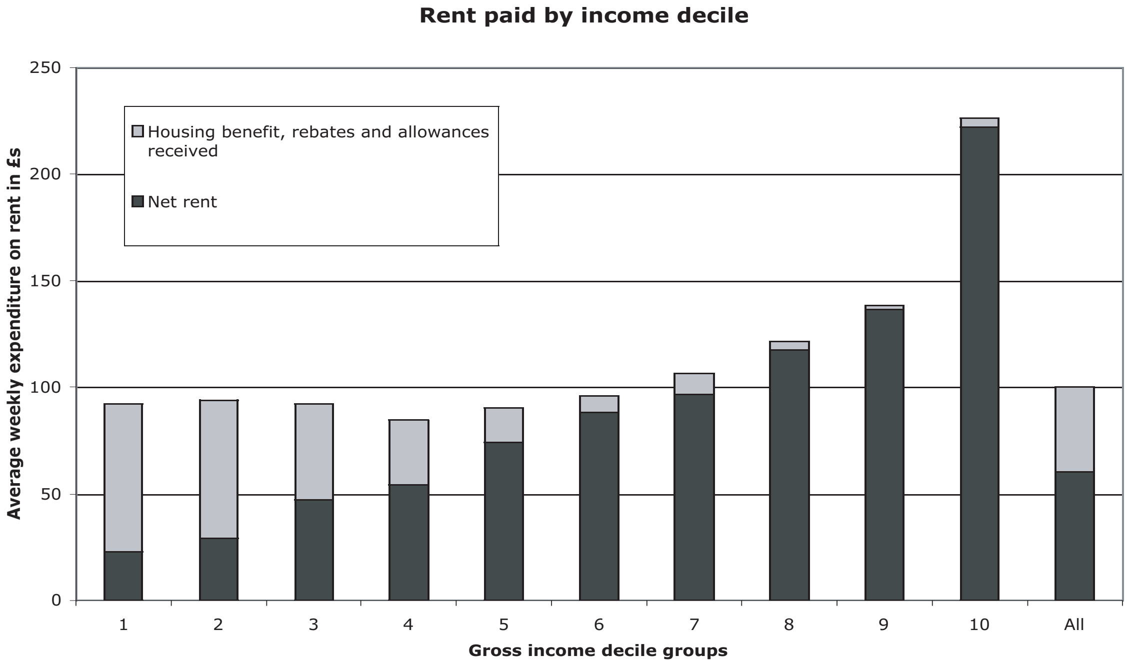
Figures 1.2 and 1.3 clarify how housing expenditure relates to gross incomes across tenures. Figure 1.2 shows that mortgage payments rise strongly with incomes, with the lowest income groups paying well below £100 per week. Figure 1.3 distinguishes gross rents and net rents (after Housing Benefit). It again shows a very clear positive relationship with incomes – with the lowest income groups among tenants paying less than £25 per week, with decreasing proportions of Housing Benefit as incomes rise up to the highest decile, where households are paying over £200 per week from their own resources.

Figure 1.2 Mortgage payments by income deciles of buyers (£ per week)



Source: *Family Spending 2007, Table 2.10*

Figure 1.3 Rent payments by both private and social renters



Source: *Family Spending 2007, Table 2.10*

The general picture is, therefore, one in which first (except for older outright owners) the vast majority of low income households are tenants and, secondly, tenants on low incomes receive a great deal of assistance with their housing costs. As a result, household expenditure on housing in the social sector and in parts of the private rented sector is kept down to reasonable levels by government assistance.

Section 2 Government Assistance to Housing

2.1 The Main Policies

There are three main strands of policy which directly aim to ensure that households do not suffer housing poverty (often defined as direct expenditure on housing above 25 per cent of income):

(i) income support for mortgage interest (ISMI) is available for eligible owner-occupiers to help the household pay mortgage interest when the household income falls below relevant income support levels through unemployment, sickness or accident. However, ISMI is only payable after six months of becoming eligible: in the meantime, insurance is meant to bridge the gap.

(ii) the availability of Housing Benefit (and since April 2008 the Local Housing Allowance (LHA) in the private rented sector) for all eligible households in the rented sectors. This personal allowance pays all rent and service charges eligible for Housing Benefit to households with incomes at the relevant income support level for their household type. Above that level, support is withdrawn as income rises. There are additional constraints which apply to the size of the property and to acceptable rent levels in the private rented sector.

(iii) the provision of social rented housing, where revenue subsidies to local authorities and capital grants to housing associations (RSLs) enable rents to be held below market levels. A national framework for rent determination set by central government specifies the level of rents that can be charged in the social rented sector. As a result, almost all social sector tenants obtain housing at a lower cost than those in the market sector. This policy provides assistance to around one in five of all households. In addition to which, nearly two thirds of social housing tenants receive Housing Benefit.

In addition (iv), there is a rapidly diminishing strand of direct rent control in the private rented sector, with rent controls remaining, to a very limited degree, for private tenants who have been in the same home since before 1988.

More fundamentally, the calculation of social security, unlike in most other European systems, does not include housing in estimating the minimum level of income required for reasonable subsistence. This is because housing costs are seen to vary too much across the country and in relation to local circumstances to allow a single formula to provide adequate housing assistance to all low income households in need. Instead, individual housing circumstances are taken into account through Housing Benefit. One impact of excluding housing costs from social security is to limit the cost of social security. But it also results in an apparently very generous Housing Benefit system – as by definition housing assistance must pay the whole rent for appropriate housing for those on the poverty line.

These policies taken together imply that:

a) all those in social housing should be fully protected from housing poverty in that rents are below market levels, and those on low incomes are eligible for Housing Benefit based on their actual rents and now LHA;

b) those in the private rented sector who claim Housing Benefit face a less generous scheme than social tenants, which can impact negatively on their residual income (i.e. that available for non-housing expenditures);

c) the main groups of tenants that may suffer housing poverty are those who are eligible but do not take up Housing Benefit. In addition, the income taper by which HB is withdrawn is quite extreme, leaving only 10p in the pound of each additional pound earned until the tenant is out of HB subsidy;

d) there are likely to be owner-occupiers, especially among the elderly, who have difficulty in paying housing related expenditures and for whom there is very little direct help available. Among mortgagors the problems relate more to those who have over-stretched themselves or whose household circumstances have changed, rather than to poverty as such. Only those with reasonable incomes can access owner-occupation.

2.2 How the policies operate

(i) Income support for mortgage interest

Support payments for mortgage holders have been available since the introduction of National Assistance in 1948. This was replaced by Supplementary Benefit in 1966, Income Support in 1988 and more recently by Jobseeker's allowance. The payment remained almost unchanged until 1995 when the restrictions were placed on the payment value and value of the loan covered for loans taken out after October 1995. The restrictions were considered necessary to control spending on the policy after poor risk assessment by lenders and borrowers, as well as rising mortgage debt in the recession of the early 1990s, saw costs rise rapidly from £71 million in 1980 to a peak of £1.2 billion in 1993.

Income support mortgage interest (ISMI) is not paid to those on very low income or the unemployed whose mortgage was in place before a claim for benefits was made. As the name suggests, the payment is intended to cover the interest payable on a mortgage and does not cover any money required to cover the capital originally borrowed or any investment that is linked to the mortgage, such as an endowment policy or pension. Loans for essential repairs or improvements may be covered, even if the agreement was entered into after a claim for income support or Jobseeker's allowance was made.

Owner-occupiers may be able to get help with mortgage interest through Income Support, income-based Jobseeker's Allowance or Pension Credit. Housing costs for owner occupiers will be taken into account in assessing the needs for Income Support. The amount is a weekly sum representing mortgage interest, interest on loans for repairs or improvements, co-ownership payments, ground rent and service charge. The level of support for mortgage interest and repairs and improvements is restricted to total loans below £100,000.

Those who are eligible for ISMI payments include:

- people over 60;
- those with mortgages dated prior to 2 October 1995;
- carers where the person looked after is eligible for certain benefits;
- single parents whose partner has died or left;
- offenders waiting for trial or sentence;
- holders of mortgage protection insurance which will not pay out because of pre-existing medical conditions; and
- those whose mortgages replace a previous mortgage on the same property that was taken out with the same lender on or before 2 October 1995.

There are, however, several caveats that limit the payments made. If a property is considered to be too expensive or too large for the claimant's needs, payments may be reduced. The value of the payment is based on the average interest rate at the time the claim is made. If this is above the interest value of the mortgage, claimants are permitted to retain the excess. Claimants may also find their payments reduced if they increase their original mortgage after making the initial claim.

A person under 60 with a new loan taken out on or after October 1995 will not receive housing costs for the first 39 weeks of a claim. Carers, persons in custody awaiting trail or sentence, persons refused payment under a mortgage protection policy because of a medical condition and lone parents claiming income support because of the death of a partner or being abandoned are exempt from this waiting period. Instead, they receive no help for the first 8 weeks, 50 per cent for the next 18 weeks and full housing eligible costs thereafter. A person with a partner aged 60 or over is entitled of full eligible housing costs straight away. A person under 60 with an existing loan (i.e. taken out before October 1995) will not get housing costs for the first 8 weeks, 50 per cent for the next 18 weeks and full eligible costs only after 26 weeks.

The total cost of ISMI rose to over £1 billion per annum in the early 1990s when the housing crisis was at its worst. This led to a change in policy to limit payments. Partly for this reason and partly because employment has improved consistently, ISMI payments were only around £350 million in 2005/06. However, in the current crisis there is increasing pressure from financial institutions to modify the rules to at least update eligibility in line with current housing costs. There are also proposals to provide a rather stronger safety net to keep people in their own homes (Stephens et al., 2008).

(ii) Housing Benefit

Housing Benefit is a benefit for people on a low income to help them pay their rent. It may be payable to people who are in receipt of other benefits, and to those who work part-time or work full-time on a low income. Housing Benefit is not available to help with the costs of a mortgage or home loan (see above). Housing Benefit does not help with the Council Tax, but those on a low income may be able to get Council Tax Benefit to help pay their Council Tax.

The principles by which Housing Benefit operates apply across the whole rented sector. The fundamental objective is to ensure that a household has, at the minimum, after paying rent eligible for subsidy, the income support level of income for that household's characteristics. As a result, household rents will be paid in full if their income is at that minimum level. Above that level subsidy will be withdrawn for each additional £ of income (the income taper).

Housing Benefit is paid through the local authority. For private rented tenants, the rent covered by Housing Benefit will normally be restricted to an amount set by a rent officer. This varies depending on whether the application was made before 7 April 2008 or after that date, because of the shift to Local Housing Allowance (see below). For social sector tenants, Housing Benefit covers the rent charged plus eligible service charges.

Finally, Housing Benefit is restricted to tenants. However, those who have bought a property using a shared ownership scheme may be eligible to receive Housing Benefit on the proportion of the property that they rent.

The cost of Housing Benefit has risen significantly and consistently in monetary terms over the last decade. In 1995/96 it cost around £11 billion, of which over £7 billion was paid to social sector tenants (who also benefitted from regulated rents) and around £3.8 billion to private tenants. In 2005/06 the total was some £14 billion, of which over £10 billion went to social tenants and around £3.7 billion to private tenants. It is worth reiterating that over that period the size of the social sector declined considerably and rent increases were heavily restricted, while the size of the private rented sector increased by more than a fifth. The changes in the amounts paid therefore reflect two different pressures: the increasing relative poverty of social tenants, and the growing constraints on Housing Benefit payments to private tenants.

New applications for Housing Benefit or those who moved on or after 7 April 2008

When tenants of a **private landlord** make a new claim for Housing Benefit, the local authority will normally calculate how much rent Housing Benefit can cover using the Local Housing Allowance rules. Local Housing Allowance rules will also normally apply if the tenant moves address, even if this is within the same local authority's area.

Under the Local Housing Allowance rules, when the local authority calculates how much Housing Benefit to pay, they will not usually look at the actual rent paid. Instead, they will use a standard Local Housing Allowance figure which has been calculated by a rent officer. The figure used will be the one which is based on the local area and the number of rooms the Housing Benefit rules say are needed for the household. This may not be the same number of rooms as the household is actually living in.

In some cases, it is possible for the Housing Benefit entitlement to be more than the rent, although only £15 a week more than the actual rent can be paid. This is intended to give the tenant an incentive to negotiate the rent.

However, more often the amount of Housing Benefit will not cover all the rent. If this is the case, the tenant has to make up the difference out of any other income, or find cheaper accommodation. Those on the lowest incomes may be able to get further help with housing costs through other sources.

Applications for Housing Benefit before 7 April 2008

There are different rules about how Housing Benefit decisions are made for private sector tenants who applied for Housing Benefit before 7 April 2008. How much of the rent Housing Benefit can cover is decided by a rent officer. Instead of using the Local Housing Allowance rules, they look at the rent actually paid and decide whether it is reasonable for Housing Benefit to cover all the rent. This depends on a number of things, including how much the rent is compared with other similar properties in the area and whether the accommodation is the right size for the household's needs.

For those who are under 25 and single with no children, the rent officer compares the actual rent paid with the market rent for a single room with shared facilities. The local authority works out how much Housing Benefit the household is entitled to based on the rent officer's decision.

If the amount of Housing Benefit does not cover all the rent, the tenant may have to make up the difference out of any other income they may have, or find cheaper accommodation. Again, low income households may be able to get further help with housing costs.

It is possible to challenge a rent officer's decision if the tenant applied for Housing Benefit before 7 April 2008 and they think the decision is wrong because, for example, there is no cheaper accommodation in the area. Appeals cannot be made directly to the rent officer, but the local authority can ask the rent office to review their decision. Those wishing to challenge a rent officer's decision should consult an experienced adviser, for example at a Citizens Advice Bureau.

Thus the difference between before and after April 2008 is that those before 2008 are eligible for their actual rent subject to adjudication by the rent officer. They never receive more than that rent and will receive less if the rent is unreasonable or they are consuming more than the appropriate space standard. Adjudications after April 2008 take account not of actual rent but rent for an appropriately sized dwelling in the locality. If the tenant can do better, they may keep up to £15 as income to spend freely. Housing Benefit for social tenants is based on the same principles. However, the actual rent charged by the social landlord is accepted as the rent on which Housing Benefit will be paid together with any eligible service charges. No account is taken of the size of the accommodation as it is assumed that the landlord allocates approximately.

(iii) The provision of social rented housing

Social rented housing is provided at a subsidised rent by local authorities and housing associations. There are roughly 4 million homes in the social housing sector. Just under half are owned by local authorities, and the number is shrinking by sales under the Right to Buy, the demolition of obsolete stock, and by the transfer of stock to housing associations. Just over half is owned by housing associations, and the number is increasing by the transfer of stock from local authorities and by new house building. Virtually all new housing in the social housing sector is now built by housing associations.

The allocation of social housing

Local authorities retain the primary role of administering the 'waiting lists' of applicants wishing to move into social housing, and have the statutory duty to secure accommodation for households whom they assess as being homeless and in priority need.

In order to enable local authorities to discharge these duties, local authorities have the right to nominate applicants to vacancies in housing association properties. These nomination rights are usually 50 per cent of the vacancies, rising to 100 per cent in the high stress areas of London.

All local authorities are free to set their own housing allocation policy as long as it conforms to certain legal guidelines. By law, all local authorities must clearly set out procedures and priorities by which social housing will be allocated and ensure that information on these policies is made publicly available. Local authorities must also ensure that the following groups are given **'reasonable preference'** under any allocation scheme:

- people who are **legally classed as homeless** (or threatened with homelessness);
- people occupying **unsanitary, overcrowded or otherwise unsatisfactory housing;**
- people who need to move for **medical or welfare reasons;** and
- people who need to move to a particular locality in the district to avoid hardship to themselves or to others. For example, to be nearer to special training opportunities or special medical facilities and who would suffer hardship if they were unable to do so.

Among those who are deemed inadequately housed, those people normally considered **'in priority need'** and therefore given preferential access to social housing include the following groups:

- **pregnant women;**
- families with **dependent children;**
- people who have been made homeless through an unexpected disaster;
- people aged 16 or 17;
- certain young people aged 18–21 who are leaving care accommodation or foster homes;
- people who are considered particularly **vulnerable** on emotional and health grounds; and
- people in prison, care or the armed forces.

On the other hand, those who are normally excluded from social housing include:

- people who are considered to have made themselves **homeless 'intentionally'** - for example, by failing to pay rent or mortgage payments when they could have afforded to do so;
- people who previously lost their home due to **rent arrears;** and
- people considered guilty of **anti-social behaviour** or convicted of a criminal offence.

Most local authorities and housing associations operate a 'points' system, whereby applicants on waiting lists gain points according to the extent to which they fall into priority groups, are overcrowded or living in insanitary conditions, and their length of time on the list. Where social housing is particularly scarce, only those in priority need may be housed, including statutory homeless households and those from vulnerable groups.

As private sector organisations, housing associations are not subject to the same statutory requirements as local authorities, although they are required by the Housing Corporation to follow regulatory guidance on allocation policies.

Homelessness and social housing

Local authorities have the statutory duty to secure accommodation for households whom they assess as being both homeless and in priority need.

'Homeless' does not mean literally 'roofless': local authorities must deal with households threatened with homelessness within 28 days. The main reason for households becoming homeless is that their family or friends, with whom they are living, are no longer willing to accommodate them. As lodgers, such households have no security of tenure, and can be evicted at will.

Only certain groups of homeless households are statutorily classified as being in 'priority need', and therefore creating a duty for the local authority to secure accommodation for them. The priority need categories are broadly:

- Households containing a pregnant woman or dependent children;
- Households that are defined as 'vulnerable', including:
  - The elderly
  - People with physical or mental illness or disability
  - People with problems of substance abuse
  - People suffering from violence or harassment
  - People who have been in care, or prison, or discharged from the armed forces
  - Young people aged 16 or 17or
  - Households made homeless by fire, flood or other emergency.

In this context, poverty is not a direct criterion. Rather it is the interface between household characteristics and circumstances taken together with their housing conditions that determines their rights to housing. Obviously these are usually closely related to poverty.

There are two main groups of people who are not eligible for assistance as homeless. These are primarily asylum seekers and people returning to the UK who are not regarded as 'habitually resident', although this status is normally acquired after six months' residence.

Households who are homeless but not in 'priority need', are therefore generally childless couples or single people, under the state pension age and without any degree of 'vulnerability'. Local authorities are only required to supply 'non priority' homeless with advice and assistance, but in practice a significant proportion of these households are rehoused by both local authorities and housing associations through their normal waiting lists.

About a quarter of all households rehoused by local authorities and housing associations are homeless and in 'priority need' and just over 10 per cent are homeless but not in 'priority need'. Roughly two thirds of all households rehoused in social housing are therefore not homeless.

Setting rents in the social rented sector

In England, the central government's policy for social rents is to ensure rents are fair and affordable. Under the Housing Green Paper issued in April 2000 (DETR, 2000), the government introduced a proposal for determining social rents. The rent restructuring policy, which was implemented in April 2002, was intended to 'harmonise' rents of similar dwellings in the local authority and the housing association sectors, and to move towards a consistent, integrated method for setting rents across all social housing stock within 10 years (ibid., para. 10.1). It also implemented a policy of charging social rents that, in part, reflect the market values of properties, but also within the affordable range for tenants. The rent-setting formula therefore included two main components, property values and average earnings, as follows:

> 70 per cent x 'average net rent' x 'relative local earning' x 'bedroom weight'
> +
> 30 per cent x 'average net rent' x 'relative property value'

The larger proportion of average earnings used in the formula was intended to guarantee that properties with very high capital values would still be affordable to those in need. A further component, namely number of bedrooms, was added to differentiate between properties of various sizes. Again the intention was to ensure that those with higher needs (usually those with dependent children) who required larger accommodation would be able to afford adequate housing. Details of each component of the rent formula are explained in the table below:

Table 2.1 The rent formula for social housing

Component	Description
Average net rent (rent excludes service charges)	Average national rent in April 2000: RSL - £53.50 per week increased each year by the HC's guideline limit for rent increases (i.e. RPI+1% from April 2000 and RPI+0.5 from April 2002). Local authority - £45.60 per week, need to adjust each year by the average guideline increase before using in the formula.
Relative local (county) earning	Average earnings for the county/Average national earnings County earnings – based on the New Earnings Survey and represent county average gross weekly earnings full-time male and female manual workers over the 1997-99 period, updated to 1999 prices. Average weekly national earnings in 1999 - £316.40.
Bedroom weight for property size	2002-05: 0.8 for bedsit, 0.9 for 1 bed, 1.0 for 2 bed, 1.05 for 3 bed and 1.1 for 4+bed The property size weights were increased in 2006 to: 0.8 for bedsit, 0.9 for 1 bed, 1.0 for 2 bed, 1.1 for 3 bed, 1.2 for 4 bed, 1.3 for 5 bed and 1.4 for 6+ bed.
Relative property value	Individual property value/National average property value Individual value: derived from the property value of the 'beacons' (the typical properties having the same attributes of the assessed property within the area), which were valued by local surveyors based on market valuations on an Existing Use Value (assuming continued residential use and vacant possession) in January 1999, as reported in the 1999 English House Condition Survey. National average property value in January 1999: RSL - £49,750. Local authority - £41,350.

The framework has now been in place for over five years and most rents are now within 5 per cent of their 'target' rents (Udagawa, 2007). The impact of this policy on the spatial patterns of rents and how they relate to property size and rents in the private sector have been examined in detail (Solomou, Wright and Whitehead 2006; Udagawa and Whitehead, 2007; Udagawa, 2008). The evidence suggests that rents are now more consistently related to property values across the country, with much lower rents in the North than in the South and particularly London. However, in terms of property size, those in smaller accommodation still pay relatively high rents while those in larger units pay much lower rents compared to market values.

(iv) Policies on rents and security in the private rented sector

Rent controls were originally imposed on private rented housing, together with security of tenure, to protect tenants from what were perceived as exploitative landlords. Today, most tenancies have been deregulated and only a small number remain. However, there is a measure of rent control which operates via the Housing Benefit system (see above) whereby benefit is payable only for a rent assessed to be 'fair' (for regulated tenancies). Assured and Assured Shorthold tenants can also apply for their rent to be set by a rent assessment committee if they think that the landlord has set the rent too high. The principles whereby the rent is set by the committee are broadly similar to those used by the Rent Service to set fair rents, except that improvements made by the tenant are not taken into account.

Assured tenancies and Assured Shorthold tenancies

These are the commonest forms of arrangement for the renting of houses and flats by private tenants. In their current form, they were introduced by the Housing Act 1988 but important changes were made by the Housing Act 1996 with effect from 28 February 1997.

In the legislation, the term 'assured tenancy' covers both assured tenancies (sometimes called 'full' or 'ordinary' assured tenancies) and assured shorthold tenancies. For clarity, this report will refer to assured tenancies and shorthold tenancies to highlight the important differences between the two.

An assured or shorthold tenancy is the usual form of letting if:
- the tenant is a private tenant and the landlord is a private landlord;
- the tenancy began on or after 15 January 1989;
- the house or flat is let as separate accommodation and is your main home.

A tenancy will not be an assured or shorthold tenancy if:
- the tenancy began before 15 January 1989;
- it is a business or holiday let;
- no rent or a very low or very high rent is charged; or
- the landlord is a 'resident landlord' (see section 1.2).

Assured and shorthold tenancies allow landlords to charge a full market rent, unlike previous forms of tenancy. Shorthold tenancies also allow landlords to let their property for a short period only and to get it back if they wish after 6 months.

Changes in the 1996 Act mean that:
- a new tenancy will automatically be a shorthold tenancy unless the landlord gives written notice that it will not be a shorthold tenancy;
- the landlord has a right to possession if the tenant owes at least 2 months' or 8 weeks' rent (rather than 3 months' or 13 weeks' rent);
- it will be easier for the landlord to evict the tenant if they cause a nuisance or annoyance to other local people; and

- if the landlord agrees a new or replacement shorthold tenancy with the tenant, they have a right to a statement of the main details of the tenancy agreement if the landlord does not provide a written agreement.

Under changes in the 1996 Act, a new shorthold tenant is:
- only able to refer their rent to a rent assessment committee during the first 6 months of the tenancy; but
- continue to have the right not to be evicted without a court order and to have the same rights as existing tenants to stay in the property.

The regulation of rent increases in the private rented sector

If the tenancy is a fixed term tenancy, the landlord can only put the rent up during that term if the tenant agrees. If they do not agree, the landlord will have to wait until the fixed term ends before he or she can raise the rent.

If the tenancy is a contractual periodic tenancy, the landlord can put the rent up if the tenant agrees. Alternatively, the landlord can use a formal procedure in the Housing Act 1988 to propose a rent increase to be payable a year after the tenancy began. He or she can then propose further increases at yearly intervals after the first increase.

When a fixed term tenancy ends and the tenancy lapses into a statutory periodic tenancy, the landlord can put the rent up if the tenant agrees. Alternatively, he or she can use the formal procedure in the Housing Act 1988 to propose a rent increase to be payable as soon as the statutory tenancy starts. The landlord can then propose further increases at yearly intervals after the first increase.

The landlord must propose the rent increase on one of two special forms, namely 'Landlord's notice proposing a new rent under an Assured Periodic Tenancy of premises situated in England'; or 'Landlord's notice proposing a new rent under an Assured Periodic Tenancy of premises situated in Wales'. The forms can be used for assured or assured shorthold tenancies.

He or she must give at least a month's notice of the proposed increase if the rent is paid on a weekly or monthly basis (more if the rent period is longer).

If the tenant accepts the rent increase, they should simply pay it from the date given in the notice.

If they do not agree with the increase, they must apply to a rent assessment committee to decide what the rent should be. A special form must be used called 'Application referring a Notice proposing a new rent under an Assured Periodic Tenancy or Agricultural Occupancy to a Rent Assessment Committee', available from law stationers or rent assessment panels (see Appendix D). (This form must also be used if the tenancy is a shorthold tenancy). The committee must receive the application before the date on which the new rent would be due.

Rent assessment committees are made up of 2 or 3 people – usually a lawyer, a property valuer and a lay person. They are drawn from rent assessment panels – bodies of people with appropriate expertise appointed by Government Ministers. There are 6 rent assessment panels in England and Wales. The committees are independent of both central and local government. There is no appeal against a committee's decision except on a point of law.

The committee may make a decision by considering the relevant papers, although the tenant or the landlord can ask for an informal hearing, which both may attend. There is no charge for a committee decision.

A shorthold tenant can also apply to a rent assessment committee at the beginning of the tenancy for a decision on the rent if they consider the rent to be significantly higher than the rent for comparable tenancies. The Housing Act 1996 made important changes to the deadline for applications.

Fair rents

Fair Rents are a form of rent control applicable for private sector rented accommodation without a residential landlord and which was let before 15 January 1989. The Rent Act 1977 sets out the rules for setting Fair Rents and the Rent Acts (Maximum Fair Rent) Order 1999 limits the amount of rent that can be charged by linking increases to the Retail Prices Index. Only about 4 per cent of all private tenancies are registered as having a fair rent (affecting approximately 115,000 households). From January 1989 to March 1997, the default was an Assured tenancy, at a market rent, but in practice landlords preferred the Assured Shorthold tenancy and 1993/4 Assured Shortholds exceeded Assured Tenancies. From March 1997 the Assured Shorthold became the default and changing legislation encouraged this trend.

2.3 Summary

These four major areas of policy – (i) assistance with mortgage interest for those whose circumstances change; (ii) Housing Benefit to support low-income households in achieving adequate rental housing; (iii) the allocation of social rented housing to lower income and vulnerable households; and (iv) rent controls below market levels in both the private and the social sector, are all directed at ensuring that, first, all households can obtain adequate housing and, secondly, that housing is affordable to households on low incomes and to those whose circumstances change for the worse. In principle they address all the major areas of concern. In practice there are gaps.

Section 3 Where are the gaps?

3.1 Owner occupation

In the private sector, i.e. owner-occupation and private renting, allocation is by willingness and capacity to pay for housing. To enter owner-occupation most households will require a mortgage, which will only be available if there is at least one member in employment. Households have generally been expected to borrow perhaps 3.5 times income, although many do in fact borrow more. Rising house prices over the last few years have resulted in access problems for many lower income households and significant numbers of households who are overstretched in terms of their repayment commitments. Problems of access and affordability have been addressed by government initiatives which have targeted assistance to help lower income households into owner-occupation. Those households that are able to access these schemes pay **less** for their owner-occupied housing than average.

The schemes include:

(i) the Right to Buy introduced in 1979 by which some 2.4 million social sector, mainly local authority, tenants have been enabled to purchase their homes at a discount and to obtain a mainstream mortgage;

(ii) shared ownership available since 1980 and now called New Build HomeBuy by which households may purchase a percentage (between 25 per cent and 75 per cent) of a new unit provided by RSL and pay rent on the other element at a usual maximum of 2.75 per cent of capital value. Such households can staircase to 100 per cent ownership; and

(iii) shared equity schemes with various names, currently including MyChoiceHomeBuy and Ownhome, which provide a shared equity loan, initially without an interest charge, on a proportion of the price up to 50 per cent. These schemes have generally been restricted to lower income employed households, notably key workers (Housing Corporation, 2008).

Those households who pay more than the average for their mortgages are those who wish to borrow more than the lenders regard as acceptable; who are higher risk because of their household circumstances, insecurity of income or the attributes of the properties they purchase; and those who use other sources of funds either because they are ineligible for a mortgage from the formal banking sector or wish to top-up their borrowing. All of these factors are related to poverty and insecurity, but they are also related to personal behaviour and aspirations.

The mortgage market is regulated both by legislation (which, for instance, forbids discrimination and 'red-lining' – i.e. refusing to lend in particular areas) and by the Financial Services Authority (FSA) as well as by self-regulation frameworks developed by the Council of Mortgage Lenders. An important development over the past few years has been the secondary mortgage markets which lend to credit impaired households.

Many of those who use the secondary mortgage market will have to pay higher rates of interest because they are perceived as being at higher risk. In addition, households, especially those looking to borrow outside generally accepted credit limits or looking for lower initial repayments, are likely to use mortgage brokers and pay arrangement fees of some hundreds and indeed thousands of pounds. There is thus a group of households just able to enter owner-occupation who are paying more for their mortgages (Whitehead with Gaus, 2007).

However, this group is not generally poor – rather, they are overstretched. Issues of poverty are concentrated among those whose circumstances change through unemployment, accident, illness or other reasons for income loss. The mechanisms for addressing these problems are private insurance (Mortgage Payment Protection Insurance - MPPI) and ISMI.

In addition, there are households that, in order to purchase, use non-formal sources of funds which are often outside the regulatory framework. Very little is now known about this group, although there is anecdotal evidence of very high interest charges and of costly buy and leaseback arrangements. These appear to be concentrated among older Right to Buy households and some parts of London where there are high concentrations of black and minority ethnic (BME) households. There is also evidence of those practices growing in the current difficult economic environment.

In this context Shelter has stated:

1. There is currently widespread concern over bad practice among some companies running 'buy and lease back' schemes, where a company offers to buy a borrower's property when they are facing mortgage arrears, and then rents it back to them so they can stay in their home. Advertising for many of these mortgage rescue schemes states that they offer struggling borrowers a way of getting out of financial trouble, releasing equity from their property, and allowing them to stay in their homes. But in reality the company will often buy the property at a price far below its full market value, and rent it back to the former owners on an assured shorthold tenancy, giving them no long-term security of tenure. After six months there is nothing to stop the new owner evicting them, leaving them homeless.

2. Adam Sampson said Shelter came across many problems with it. ‘People are being ripped off. We are seeing people who are getting only 50 per cent or 60 per cent of the value of their homes instead of the 70 per cent to 90 per cent they should be getting. Many of the promises that are made that people can stay in their homes for the rest of their lives are not being honoured. Some of these schemes are themselves financially unsustainable. We have had people whose homes are being repossessed because the people they sold them too couldn't keep up with their payments.’

3. John Fingleton, OFT Chief Executive, said that they wanted to take ‘a good look’ at whether consumers were adequately informed and protected. ‘Sale and rent back schemes might be helpful for some consumers but there are a number of potential concerns including whether consumers in difficult circumstances are making well informed choices.’

The vast majority of those in poverty in the owner-occupied sector are older households who are often seen as being asset rich, yet income poor. Those households generally pay no mortgage costs because they are outright owners. Their direct housing costs are therefore low. However, they face the continuing costs of upkeep for their home; often these homes are older, in a poor state of repair and have inadequate thermal insulation. Moreover, households have to pay Council Tax related to the value of their home. Mortgage mechanisms for releasing equity are generally poor value for money and may adversely impact on the person’s eligibility of tax credits and income support. Such households are thus not poor in terms of direct payments for housing but have to spend more on housing related services and taxation. Government assistance in this context is limited to Council Tax Relief, some income related grants and loans for insulation and other improvements, and general income support.

Thus, in the owner-occupied sector, there are three main groups of households who may be poor because of housing decisions:

a) those who overstretch themselves in terms of borrowing. This group will generally not be on very low incomes, but rather as a result of their high housing expenditure may not have adequate residual income to purchase other necessities of life. This group may be paying more for their mortgage especially if they have not been able to save for a deposit or they have borrowed outside normal limits. This additional cost relates to the higher risks to lenders;

b) those whose circumstances change for the worse and therefore find themselves in financial difficulties. These are supported to a limited extent by insurance in the form of MPPI and by ISMI; and

c) those who become poorer as they grow older, notably through loss of income on retirement. This group generally pay low direct housing costs because they no longer have a mortgage but pay high housing related costs because they cannot adjust these costs without moving. The impact of the Council Tax is modified by Council Tax Relief (so the poor who claim pay less). Other costs are market determined but may be higher per unit because of the type of housing in which older households live.

3.2 The private rented sector

Households in the **private rented sector** also pay market rents. However, as already noted, if they are eligible for Housing Benefit their income will be increased to cover all or part of their direct rental payments.

For many households, the issues in the context of private renting relate mainly to obtaining value for money, to the high housing costs of those whose incomes are just above the Housing Benefit eligibility levels (and more generally to the steepness of the income taper), and to those who for one reason or another do not take up Housing Benefit.

The first relates to what the market provides and, in this context, there is considerable evidence that rents are not strongly related to either square metres or to quality of accommodation (Crook and Kemp, 1995).

Most of this evidence suggests rather that rents, especially at the bottom end of the market, relate to the number of rooms and the number of persons accommodated and their capacity to pay. To this extent it is clear that there are issues of relative market power and that those on lower incomes will generally pay more per unit of quality, while those further up the market will obtain higher quality and more space at lower marginal costs.

A more general issue is that what private tenants are obtaining is quite different from the housing consumed in other tenures in that they have very limited security of tenure. Issues of eviction, harassment and uncertainty are clearly concentrated among poor, vulnerable households. They are addressed through regulation, the provision of Housing Benefit and social housing. Thus there are general issues in relation to the suitability of private renting for poorer households and the value for money they receive. Because of the availability of Housing Benefit, the vast majority of the very poor pay less for their housing. The gaps are restricted to:

(i) those who do not take up Housing Benefit;

(ii) to the extent that not all the rent is fully covered, reducing residual income.

3.3 The social sector

In the **social sector** the rents policy together with Housing Benefit ensures that those who gain access to social housing pay **less** for their housing. Moreover, landlords have a strong incentive to ensure those eligible for Housing Benefit actually claim it. The problems of poverty therefore relate to those who are excluded from social housing; those who are inadequately housed in the sector, mainly in terms of dwellings that do not meet the Decent Homes standard and through overcrowding where the quality and quantity determined by government standards cannot be achieved; and the problems associated with the Housing Benefit income taper and disincentives to work. These are Housing Benefit problems – but they are not an outcome of the poor paying more either in terms of total payments or payments per unit of housing quality.

Finally the most important issues arising from these complex tenure specific arrangements is who is excluded from suitable accommodation by poverty: in particular, who is homeless or living with family and friends. This is obviously an area where, in particular, while not paying more specifically for housing, households actually pay more for many other services. There is a great deal of evidence that such households suffer major costs in terms of health, education, costs of organising their lives and the risks they face (Whitehead, 1998). Again, though in general terms, homeless households who are generally poor pay more on the broadest definition of wellbeing, they do not generally pay more specifically for housing.

The next section looks at the empirical evidence on these issues: who lives in each tenure; what they pay for housing; how government assistance impacts on their payments; and what types of accommodation they obtain.

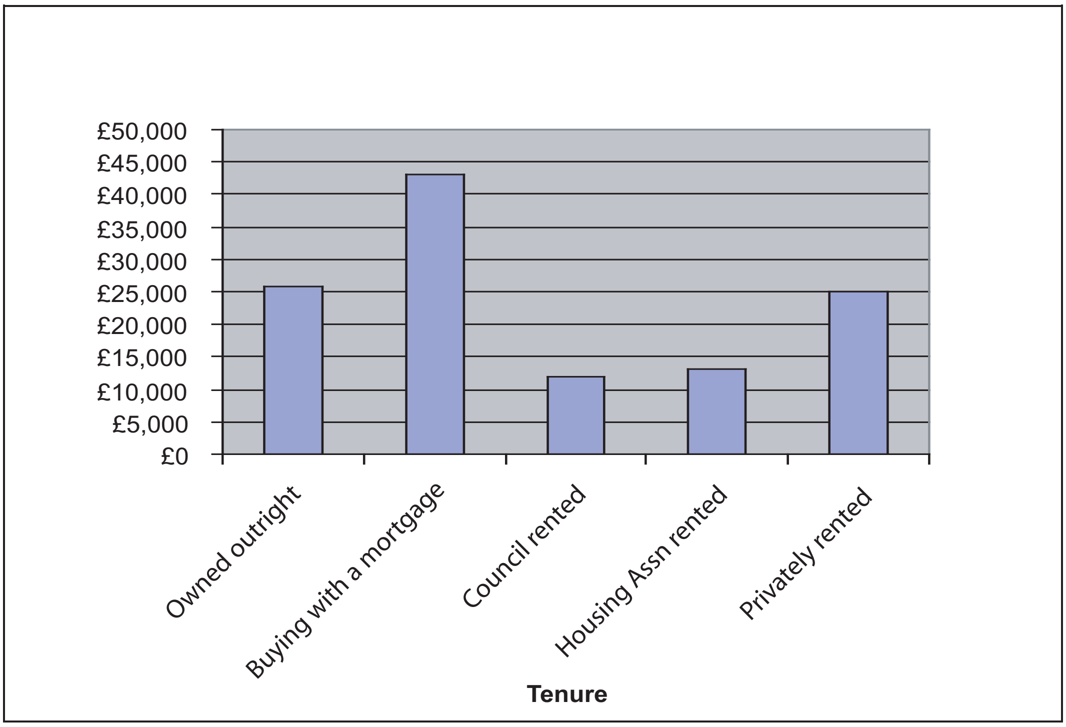
Because housing has been the subject of so much government intervention, the analysis of whether the poor pay more is centrally an analysis of the extent to which government policy has been effective in ensuring that poorer households both achieve adequate housing and are able to pay for that housing, while still able to afford other basic necessities (Whitehead, 1983; Hancock, 1984). It is that issue which mainly concerns this paper. However, to set this analysis within a broader context, we first clarify the economic reasons why we might expect the poor to pay more than the average household.

Section 4: Poverty and Housing Costs

4.1 Income by tenure

The starting point must be an analysis of incomes and housing costs by tenure, simply because government assistance with housing costs is so tenure specific. As we have noted throughout this paper, the vast majority of poorer households pay less for their housing than average. The next question is, therefore, whether taking account of their low incomes they still pay more as a proportion of that income. Overall mean gross incomes were not far short of £30,000 in 2007, but social tenants have average incomes around or just above 40 per cent of that level. Average incomes of private rental sector tenants' incomes are around 80 per cent of the overall average, and outright owners at 87 per cent of the average both appear relatively well off (figure 4.1).

Figure 4.1 Mean gross annual income of HRP (and partner) by tenure, England 2006/07



Source: *Survey of English Housing 2006/07*

Figure 4.1 gives more detail on how incomes are distributed within each tenure. It shows clearly that those buying with a mortgage are generally more affluent and that there are significant numbers of private tenants who also have relatively high incomes.

Table 4.1 shows the distribution of households by tenure and income category and shows that while 46 per cent of all households have incomes below £20,000, 84 per cent of social tenants have incomes below that level. This was followed by private tenants and those who own outright at 55 per cent and 54 per cent of households with incomes below £20k respectively. Moreover, 55 per cent of social tenants have gross incomes below £10,000 p.a. followed by private tenants at 29 per cent below this figure.

These figures make it clear that poverty is heavily concentrated in social renting, but that there are significant proportions of private tenants and outright owners who have incomes that are less than one third of the overall average.

Table 4.1: Gross Income by Tenure (Household Representative Plus Partner) England 2006/07 (%)

	Under £5k	£5k but under £10k	£10k but under £20k	£20k but under £30k	£30k but under £50k	£50k and over	Total (m) (%)
Owned outright	3	19	32	19	15	10	4.8 (27.6)
Buying with a mortgage	1	3	14	20	35	27	6.9 (39.7)
All owner-occupation	2	10	22	20	27	20	11.7 (67.9)
Rented from social landlords	14	41	29	9	6	1	3.5 (20.1)
Rented privately	9	20	26	19	18	8	2.2 (12.6)
All tenures	5	17	24	17	22	15	17.4

Source: *Survey of English Housing 2006/07*

When we look at the numbers of households affected, the picture appears rather different because owner-occupation is so much the dominant tenure. Table 4.2 shows the numbers in the lowest income groups (below £10,000 p.a. and below £20,000). These figures should be treated with particular care because of non-response on the income questions.

Table 4.2: The Numbers of Households in Poverty by Tenure

	Under £10k		Under £20k		Total	
	Number (000)	%	Number (000)	%	Number (m)	%
Owned outright	1,090	28	879	38	4.8	28
Buying with mortgage	274	7	418	18	6.4	40
All owner-occupiers	1,365	35	1,297	56	11.7	68
Rents from social landlord	1,914	49	697	30	3.5	20
Rented privately	628	16	317	14	2.2	13
All tenures	3,907	100	2,311	100	17.4	100

Source: *Survey of English Housing 2006/07*

Even in numbers terms social tenants clearly still dominate among the very poor followed by outright owners, most of whom are elderly. Owner-occupiers dominate among those with incomes between £10k and £20k

4.2 Vulnerable households by tenure

The next step is to relate tenure to the attributes of poorer households.

Table 4.3: Household Attributes by Tenure (%)

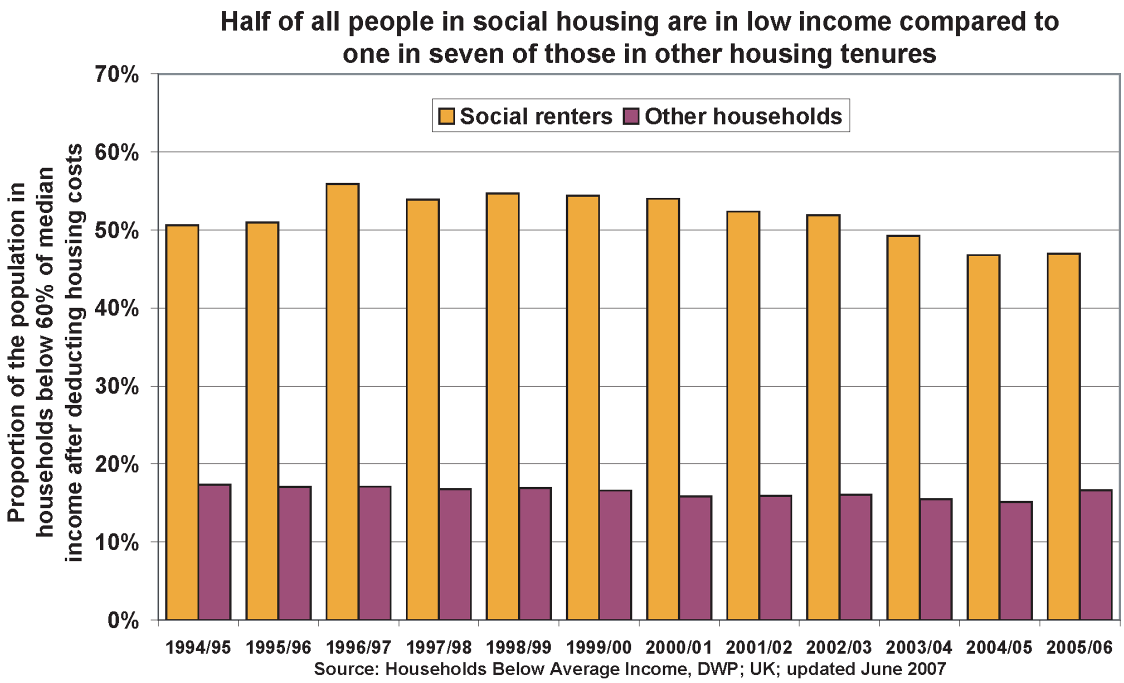
Ethnicity	Owned outright	Buying with mortgage	Social Renting	Private Renting	Total (%)
All BME	15	35	27	23	8.6
Unemployed	1	1	6	4	2
Retired	57	3	32	?	26
Lone parents with dependent children	6	28	46	19	7
One person households	38	23	26	13	28.9
Proportion with no working member	57	6	62	27	34
Tenure	31	39	18	12	20.8m

Source: *Survey of English Housing 2006/07*

Table 4.3 gives some statistics on the attributes of households in the different tenures. They reflect the extent to which government policy and the market together lead to very different concentrations of vulnerable groups in the different tenures. Again it shows that much higher proportions of vulnerable households are to be found in the social rented sector, but that there are also concentrations of certain types of vulnerability, notably unemployed, lone parents and minority households in the private rented sector, as well as concentrations of elderly outright owners in the owner-occupied sector.

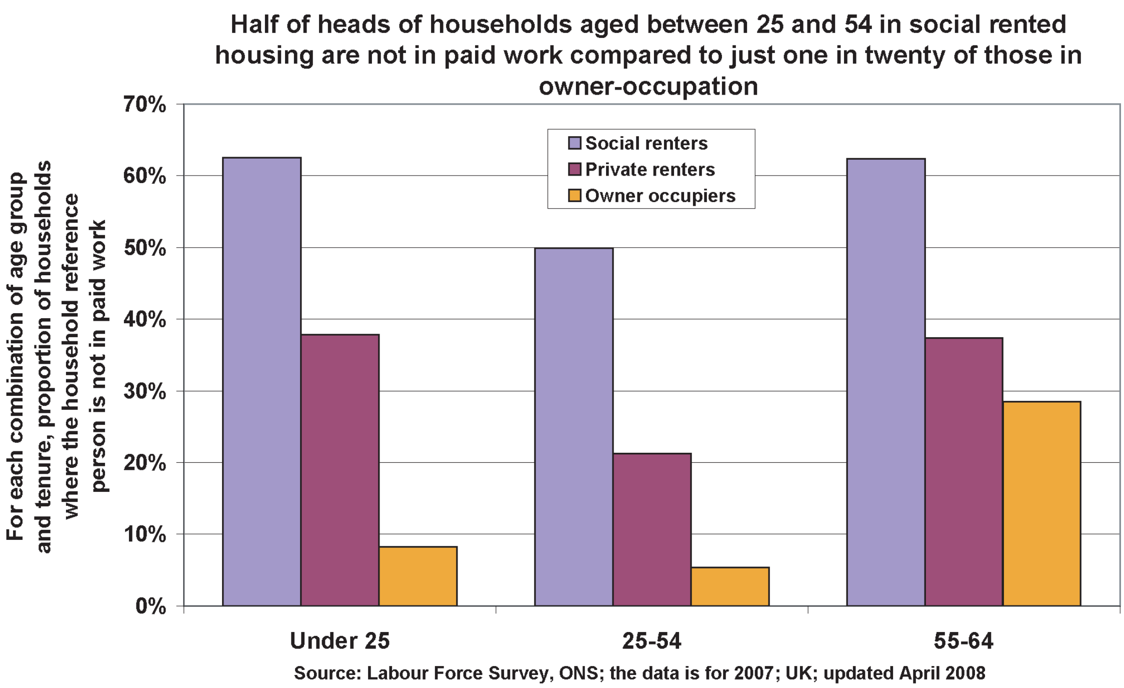
Further evidence from the Department of Work and Pensions helps to show the extent to which those on low incomes (Figure 4.2) and without employment (Figure 4.3) are concentrated in the social sector. This also shows that the problems associated with the lack of employment for those over 25 (below this age many are students) increase with age. This is important in the context of housing requirements which tend also to increase with age.

Figure 4.2



In these Department of Work and Pension figures, income is defined as disposable household income after deducting housing costs, and the low income threshold is determined at 60 per cent median household income. All data had been adjusted to account for differences in household size and composition and the self-employed are included in the calculations. They are, therefore, much more directly related to more widely used definitions of poverty.

Figure 4.3



Housing Poverty among the elderly

Poverty is heavily concentrated among older households, of which the largest numbers are to be found in social housing and among owner-occupiers who own outright. Among these owner-occupiers, many older homeowners are financially or physically unable to maintain their properties. Owner occupier households that own their property outright, who are single (with or without children and divorced or separated), originate from a black or minority ethnic background, are female or headed by someone from a manual socio-economic background, are most likely to be classified as being in poverty.

In the first instance, owner-occupiers are expected to fund repairs and maintenance costs from savings or, for larger schemes, through equity release. The Survey of English Housing suggests that 12 per cent of older home owner households aged 70 years or over, and 7 per cent of those aged 60-69 years, would not be able to pay for major repairs. Only 1 per cent of home owners aged 60 and over would draw on flexible mortgage equity. Handyperson schemes may be beneficial, but older homeowners have a unique need for larger scale affordable, quality repairs. The Regulatory Reform Order 2002 allows local authorities more discretion related to assistance with renovations and repairs but this is limited.

It should also be noted that census data from 2001 records the fact that approximately 40,000 older households live in park homes, caravans or other mobile or temporary structures – many of these households are thought to be poor, although there is no detailed statistical evidence.

Age Concern (2006) report that at least 4 per cent of older people live in private rented accommodation in some of the worst housing conditions and 11 per cent of those are aged 65 and over. Thirty five per cent of aged renters have regulated tenancies, but 24 per cent of older private renters have assured shorthold tenancies that are relatively insecure.

One quarter of all homeless people are aged over 50 (St Mungo's, 2004). Age Concern note that homeless agencies are less effective at dealing with and permanently placing older clients and suggests that greater homelessness prevention measures are needed for this group.

Poor people living in different housing tenures report a range of detrimental factors relating to housing, health and social exclusion, though the figures are suggestive rather than definitive.

Poor people in rented accommodation are more likely than poor home-owners to be dissatisfied with their neighbourhoods and to experience social exclusion on all dimensions considered by the survey: they smoke more, report that their general health is not good, lack adequate social support, and vote less. Poor home-owners, on the other hand, are more likely than poor people living in rented accommodation to report a physical problem with their accommodation and to experience poor mental health.

4.3 How Much do Households Pay for their Housing?

We have already noted how difficult it is to compare like for like in the context of housing costs. Here we look further at the main costs – rents and mortgages - and then at more detailed evidence for poorer households. Table 4.4 shows two main expenditures – rent (gross and after Housing Benefit) and mortgage by income deciles. It shows clearly that both rents and mortgages generally rise with income. It also shows that those in the two lowest income groups among renters are on average very well protected by Housing Benefit, while the housing they live in if anything has higher rents than that in the next two deciles.

Table 4.4: Main housing expenditures by income deciles (£s per week)											
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**All**
Rents by renters	92.20	94.00	92.00	84.70	90.20	95.90	106.50	121.40	138.10	226.40	100.10
Gross rent	92.20	94.00	92.00	84.70	90.20	95.90	106.50	121.40	138.10	226.40	100.10
Less housing benefit, rebates and allowances received	69.50	65.00	44.80	30.50	16.30	7.90	[9.80]	[4.10]	[1.50]	[4.40]	40.20
Net rent	26.60	28.90	47.20	54.20	73.90	88.00	96.60	117.30	136.60	221.90	60.00
Mortgage by mortgage holders	82.80	82.30	74.10	85.60	94.00	100.10	114.10	126.70	149.30	218.70	131.50
Mortgage interest payments	61.00	52.40	50.30	55.50	60.80	64.80	72.00	78.90	94.20	130.80	82.40
Mortgage protection premiums	[1.20]	2.70	3.10	3.10	4.00	4.80	4.40	4.30	5.20	5.40	4.50
Capital repayment of mortgage	20.60	27.20	20.70	27.10	29.30	30.50	37.70	43.60	49.90	82.50	44.70

Source: *Table 2.10 Family Spending 2007*

Turning particularly to poorer households, Figure 4 compares rents in the social sector, rents in the private sector and weekly outgoings for buyers in the lower quartile of the housing market (Dataspring, 2007). It shows clearly that:

(i) those in the market sector have to pay very much higher housing costs than those in social renting; *and*

(ii) owner-occupation costs have risen particularly rapidly over the last few years.

As a result, there is an affordability gap between those who have gained access to social housing and those who have to find their housing in the market sector.

Table 4.5 relates these housing costs to income, distinguishing between London and England as a whole, because London is the only region that stands out as different. The first column shows rents for new entrants into social housing against actual incomes including Housing Benefit as income. At between 30-35 per cent, rent is accounting for a significant proportion of total income including benefits. The other three columns show the ratio of rents and housing costs against lower quartile earnings and clearly reflect how difficult it is for those in the lowest quartile to afford housing, if they are not in receipt of benefits. It also shows how much greater the gap has become between renting and owning and the particular difficulties faced by low income households in London (Banks & Whitehead, forthcoming).

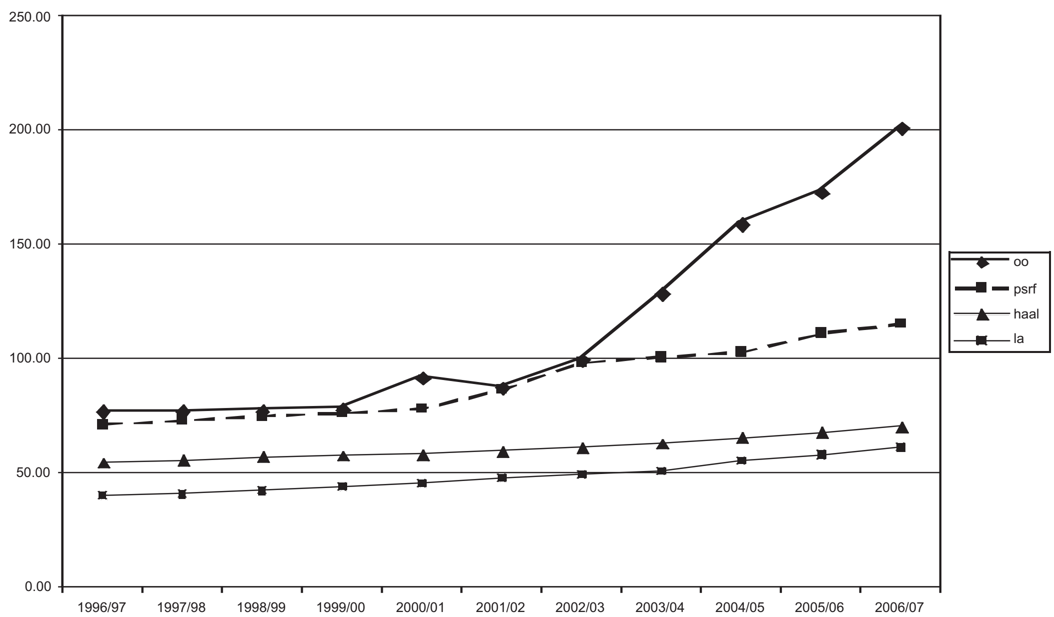
Table 4.5: Rent and Housing Costs/Income (London and England)				
	CORE HA rent CORE income plus Housing Benefit	CORE rent LQ ASHE	PRS/ LQ ASHE	OO/LQ ASHE
2002/03				
London	0.35	0.27	0.56	0.67
England	0 31	0.29	0.47	0.47
2006/07				
London	0.036	0.31	0.57	0.98
England	0.031	0.31	0.51	0.89

Source: *Banks & Whitehead, forthcoming*

Key

CORE	Continuous Recording System
HA	housing association
PRS	private rented sector
LQ	lower quartile
OO	owner occupation
ASHE	annual series of homes and earnings

Figure 4.4: A comparison of the user costs of owning, renting privately, renting through a social landlord and renting from a local authority, £ per week, England 1996- 2006



Source: *Dataspring*

Key

oo:	user cost of owner occupation
psrf:	private sector referred rents
haal:	housing association all lets (from CORE)
la:	local authority rents

4.4 Particular issues

1: Housing benefit

Table 4.6 gives some general definition on the numbers of households assisted by Housing Benefit. At over 4 million claimants it is available to around 1 in 6 of all households. Moreover, the average amount of assistance is very large both in absolute terms and as a proportion of incomes.

Table 4.6: Housing Benefits

	1991/92	1996/97	2001/02	2006/07
Number of claimants (000s)				
Rent rebates	2891	2887	2103	1684
Rent allowances	1219	1875	0764	2341
Average payment (£ per annum)				
Rent rebates	1184	1880	2293	3047
Rent allowances	1694	2735	3156	3840

Table 4.7 clarifies the incomes at which particular groups of households become ineligible for Housing Benefit at different rent levels. Different types of household not only have different Housing Benefit allowances but also are allowed to earn different amounts of income, which is disregarded for benefit purposes. Many low income tenants with children in London, for instance, will be living in housing with rents at or above £120 per week. Such households will have incomes of over £20k per annum before they cease to be eligible for benefit.

Table 4.7: Gross Weekly Earning levels at which Housing Benefit Entitlement Ceases (examples)

	Housing benefit allowances £ per week	Income disregard	Rent level per week		
			£70	£100	£120
Household type					
Single person >25	59.15	5.00	217.88	291.44	337.36
Lone parent plus one child	124.03	25.00	179.01	349.12	395.05
Couple plus two children	214.13	10.00	271.04	424.89	515.47

Source: *Wilcox 2008, Table 119*

Tables 4.8 and 4.9 look at the other side of the coin: take-up rates. They suggest that fewer than 10 per cent of local authority tenants and a slightly higher proportion of private tenants do not take up benefits. The amounts unclaimed are also on average relatively small but not insignificant for those on low incomes. Table 4.9 shows that those least likely to claim are couples and other households. It is these groups, especially in private renting, that pay the full cost of their housing.

Table 4.8: Housing Benefit: Take-up Rates by Tenure (estimates 2004/05)			
	Number (000s)	Take-up ranges	Median unclaimed amount £m[2]
Local authority tenants	1860	89:95	300
Private renters	2060	80:88	950

Source: *DWP in Wilcox, 2008, Table 117a*

Table 4.9: Housing Benefit: Take-up Rates by Household Type			
	Number (000s)	Take-up ranges	Median unclaimed amount £m
Couples plus children	180	77:84	95
Lone parents	880	93:100	90
Other non pensions	1240	82:91	495
Pensioners	1610	81:87	858
All	**3910**	**84:91**	**1225**

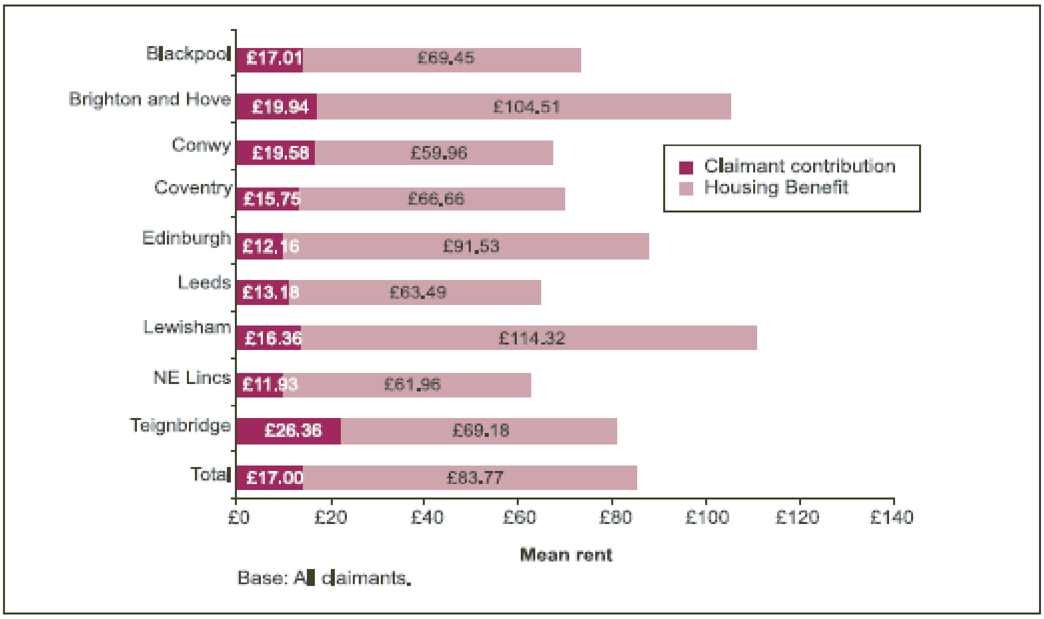
Source: *DWP in Wilcox, 2008, Table 117b*

A final issue and in many ways the most important is the extent to which Housing Benefit does not cover the full rent that private tenants have to pay. A Department of Work and Pensions report (2005) showed that Housing Benefit did not cover the full cost of the rent for almost 60 per cent of all claimants. Figure 4.5 provides some examples. There were regional variations from 41 per cent in Edinburgh to 82 per cent in Teignbridge and 77 per cent in North East Lincolnshire, where only about one in five claimants received Housing Benefit that covered the full rent. A combination of local housing market factors, claimant characteristics and incomes, and the application of Housing Benefit regulations, all affect these differences.

On average, Housing Benefit recipients were required to top up this payment with around £17 per week of their own funds, and there are significant variations in the amounts claimants are required to pay towards their rent, from £26.36 per week in Teignbridge to £11.93 in North East Lincolnshire. Those aged between 25 and 49 years or living in detached or semi-detached houses were most likely to experience this shortfall.

[2] The median is the mid point of the ranges of total unclaimed benefits estimated by DWP.

Figure 4.5 Amount of rent paid by claimant and by Housing Benefit, by Pathfinder area



Source: *Department of Work and Pensions (2005)*

2: Homelessness

The groups that face the worst difficulties are those who are homeless. They pay more, not in direct financial terms, but in the difficulties they face, and there is significant evidence that homeless households suffer especially in terms of health and education.

The definition of homeless includes all those that government recognises they have a legal commitment to house. Rough sleepers are a tiny proportion of the total, currently running at less than 1,000 at any given time. Numbers of those homeless officially recognised as homeless reached their maximum in 2003 at over 200,000. Since then numbers have fallen sharply until, in 2007, there were around 100,000. The big change has been in the numbers of those deemed 'not in priority need' as acceptance procedures have been tightened up. Those in priority need, which include all households with dependent children, rose slowly to their peak in 2003 at around 70,000 in 2003 and have now fallen to around 40,000 households.

i) Health

It is generally accepted that housing impacts on health. Whitehead (1998) notes how the risk of domestic accidents, fire related deaths and susceptibility to infectious diseases increases significantly for those living in temporary accommodation and bedsits. The cold is cited as the most significant risk, both to those unable to afford to heat their homes and those sleeping on the street, with hypothermia or heart attacks leading to 40,000 more deaths per annum during the colder months.

Although direct risks have yet to be quantified, a report published by Shelter (Harker, 2006) quotes research from the US that reports that: 'Homeless children have four times as many respiratory infections, five times as many stomach and diarrhoeal infections, twice as many emergency hospitalisations, six times as many speech and stammering problems, and four times the rate of asthma.' Harker estimates that lack of adequate housing increases the likelihood of a child becoming seriously ill or disabled by 25 per cent. However, ill health in homeless children can often start before they are born, as pregnant mothers are more likely to deliver babies of low birth weight which is linked to other serious health conditions.

ii) Education

A lack of permanent, good housing impacts the educational aspirations and abilities of both adults and children. Children who are forced to move home and thus change school regularly can quickly fall behind and may be susceptible to bullying. Shelter estimates that 8 per cent of children living in substandard accommodation lose out on a quarter of their schooling, with transport problems and lack of school places accounting for 55 per cent of reasons cited for children missing school (Mitchell et al., 2004). In addition to this, dilapidated accommodation and estates, potential physical and mental health problems and truancy compound low achievement and examination results. Whitehead (1998) found that this experience is not limited to one generation but that there is a 'continuing cycle of low incomes, including low educational attainment for the next generation'.

Table 4.10 below shows the numbers of households in the different groups that are typically rehoused in social housing in any one year:

Table 4.10: Lettings to new tenant and numbers of homeless rehoused 2005/06: all social housing

All social housing	1 bedroom	2+ bedroom	Total
Not homeless	119512	90865	210377
Homeless: priority due to children/pregnancy	120	42695	42815
Homeless: priority due to vulnerability	32640	1616	34256
Homeless: non priority	29795	5831	35626
Total	**182067**	**141007**	**323074**

Source: *Housing Corporation (2007)*

By providing over 100,000 lettings to homeless households, the social sector is making a major contribution to ensuring that this particular group of disadvantaged households no longer pay more.

Table 4.10 shows that the majority of homeless households that are in priority need due to their vulnerability, and the majority of non-priority homeless, are rehoused in one bedroom accommodation. The table also shows that the majority (56 per cent) of all lettings in social housing are in one bedroom properties rather than in family accommodation. This reflects the fact that so many homeless households are vulnerable adults.

Section 5: Quality, Energy Efficiency and Poverty

5.1 Housing quality

One way in which the poor pay more relates to the quantity and quality of housing that they obtain for their money. The evidence is, as always, piecemeal and here we present data on only three aspects: age of and condition of housing, energy efficiency and fuel poverty. Table 5.1 shows that older dwellings are heavily concentrated in the private rented sector, while social housing is disproportionately post war. On a wide range of more qualitative evidence, we can say with some certainty that on average older units are less energy efficient and therefore occupiers obtain worse value for money.

Table 5.1

	Year property built			
	Before 1919	**1919-1944**	**1945-1984**	**1985 or Later**
Owner-occupiers	20	20	45	15
Rented social landlords	6	15	65	14
Rented privately	37	19	28	16
All tenures	20	19	47	15
Total (m)	4.1	3.9	9.6	3.1

Source: *DCLG, English House Condition Survey, 2006*

Most of the data on quality comes from the English House Condition Survey, a regular survey which now concentrates on examining the extent to which dwellings meet the Decent Homes requirements in the social sector, among 'vulnerable households' in the private sector and in deprived neighbourhoods, as well as on liveability in the immediate area. All of these variables can be seen as surrogates for poverty and all show a concentration of poor conditions.

The government's commitment to ensuring that all social sector housing should meet the Decent Homes standard by 2010 and targeting vulnerable households in the private sector was first set out in the 2003 Communities Plan (Sustainable Communities: Building for the Future). The definition of decent home was updated in April 2006 when the Housing Health and Safety Rating system (HHSRS) came into force replacing the statutory fitness standard (A Decent Home Definitions and guidance for implications June 2006 updates).

A decent home is one that meets the following four criteria:

a) It meets the current **statutory minimum** standard for housing. From April 2006 the fitness standard was replaced by the Housing Health and Safety Rating System (HHSRS). Currently, there is insufficient data to report change since 1996 on decent homes incorporating the HHSRS. Trends and assessment of progress are, therefore, based on decent homes incorporating fitness as the statutory standard, which provides consistency in the measure.

b) It is in a reasonable state of **repair** (related to the age and condition of a range of building components including walls, roofs, windows, doors, chimneys, electrics and heating systems).

c) It has reasonably **modern facilities and services** (related to age, size and layout/location of the kitchen, bathroom and WC and any common areas for blocks of flats, and to noise insulation).

d) It provides a reasonable degree of **thermal comfort** (related to insulation and heating efficiency).

Vulnerable households are households in receipt of at least one of the principal means tested or disability related benefits.

The definition of vulnerable households, therefore, includes households in receipt of Income Support, Housing Benefit, Council Tax Benefit, Job Seekers Allowance, Attendance Allowance, Disability Living Allowance, Industrial Injuries Disablement benefit, War Disablement Pension, Pension Credit, Child Tax Credit and Working Tax Credit. For Child Tax Credit and Working Tax Credit, the household is only considered vulnerable if the household has a relevant income of less than around £15,050.

Table 5.2: Housing conditions by tenure: 2005

Tenure	% in this group that:		
	Are non-decent homes	Fail thermal comfort only	Those failing fitness, repair or modernisation
Owner-occupied	24.9	15.2	9.7
Private rented	40.6	19.4	21.2
Local authority	33.7	19.1	14.6
Registered social landlord	23.88	16.5	7.4

Source: *DCLG, English House Condition Survey 2006: Annual Report 2007*

The evidence shows that there has been consistent improvement in terms of the numbers and percentages of households living in decent homes since 2003. In 2003 some 6.7 million homes were defined as non-decent, of which 5.3 million were in the private sector. In proportional terms, 35 per cent of social sector dwellings and 30 per cent of private sector dwellings were in this category based on the fitness definition. Seventy-three per cent of these dwellings defined as below the decent homes standard failed the thermal comfort element. By 2006 these figures had fallen to 5.9 million in total, of which 4.8 million were in the private sector, accounting for 26.4 per cent of all private sector homes and 28.7 per cent in the social sector respectively. Thus (i) total numbers of non-decent homes had declined significantly and (ii) the gap between social and private had narrowed.

Using the updated definition of decent homes incorporating the HHSRS, in 2006 3.2 million 'vulnerable' households[3] live in the private sector and of these 1.8 million (57%) live in non-decent homes (Table 5.3). Those vulnerable households who are private tenants tend to be living in worse housing conditions compared to their counterparts in the owner occupied sector; just 42 per cent of vulnerable private tenants live in decent homes compared to 62 per cent of vulnerable owner occupiers.

[3] Vulnerable household are households in receipt of at least one of the principal means tested or disability related benefits.

The problems at the bottom end of the private rented sector are not confined to condition. Statistics gathered from Shelter's work with clients found that, from approximately 50,000 issues relating to the private rented sector logged for the year ending 31 March 2006, the most common problem for tenants from the sector was homelessness (due to eviction), with a total of 9,559 instances. The other principal issues listed were landlord possession (6,786), landlord/tenant (other) (6,396), damp/disrepair (3,208), rent arrears (2,977) and Housing Benefit issues (2,615).

Table 5.3: Private sector vulnerable households living in non-decent homes (using HHSRS as the statutory standards), 2006

	Decent	non decent	all homes	decent percentage;	non-decent	all homes
Numbers ('000s):						
non vulnerable private	9,182	5,24	14,306	64.21	35.8	100.0
vulnerable private	1,827	1,362	3,189	57.3	42.7	100.00
all households	**13,513**	**7,706**	**21,219**	**63.7**	**36.3**	**100.0**

Base: *all private sector vulnerable, private sector non-vulnerable and social sector households*
Note: *Decent Homes incorporating the HHSRS as the statutory component.*

Overall, therefore, the evidence suggests that the worst conditions are to be found in the private rented sector where tenants without subsidy are paying some of the highest housing costs. This is the main area where the poor do indeed pay more.

5.2 Energy efficiency in the home

The English House Condition Survey also shows how energy efficiency is distributed between tenures.

In 2006, over two thirds of homes (70%) have an energy performance rating of band D or E according to the Energy Performance Certificate (EPC) bands, Table 5.4. Less than 10 per cent of homes (1.7 million) achieve an energy rating of band C or higher. A fifth of homes (3.7 million) are in the most energy efficient bands (F or G) although less than 5 per cent of homes (900 thousand) are in band G.

Social sector homes tend to be much more energy efficient than those in the private sector. Some 65 per cent (2.6 million) are in bands D or higher, compared to 36 per cent of privately rented and only 32 per cent of owner occupied homes.

Table 5.4: Energy Performance Certificate (EPC) bands by tenure, 2006				
	whole stock	**owner occupied**	**private rented**	**social sector**
Band B and C (69-91)	7.9	4.1	10.1	21.5
Band D (55-68)	30.4	27.6	26.4	43.9
Band E (39-54)	40.9	45.0	36.9	27.7
Band F and G (1-38)	20.7	23.3	20.6	7.0
Total (numbers)	21,989	15,442	2,611	3,936
Note: *EPC bands are based on SAP rating which are shown in brackets.*				

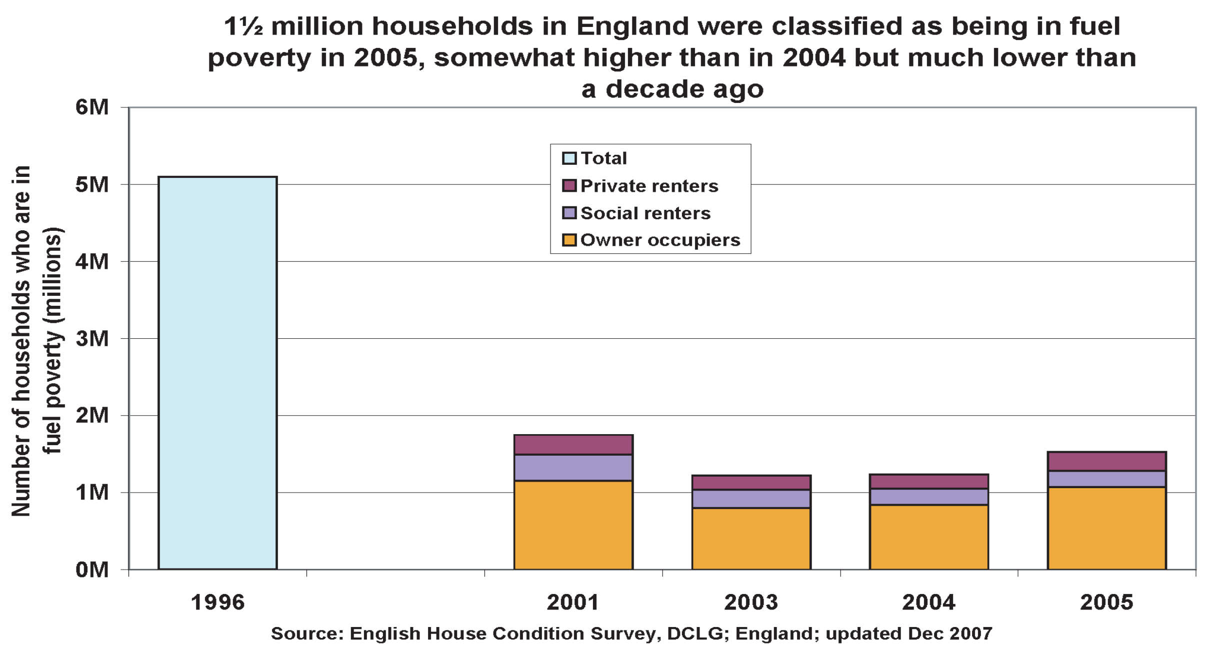
Overall, the picture on energy efficiency relates closely to the aspects of quality and implicitly costs. The groups that pay more for less are concentrated in the private rented sector among those not eligible or not claiming Housing Benefit.

5.3 Housing and fuel poverty

The survey also directly examines fuel poverty by tenure and shows that:

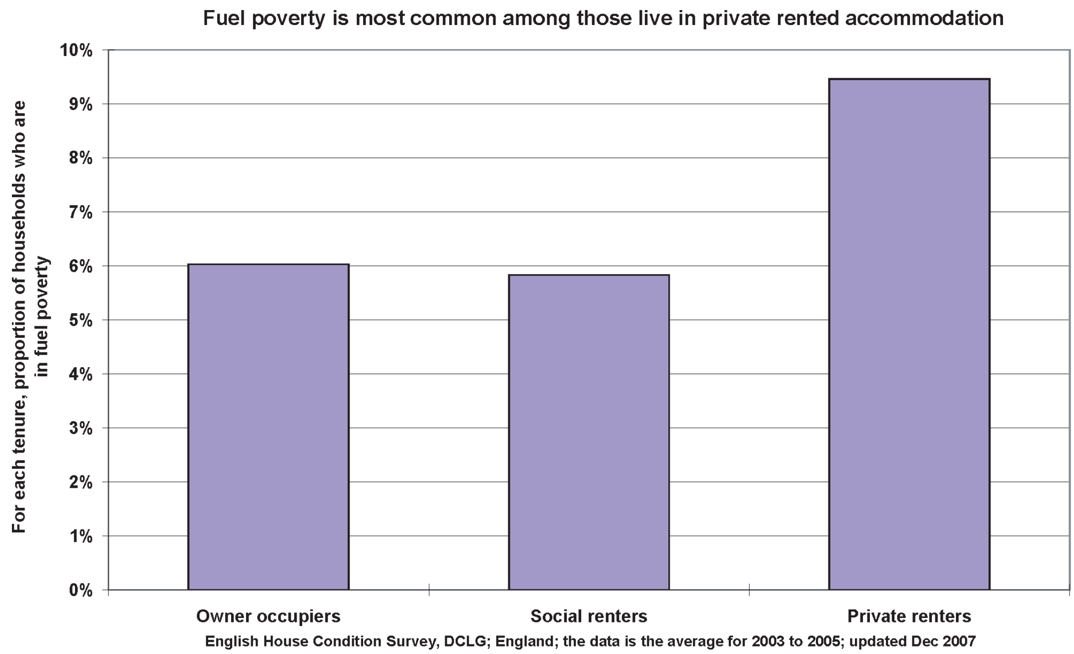
(i) 1.5 million households in England were classified as being in fuel poverty in 2005, somewhat higher than in 2003 and 2004 (reflecting rising costs), but far lower than in 1996 when 5 million households were defined as in fuel poverty (Figure 5.1). At this point the improvement looked impressive. However, current estimates suggest that the numbers may have increased to as much as 5.5m by the end of 2008 as a result of increasing energy costs.

Figure 5.1: Households by tenure in fuel poverty



(ii) the vast majority of these households live in the owner occupied sector, but in proportionate terms the problems are concentrated among private tenants (Figure 5.2); and

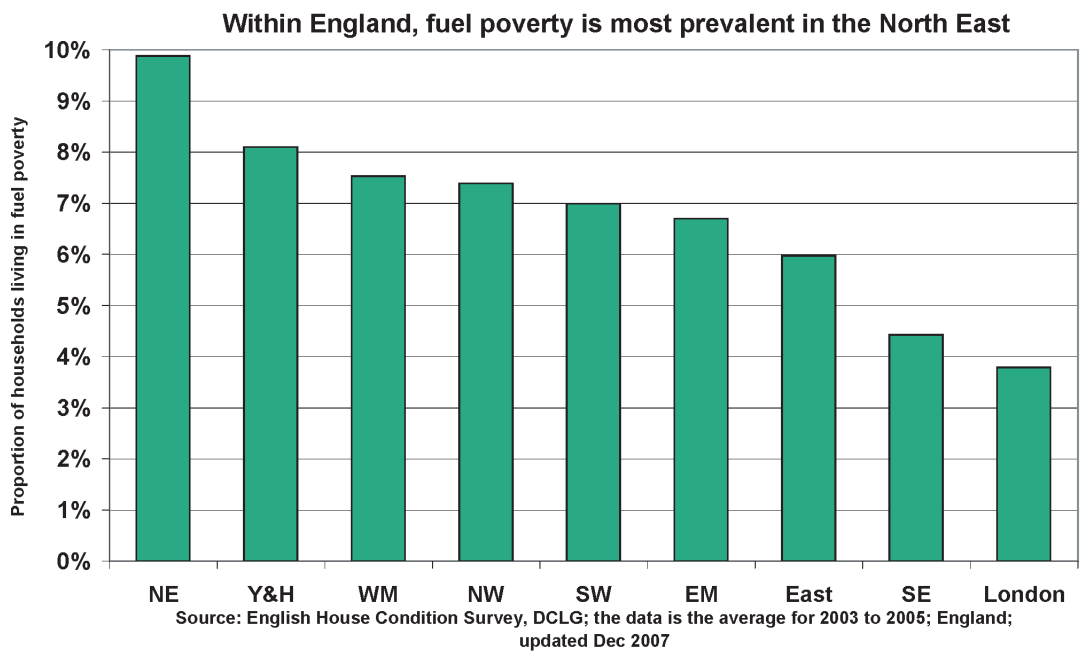
Figure 5.2: Concentrations of fuel poverty by tenure



(iii) that fuel poverty is more heavily concentrated in northern regions, and least in London – even though some 30 per cent of the private rented sector is concentrated in London (figure5.3).

The picture on fuel poverty is therefore very similar to that for energy efficiency and the quality of the home. In absolute terms, there are significant problems in the owner-occupied sector, concentrated among elderly outright owners. Proportionately, though, the problems are heavily concentrated among private tenants, the group where housing assistance also tends to be least effective.

Figure 5.3: Fuel poverty by region



Section 6: Conclusions

It has generally been accepted in the UK, and indeed across advanced economies, that the market alone cannot provide adequate housing for all at an affordable price. In part this is because of market failures inherent in the nature of housing. It is also because the distribution of income is too uneven to enable all households to compete effectively in the marketplace. However, especially in Western Europe, it is also because housing is seen as part of the welfare state contract between the state and its citizens.

Yet housing also benefits from the choice and range of provision that can be achieved in the market. As a result, housing is seen as archetypal, appropriate for provision and allocation through a mixed economy - ranging from market provision for those who are reasonably well off, subsidy to enable others to obtain adequate housing, and the direct provision and allocation of publicly owned housing. The mix has changed over the decades with far more emphasis on market involvement – and in liberalising these markets. Yet government is still a major player and expects to remain so in the foreseeable future.

The range of policies from direct provision, subsidies to investment in new and regenerated properties, rent control and income related subsides for lower income households - together with a range of regulation on land use, standards of provision and occupancy and financial services - ensures that, in the main, lower income households pay less for their housing than those further up the income scale. Those who fall through the gaps of the comprehensive range of polices to assist poorer households include:

(i) households who are unable to find their own accommodation and are therefore not eligible for housing benefit. Those in priority need within this group will be accommodated, but often the housing they obtain is inadequate and insecure, at least in the short term;

(ii) households in the private rented sector who, while eligible, do not claim housing benefit; who have large housing costs not eligible for subsidy; or who are just above the eligibility level for benefits. These households may pay significant proportions of their income in housing;

(iii) outright owner-occupiers who may be asset rich but who do not have the income to maintain and live comfortably in their homes; and

(iv) those mortgagors who have overstretched themselves and whose circumstances change for the worse.

More generally, the costs of housing across the board have been rising over the last twenty years and can be expected to continue to do so into the future.

Finally, while housing poverty in itself may be well addressed by policy for the vast majority of households, housing related expenditures including property taxes, energy, utilities and other housing related bills are a major concern for many poorer households, especially those who live in older dwellings that are more difficult to maintain. Moreover, these bills are currently rising much faster than incomes, putting additional strain on household budgets.

Annex 1: Subsidies by region

Table A.1 Help with Housing Costs in all Tenures - Great Britain (£m)				
	1991/92	1995/06	2001/02	2005/06
Social housing				
Council subsidy	897	-484	-1,184	179
Housing association grant	2,116	1,640	1,238	1,381
Housing benefit (council)	4,068	5,430	5,258	5,263
Housing benefit (RSLs)	534	1,640	3,019	4,959
Total	**7,615**	**8,226**	**8,331**	**11,782**
Private renting				
Housing benefit	1,892	3,804	2,888	3,723
Homeowners				
ISMI	925	1,016	484	355
Total all tenures	17,785	6,940	14,675	16,935

Source: *Wilcox table 122*

Table A.2 Housing Benefit spending by region, 2004-05 (2006-07 prices)			
	Spending per recipient (£ per week)		
	Private rented sector	**Housing association**	**Local authority**
Greater London	131	94	84
South East	93	70	59
East	81	64	54
South West	76	61	51
West Midlands	70	57	50
North West	66	57	48
Yorkshire and the Humber	62	58	44
East Midlands	61	58	46
North East	60	54	44
England	**78**	**64**	**53**

Source: *Hills (2007) Figures adjusted by GDP deflator to 2006-07 prices.*

Table A. 3 Estimated economic rents and net present value of economic subsidy by region, 2004							
	Capital value (£)	**PRS rents less M&M1 (%)+**	**Economic rent (£/w)**	**Actual rent (£/w)**	**Economic subsidy (£/w)**	**Net present value**	
						15 years	**20 years**
(a) Local authorities							
North East	58,600	2.36	55	43	11	9,000	11,500
North West	65,100	2.68	65	47	17	15,400	19,100
Yorkshire & the Humber	62,200	2.99	65	44	20	16,700	20,600
East Midlands	77,700	2.36	67	46	21	17,200	21,200
West Midlands	73,900	2.46	67	49	17	15,400	19,000
East of England	128,200	2.77	101	55	46	36,700	44,400
London	165,200	2.68	138	67	71	55,400	66,700
South East	128,000	2.58	98	59	38	32,100	39,000
South West	100,800	2.32	76	50	26	22,700	27,700
England	**100,700**	**2.66**	**87**	**53**	**34**	**28,000**	**34,100**
(b) Housing associations							
North East	59,600	2.36	55	49	6	7,300	9,500
North West	65,500	2.68	65	52	13	14,600	18,200
Yorkshire & the Humber	66,010	2.99	67	50	17	18,200	22,400
East Midlands	85,400	2.36	70	53	18	17,000	21,200
West Midlands	87,300	2.46	73	52	20	18,100	22,400
East of England	119,200	2.77	96	60	35	29,800	36,300
London	189,100	2.68	150	70	80	60,500	72,800
South East	142,400	2.58	105	67	38	34,200	41,700
South West	117,000	2.32	83	58	25	24,300	29,800
England	**111,400**	**2.66**	**93**	**61**	**31**	**29,400**	**35,900**

Source: *Hills (2007)*

Note: 1. *Private sector rents in region less allowance for management and maintenance in region (based on spending in social sector) as percentage of capital values in private sector.*

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The Poverty Site	http://www.poverty.org.uk/index.htm
The Rent Service	http://www.therentservice.gov.uk/index.asp

Water

"France and the UK are the only two OECD countries whose water operations are mostly run by private companies. Both countries have virtually universal connection to water supply for urban populations. However, even in these two cases, universal coverage was also achieved through the predominant role of public operators and public finance."

Emanuele Lobina Senior Research Fellow
and
David Hall Director

Public Services International Research Unit,
Business School, University of Greenwich

1. Introduction

Based primarily on published sources, this paper looks specifically at the provision of water supply and sanitation services for low-income consumers in England and Wales. Related issues are increasingly attracting attention due to concerns with the affordability of such essential services. There is strong evidence that the 'poor pay more' syndrome applies to the water sector in England and Wales. More precisely, the poor pay more to get an equivalent amount of water or level of service. The table below shows that water poverty, defined as the percentage of households paying above 3 per cent of their disposable income in water bills, affects households in the lowest income quintile by more than three times the average of all households.

Table B of Cross Government Review of Water Affordability report

PERCENTAGE OF HOUSEHOLDS SPENDING MORE THAN 3 PER CENT OF DISPOSABLE INCOME ON WATER AND SEWERAGE BILLS

Average Income	*2004–05*	*2005–06*	*2009–10*
Working household with children	1.2%	1.5%	1.9%
Working household without children	3.2%	3.8%	4.1%
Non Working household with children	16.5%	19.0%	23.0%
Non working household without children	29.9%	33.4%	36.5%
Pensioners	11.6%	13.6%	16.9%
All households	7.9%	9.2%	10.7%

Lowest income quintile	*2004–05*	*2005–06*	*2009–10*
Working household with children	6.3%	7.4%	9.5%
Working household without children	29.5%	33.2%	37.2%
Non working household with children	20.6%	23.3%	27.6%
Non working household without children	47.1%	51.7%	55.0%
Pensioners	28.0%	32.3%	37.5%
All households	29.4%	32.9%	36.9%

Source: *CCWater evidence to House of Lords (House of Lords Science and Technology Committee, 2006b: 144).*

In 2004-05 households in the lowest income quintile were spending an average of 2.92 per cent of their annual disposable income on water bills. This compared with 1.02 per cent spent by average income earners and 4.54 per cent spent by pensioners. Projections for the year 2009-10 were at 3.14 per cent for the lowest income quintile, 4.87 per cent for pensioners and 1.10 per cent for average income earners (Department for Environment, Food and Rural Affairs, 2004: 17).

The paper first addresses the characteristics of the service and the market and institutional structure. It then illustrates charging methods and the mechanisms adopted to ensure the affordability of provision for low-income consumers. Final sections discuss findings on possible approaches to addressing affordability. In so doing, the analysis focuses on England and Wales but it also draws on international experience.

The technical characteristics of water supply and sewerage affect the way in which these services are organised and the extent to which it is possible or desirable to introduce different forms of competition. The fact that the bulk of activities constitute a natural monopoly means that, with minor exceptions, services are typically organised as local or regional long term monopolies. This also restricts opportunities for introducing the most advanced forms of competition, notably product market competition, and implies a more important role of regulation.

In 1989, the Thatcher government privatised the water industry in England and Wales by transferring the whole ownership of operations and infrastructure to 10 regional private companies. It also required the privatised water undertakers to finance all operating and capital expenditure by resorting to the private capital market and to be subject to regulatory oversight. The implications of this political decision go beyond the mere technical dimension. As private companies' remit is to maximise return to their shareholders, they prioritise commercial considerations and aim at social objectives as far as these do not conflict with their profitability.

The technical characteristics of water services also inform alternative approaches to charging and measuring consumption. There is a particular problem of assessing consumption in England and Wales and attempts to address this issue might have repercussions on affordability for low income consumers. The majority of residential consumers are not metered and their charges are based on the rateable value of the premises. The issue of metering raises complex questions of reconciling economic efficiency and responsible use of resources with the need to ensure that all consumers are able to access an affordable supply of this essential service.

Government policy has a major role to play in addressing the limitations of the market. Statutory Universal Service Obligations imply that undertakers have a duty to serve any customer demanding to be connected to the network. Also, rural consumers do not pay systematically more than urban consumers in order to avoid discrimination through cherry-picking. The disconnection of occupied houses is banned by law. On the other hand, there are statutory requirements on the companies to include special provision for assistance for metered consumers with above average consumption, but on the basis of narrow and inflexible criteria. The take-up rate of this assistance is extremely low.

Ultimately, affordability is affected by the action or inaction of the most powerful stakeholders: the privatised companies, the economic regulator and government. Costs borne by low income and vulnerable consumers are a direct result of the level of charges. At the same time, the social impact of charges can be alleviated by favouring solidarity in redistributing overall costs between high and low income consumers, by providing financial support to households facing difficulties in paying bills, and by reducing overall costs. Success of attempts to address affordability concerns thus depends on the combined effect of a mix of decisions, while adoption requires careful consideration of a variety of social, economic, environmental and technical issues.

2. Characteristics of the service

Water supply services imply the abstraction of water from a natural source, such as surface water (e.g. rivers and lakes) or groundwater (i.e. aquifers), its treatment to make it fit for human consumption and, finally, its distribution to households and commercial users via a pipeline network. Sewerage implies the collection of sewage from households and commercial and industrial users and its transportation through a sewerage pipeline network to a wastewater treatment plant, where sewage is treated to reduce its capacity to pollute before being released into a water body. Sewerage and wastewater treatment are also referred to as sanitation services.

Like energy, water is a fundamental necessity for human life. It is also an entirely standard product; there is relatively little opportunity to postpone demand and it is a major purchase for many large industrial consumers as well as residential consumers.

Water supply and sanitation represent essential services, satisfying basic human needs (e.g. drinking, cooking and personal hygiene) and preventing public health hazards (e.g. prevention of water-borne diseases through the removal and treatment of sewage). In January 2007, over 11,000 readers of the British Medical Journal (BMJ) chose 'the sanitary revolution'— connecting people's homes both to clean piped water and to sewers to dispose of their waste - as the most important medical milestone since 1840. They thought it was more important than antibiotics, vaccination, or the discovery of the structure of DNA.[1] The system was first introduced in London in the nineteenth century, to reduce the number of people killed by infectious diseases. The motive was not just humanitarian: the diseases were killing off male breadwinners, and so there were demands for the state to carry the cost of supporting the families. The removal of sewage was crucial in curbing the diseases, and the main reason for connecting every house to clean water was to flush the sewage. To deal with the public problem of the diseases, all households, rich and poor, were connected to water supply and sewers. The system was financed and run by the public sector (Hall and Lobina, 2008: 5).

Due to the essential nature of the needs addressed by water services, there is relatively limited opportunity to postpone demand. Such opportunity might arise more easily for uses related to the satisfaction of non essential needs, such as watering gardens or car washing. It is usually in relation to such non essential uses that restrictions in water supply are first introduced in case of drought, for example in the form of hosepipe bans.

The technology adopted for service provision usually relies on a network of drinking water pipelines and a network of sewers connecting the households and industrial and commercial users in a given operating area. This might be limited to a single city or a number of urban centres and the surrounding rural areas, depending on the operator's remit as defined by the responsible public authorities. No EU directive has to date liberalised the water sector, for example by providing for competition in the market or the freedom of operators to offer their services to customers inside an incumbent operator's operating area. This is also unlikely to occur due to the high fixed costs associated with distribution and the high costs of transporting water over long distances, which would contain the economic impact of liberalisation (Gee, 2008: 8,12). Water and sewerage networks are thus generally limited in scale, for example there is no unique network enabling the transportation of water throughout England and Wales (Sawkins and Dickie, 2008: 98). As a result, water supply and sanitation constitute local services.

Other implications of the technology adopted include the fact that water services are highly capital intensive, a natural monopoly, and that water is supplied as an entirely standard product, whereby suitability for human consumption is strictly guaranteed irrespective of its final use. Attention has recently been given to the potential of enhancing the efficient use of water by duplicating the set of pipes within any served premise, allowing for the separation of drinking water from raw water, which could be then used for flushing toilets, gardening and washing cars. Due to the high costs this would require, at present the predominant mode of delivery consists in the supply of standardised drinking water which is then used for all purposes.

Served premises may be charged on the basis of the volume of water consumed in case metering is available (although in many countries, the norm is that bills are the sum of a fixed charge and a volumetric component depending on the number and cost of cubic metres effectively consumed). In cases where metering is not adopted, as is the case in most households in England and Wales, charging might reflect other criteria such as the rateable value of the property.

Finally, like energy, water is characterised by derived demand. More precisely, part of the demand for water reflects the need to satisfy basic human needs (e.g. drinking, cooking, personal hygiene) and implies the direct consumption of water. Part of the demand for water is, however, derived in that the consumption of water takes place through appliances such as dishwashers, washing machines and toilets. Derived demand might result in reduced consumption for low income families in case of price hikes. Should the upgrade of appliances be beyond the financial means of deprived households, these may opt for reducing water consumption. This situation might in turn produce health hazards (Bakker, 2003: 141). By contrast, should a third party (e.g. government) bear the financial costs of upgrading appliances, the objective of greater efficiency in water use could be achieved at no social cost. However, it should be noted that the described interrelationship between derived demand and reduced consumption in case of price increases is only valid in case of charges based on metering. If charges are calculated on the basis of the rateable property value with no relation to metering, reducing consumption would not affect the amount paid in household bills.

2.1. Water services and Universal Service Obligations

The essential nature of the service has also other implications. Water services are provided to individual households and commercial consumers but their provision has a broader social significance. For example, deficiency in the provision of service to a limited number of individuals might result in the spreading of water-borne diseases to an entire community. The provision of water services may thus be subject to universal service obligations (USOs) defining the minimum standards that users are entitled to enjoy. A 1996 communication of the European Commission identified the following basic operating principles as underpinning the delivery of services of general interest, including water: continuity, equal access, universality and openness (de Luca, 1998: vii). More precisely:

> *The notion of public service obligation (or Universal Service Obligation) has been defined in Community legislation as the permanent and obligatory provision of a range of services easily accessible to users. Such services may also have to meet specified quality targets and be available at affordable prices. Member States have wide discretion in defining the detailed specifications relating to these aspects (European Commission, 2007).*[2]

USOs have attracted the attention of economists and neo-liberal observers as they are seen as impediments to the introduction of liberalisation and competition in sectors where these apply (Asian Development Bank, 2007). Conversely, USOs can be seen as safeguards for vulnerable users and, in light of the above discussion, society as a whole from the effects of the market and competition:

> *Universal service, in particular the definition of specific universal service obligations is a key accompaniment to market liberalisation of service sectors such as telecommunications in the European Union. The definition and guarantee of universal service ensures that the continuous accessibility and quality of established services is maintained for all users and consumers during the process of passing from monopoly provision to openly competitive markets.*

In this sense, EU law provides for the introduction of USOs in those Services of General Economic Interest (SGEI) that have been liberalised by European directives. Such services include electricity, postal services and electronic communications but not water (Sauter, 2007: 16-17).

However, the fact that EU law does not require member states to subject water service provision to liberalisation and thus USOs, has not prevented those states from introducing equivalent public service obligations in domestic law. In England and Wales, such obligations on water supply operators derive from section 37 of the Water Industry Act 1991,[3] adopted after the 1989 privatisation of the industry. This states that:

> *It shall be the duty of every water undertaker to develop and maintain an efficient and economical system of water supply within its area and to ensure that all such arrangements have been made— (a) for providing supplies of water to premises in that area and for making such supplies available to persons who demand them; and (b) for maintaining, improving and extending the water undertaker's water mains and other pipes, as are necessary for securing that the undertaker is and continues to be able to meet its obligations under this Part'.*[4]

In addition, the protection of rural customers from discriminatory charging is provided for by section 2 (3)(a)(i) of the Water Industry Act 1991.

2.2. Water services as a natural monopoly and competition: the international practice

The technical characteristics of water supply and sanitation services affect their organisation and regulation or, in other words, the public-private interface in the delivery of such services. Because, at current technology levels, it is excessively expensive to set up more than one pipeline network to allow more operators to compete among themselves (i.e. to introduce competition in the market), water supply is regarded as a typical natural monopoly. This implies that only one operator, whether public or private, is allowed to operate in a given operation area (e.g. in a municipality, but the area of operations can extend to an entire region or country depending on national law). If the water supply operator is a public undertaking (e.g. an administrative department or a public enterprise), it is often appointed without competition for an unlimited duration and is subject to the scrutiny of public authorities.

In recent years, the international practice in case of appointment of a private company as water supply operator is that this is subject to competition for the market (or Demsetz competition), in the form of competitive bidding whereby the successful bidder enters into a long term contract (typically up to 30 years). Throughout the duration of the contract, the private operator is often subject to the scrutiny of local authorities or regulation by a specialised agency, to try to prevent it abusing its monopolistic position at the expense of consumers and the environment (e.g. by overcharging consumers or under-investing in the system). Regulation is intended to be a substitute for competition, whose introduction in the water sector is limited. The above also applies to sewerage which is also a natural monopoly, at least as regards sewage collection and transport through pipelines. It is, in fact, technically possible to have a separate operator for any wastewater treatment plant. It is technically possible, and it does happen in some cases, to separate the operations of water supply, sewerage and wastewater treatment services. Another approach consists in entrusting a single operator with the long term operation of the whole water supply and sanitation system to facilitate the integrated management of water services and water resources.

2.3. A brief history of the organisation of water services in OECD countries

The history of the development of water and sanitation systems in OECD countries shows a common pattern. In Europe, urban water systems began developing in the 17th or 18th centuries as a limited service to affluent customers and as a public assistance for fire control. As cities grew in the nineteenth century, the demand for water consumption grew and the public health issues became more acute. While the initial systems were usually started by private companies, the utilities were soon taken over by municipalities in nearly all European countries, including the UK, during the nineteenth century (Hall and Lobina, 2006: 3-6).

There were a common set of reasons for this:

> *During the 19th century, the previously private systems came under public ownership and public provision because of the inefficiency, costs and corruption connected to them. In the late 19th century, the emphasis was on municipalisation. Democratically elected city councils bought existing utilities and transport systems and set up new ones of their own. This resulted in more effective control, higher employment, and greater benefits to the local people. Councils also gained the right to borrow money to invest in the development of their own systems* (Juuti and Katko 2005).

The extension of water systems in European cities thus almost entirely took place under public operators, whether municipal departments, municipally-owned companies, or state-owned companies, ad public finance: the role of the private companies withered away.

This development was part of a broader political process, namely the development of municipal socialism, also known as gas and water socialism, which drove the development of local public services in northern countries. The same process occurred in the USA, where municipalities undertook the major investments needed to extend systems, and did so because of the multiplicity of public needs and the reluctance of the private sector to make the large investments necessary. By 1897, 82 per cent of the largest cities were served by municipal operations. At the end of the twentieth century, the proportion was broadly the same, and was not expected to change significantly. Public finance was a crucial part of the process:

> *The central issue was the ability of cities to incur debt to fund major projects and to sustain the high costs of operation. As the 19th century unfolded, city finances underwent changes in scope and complexity that ultimately made the development of public water supply systems achievable (Melosi, 2000: 245-246).*

France and the UK are the only two OECD countries whose water operations are mostly run by private companies. Both countries have virtually universal connection to water supply for urban populations. However, even in these two cases, universal coverage was also achieved through the predominant role of public operators and public finance. Historically, resort to private operations, market forces and competition have not been central to attaining vital social objectives.

Pézon (2003) shows that the history of French water falls into three distinct periods. During the period of private concessions in the second half of the nineteenth century, there was very little growth in connections to the network. Virtually all the growth in the extension of the network took place during the first two-thirds of the twentieth century, a period when municipal undertakings became the dominant vehicle for investment and operation. The municipalities had, in fact, found that it was not legally possible to force concession companies to extend the network as public policy required, and therefore adopted a different system to achieve this objective. From the 1960s, delegation to the private sector grew again to become the dominant mode, but this time typically under lease contracts, under which responsibility for investments remained with the municipalities (Hall and Lobina, 2006: 4-5).

Until 1989, water services in the UK had been provided by municipalities (until 1974) and then by state-owned regional authorities until 1989. Virtually 100 per cent connection of urban population had been achieved well before that date: privatised water companies have, historically, contributed little to the extension of urban water supply systems in England or Wales (still less in Scotland and Northern Ireland, where the systems remain public) (Hall and Lobina, 2006: 4).

To date, 'over 90% of domestic water and wastewater services world-wide are provided by the public sector and this is likely to remain the case' (Rogers and Hall, 2003: 32). Internationally, English-style outright privatisation of water operations, finance and infrastructure ownership remain an isolated exception.

3. Service provision for low income consumers in OECD countries

Smets (2005) offers a taxonomy of mechanisms devised to support the provision of affordable water services for low income consumers. This includes the following measures:

- 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/or between rural and urban areas. This approach might include progressive pricing in the form of rising block tariffs, which requires metering to be in place.
- Providing general income support to low income or vulnerable consumers.
- Providing special assistance to consumers who cannot afford to pay their bills.

Interestingly, Smets (2005: 19) observes that: 'In general, countries implement a mix of general and special measures because no measure provides a perfect response to the issue of affordability. The choice of the appropriate mix of measures depends on a large number of factors and no measure except general support can be said to be applicable to every developed country. Recent history, legal tradition, law enforceability and equity considerations play a large role which often goes beyond mere economic considerations.'

4. Market structure in England and Wales

Historically, water services in England and Wales were taken over by local authorities from the late nineteenth century onwards, and a mixed pattern developed with some individual authorities running water companies, some large inter-municipal operators, and a number of private water supply-only companies. In 1974 the service was reorganised. Ten unitary regional water authorities (RWAs) were created, each covering a river basin area, and each responsible for water quality, water supply and sanitation throughout the area. The authorities were appointed by the government, not by municipalities, and so were no longer accountable to local government (Lobina and Hall, 2001: 4). The 29 private water supply-only companies continued their activity, serving around a quarter of the population in England and Wales (Sawkins and Vickie, 2008: 72).

In 1989, the Thatcher government privatised water supply and sewerage with the listing on the stock exchange of the 10 RWAs. The 10 privatised water and sewerage companies (WaSCs) also acquired the full ownership of infrastructure and acted as monopoly operators in their respective regions. The 29 private water supply-only companies continued to exist, although their number has been reduced to 13 as of June 2008 as a result of mergers and acquisitions (Department for Environment, Food and Rural Affairs, 2008c: 8). Institutional arrangements varied throughout the years. At present, the WaSCs operate under 25-year licences that are automatically renewed, unless a 25-year advance termination notice is served by the government. The Water Industry Act 1991 provides for water operators' USO within their area of operation. More precisely, water undertakers have an obligation to 'provide supplies of water to premises in [their area] and…make such supplies available to persons who demand them' (Water Act, s. 37(I) as in Bakker, 2003: 139).

The privatisation process created three regulators: the Drinking Water Inspectorate (DWI) for monitoring water quality; the National Rivers Authority (now the Environment Agency) for monitoring river and environmental pollution; and the economic regulator Ofwat, to set the price regime that companies follow (Lobina and Hall, 2001: 7-8). Under the privatised system, the regulator, Ofwat, is responsible for setting price limits and incentives so that the companies, while making a profit, can deliver a good quality, reliable and affordable service. The water companies are responsible to their shareholders for achieving the best possible return. The system is intended to result in regulations which create incentives for the companies to improve their performance, but also creates incentives for the companies to try and arrive at a more favourable deal for themselves at the expense of consumers (Hall and Lobina, 2007: 13). This is illustrated in section 5.1 below.

4.1. Competition

The listing on the stock exchange protected the new privatised WaSCs from competition for the market (for example, in the form of competitive bidding for long term concession contracts). Furthermore, the combined effect of the automatic licence renewal and the extension of the termination notice to 25 years considerably restricted the opportunity for contestability of the market (see section 6.3.1 '25 years concessions, plus 25 years notice of termination: eternal private monopolies'). Because of the absence of competition in the market, Ofwat adopts yardstick or benchmarking competition and compares the companies' performances with each other (Lobina and Hall, 2001: 5).

Another, but to date limited, form of competition is the replacement of WaSCs by another vertically integrated water and/or sewerage company in limited areas. This takes place through inset appointments, whereby the new licensee offers to provide the service at more favourable conditions (e.g. lower price) than the former incumbent undertaker. As of May 2008, 16 inset appointments had been granted, involving a change in supplier for up to 7,000 new household customers and 52 commercial customers (Ofwat, 2008: 85). In May 2008, Ofwat launched a proposal for the extension of competition in England and Wales, including competition in the market in the form of retail competition for businesses first and then households too. This is intended to allow water customers to switch supplier in the same way as is possible for energy customers (Ofwat, 2008: 21-23). It remains to be seen whether the introduction of greater competition in water supply and sewerage provision for businesses and households will successfully deliver the intended economic, social and environmental objectives and perform better than regulation (see Ofwat, 2008: 19-21).

4.2. Consumer representation

The regulatory framework also provides for consumer representation, although there had been no independent consumer voice until 2005. Upon privatisation, consumer representation was organised through regional Customer Service Committees (CSCs), one for each of the 10 WaSCs, which were created as an integral part of the structure of Ofwat itself.[5] Ofwat created a national non-statutory body, the Ofwat National Customer Council (ONCC), consisting of the chairs of the 10 CSCs.[6] In 2002, the body renamed itself 'WaterVoice', with the ONCC known as the WaterVoice Council and the CSCs known as WaterVoice Committees. The committees' statutory duties were to represent the interests of all customers and investigating and monitoring complaints about the water companies. The committees were appointed, staffed and financed through Ofwat. The chairpersons were appointed by the Director-General of Ofwat, and then the chair appointed the other members of the committee. Staff comprised of Ofwat employees, and WaterVoice's budget came from Ofwat. WaterVoice reported annually to the Director-General of Ofwat (de la Motte, 2005: 15).

The Water Act 2003 set up an independent Consumer Council for Water (CCWater), replacing WaterVoice, with the change due to come into effect in October 2005.[7] The Consumer Council was to be closer to the model employed in the other network industries. Ofwat said that it had anticipated the setting up of CCWater by treating the existing consumer body, WaterVoice, 'as an independent consumer representative whose views may well differ at times from our own'[8] (de la Motte, 2005: 15). However, Ofwat thinking still informs CCWater's views. For example, CCWater's Chief Executive is Ofwat's former Director of Competition and Consumer Affairs (Consumer Council for Water, 2008b: 18)[9].

5. Pricing in England and Wales

Ofwat sets monopoly prices by the price-cap procedure, carried out every five years according to a formula RPI + k. 'RPI represents the general retail price index, and k adjusts this by reference to performance standards, efficiency and service and levels (Lobina and Hall, 2001: 16). Within this overall permitted increase (or required decrease), each company may apply different increases to metered or unmetered water, for example. However, charging schemes must also avoid discrimination, recover fairly the costs of providing each service, and maintain a balance between measured and unmeasured household bills (no greater than the extra costs of providing a metered service).[10] Overall, charges should broadly relate to the costs of providing the service, for metered and non-metered customers alike[11] (de la Motte, 2005: 18). In particular, Ofwat has a statutory duty to protect rural customers, which implies that urban consumers cross-subsidise rural consumers (Bakker, 2003: 129; Sawkins and Dickie, 2008: 76). Ofwat refers to this as geographic averaging of water and sewerage charges across an incumbent company's region, which means that household and non-household customers 'in areas that are more expensive to supply are subsidised by customers in other areas of the same region' (Ofwat, 2008: 59).

Since 1989, all new households are fitted with a meter, but the majority of consumers remain unmetered and so are charged irrespective of consumption volumes. Charges for unmetered customers are calculated on the basis of the rateable property value, on the assumption that these represent a proxy for wealth so to allow cross-subsidisation between different classes of consumers within the same region. However, it has been recognised that property values are very imperfectly related to family income (Bakker, 2003: 123-124). The limits of the retail value mechanism are compounded by the fact that it does not represent current property values, but rateable values from the 1970s (Department for Environment, Food and Rural Affairs, 2008a: 12). Smets (2005: 6) observes that in many European countries water supply is metered and that the introduction of metering leads to a reduction of around 10 per cent in consumption. Among OECD countries, the UK is not alone in having no or limited metering as this condition characterises also Canada, New Zealand, Denmark, Iceland, Ireland and Norway. Interestingly, water consumption in Ireland is 'quite reasonable' despite the fact that consumers pay for the service through taxation rather than charges (Smets, 2005: 6, 10).

The percentage of households that have a meter installed is currently increasing (see section below 5.4. 'Implications of measurement methods for charging and affordability'). This is because households deciding to switch to metering do not have to bear individually the cost of installing the device, as this is covered through cross-subsidisation by water undertakers spreading it across their whole customer base (Bakker, 2003: 150). However, there are implications for consumers switching to metering as was recognised by the government in 2000, arguing that the 'link between water use and cost [established by a meter] is precisely [what] creates the possibility of hardship for customers most in need' (Department of the Environment, Transport and Regions, 2000, para 4.3.1, as in Bakker, 2001: 137-138, 155). More precisely, large low-income families are likely to be penalised by metering-based charges in respect of rateable property value-based charges (Bakker, 2003: 129-130).

5.1. Price variations since privatisation and impact on affordability

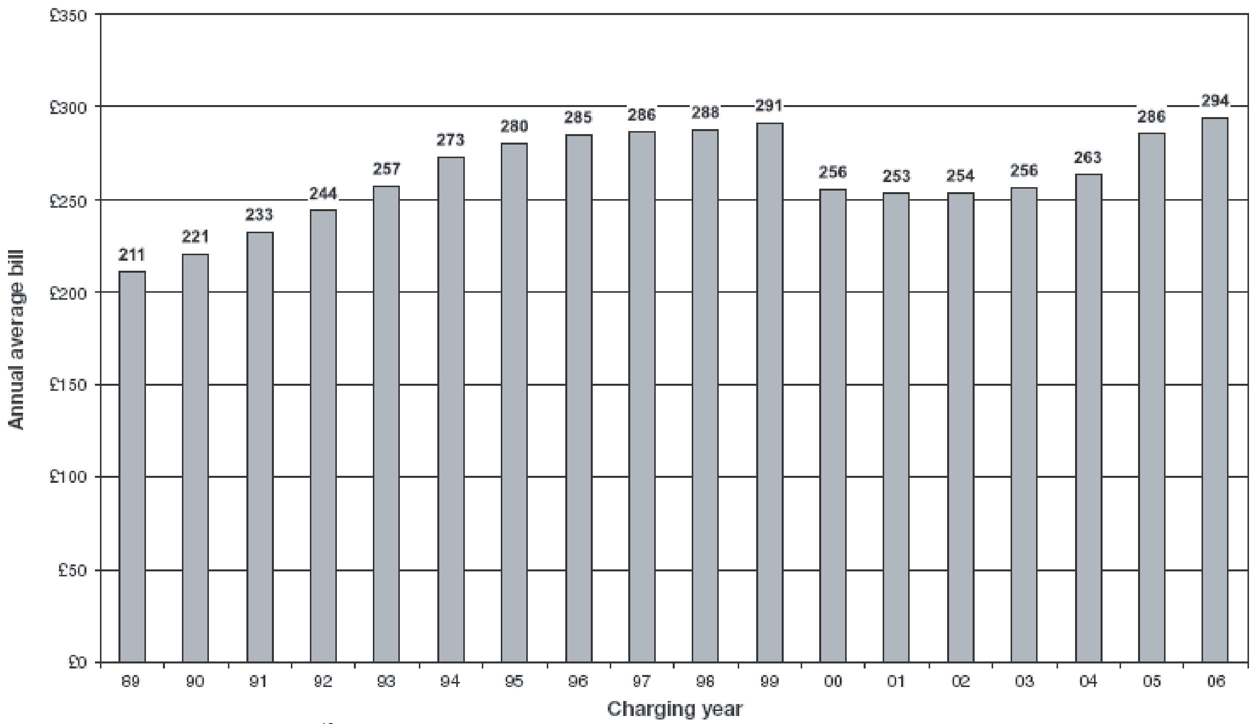
The universal experience of water privatisation in the UK was a sharp increase in the cost of water. In cash terms, the average annual bill for water and sewerage rose from £120 per year in 1989 to £294 in 2006, an increase of 245 per cent in 17 years. In real terms, it represents a rise of 39 per cent over and above the general rate of inflation (Hall and Lobina, 2007: 10). The trend in price variations seems to be continuing. 'The average household bill in 2007/08 is £312 for water and sewerage. This is a real terms increase of 42% since privatisation in 1989' (Department for Environment, Food and Rural Affairs, 2008a: 83).

Price rises since privatisation have been dictated by the increase in capital expenditure as a result of EU Directives on water and wastewater quality standards (Bakker, 2003: 129, 134). However, a breakdown of cost components from 1989 to 2004 shows that, while operating costs have remained roughly constant in real terms, the entire increase in customers' bills is due to the various elements associated with capital – capital charges, interest, and profits – which have approximately doubled, in real terms, over this period[12] (Hall and Lobina, 2007: 10-11). The pattern of price increases shows clearly that there was an initial rapid rise during the early 1990s, slower but still significant rises during the later 1990s, and then a one-off drop of about 12 per cent in 2000, following the price review. The price reductions in the 1999 review were largely due to 'clawing back' the overgenerous settlements of previous years. Prices then levelled out, but since 2004 have risen sharply once again, following a new price review. The increase from 2004-2006 is the highest rise over two years since 1993-1994 (Hall and Lobina, 2007: 10).

Price increases are linked to the rise in water poverty, especially in regions like the South West, which are affected by higher costs as a result of lower urbanisation, water scarcity and a longer coastline imposing higher wastewater treatment costs. The Consumer Council for Water noted that, while the average water bill increase across England and Wales was 5.8 per cent since 1 April 2008, there was evidence of individual pensioners in the South West being hit by hikes in water bills by up to 54 per cent since 2004. Water bills in the South West were already the highest in England and Wales and it was estimated that a third of people living in the region would be affected by water poverty by 2010 (Howard, 2008).

The correlation between price increases and problems with affordability has also been observed by the 2004 cross-government review of water affordability. The report noted that 'prior to 1999, the proportion of households spending more than 3% of income on water charges was fairly constant at around 15%'. This changed from 1997-8 to 2002-3 when the percentage fell from 15% to 9% (Department for Environment, Food and Rural Affairs, 2004: 10-11). The table below shows the real term increase in water bills from 1989 to 2006. With bills on the increase again after 2004, so again is water poverty (Howard, 2008).

Chart A. Average annual cost of water 1989-2004
(£ real terms, 2006 prices, excluding general inflation)



Source: *Ofwat 2006*[13]

However, affordability is not only determined by changes in water price but also by variations in households' income. The following sub-section looks at governmental policies affecting both pricing mechanisms and low income households' income, and in turn impacting on affordability.

5.2. Governmental policies affecting affordability

Prior to 1974, public ownership had been accompanied by subsidies aiming to universal provision and equitable access, so that charges were not only determined by cost recovery imperatives. Costs were attributed to consumers according to their ability to pay. After 1974, water and sewerage bills for the majority of consumers stopped being recovered through local taxes and started being charged separately. The adoption of rateable property value as the base for charging was aimed at allowing intra-regional cross-subsidisation between high and low income consumers. In addition, the 1974 Water Charges Equalization Act provided for water undertakers with below average financing costs to pay an 'equalisation levy' in favour of water undertakers with above average financing costs. Overall, equalisation payments revolved around 2% of the water industry's income from unmeasured water, but 'had in some cases a significant impact on water bills'. The Labour government was committed to phasing out subsidies for nationalised industries and so the equalisation mechanism was a form of interregional cross-subsidisation among consumers and did not imply subsidies from central government (Bakker, 2003: 124-126).

Following the 1979 election, the Thatcher government suspended the equalisation scheme arguing that, in the pursuit of social equity, equalisation was undermining efficiency by removing incentives for operators to control costs. By the late 1980s, increases imposed by government in the required rate of return resulted in capital charges increasing at double the previous rate and water bills increasing above inflation (Bakker, 2003: 127). In other words, publicly owned RWAs were being gradually prepared for the pricing regime that would apply under privatisation.

Privatisation was followed by a reform in the benefit system for consumers facing difficulty in paying for water bills, and the new arrangements negatively affected affordability. Prior to privatisation, households unable to pay for services would receive financial support through the tax and benefit system. More precisely, claimants of Supplementary Benefit would receive automatically an amount of money fully rebating water supply and sewerage charges. The Supplementary Benefit scheme was replaced by Income Support in 1988 which, however, broke the automatic link between water charges and the financial support of low income consumers. This erosion in financial support was due to the fact that the Rossi index, used to update means-tested benefits, did not include water charges until 1992 and 'generally lagged well behind water and sewerage charge increases' (Sawkins and Dickie, 2008: 78-79). On the diminishing financial support provided by the benefits system, see also Fitch (2002) and the National Consumer Council in House of Commons Environment, Food and Rural Affairs Committee (2003: 13). In addition, Income Support did not and does not vary regionally, so that it fails to reflect higher costs borne by water consumers in higher charging regions such as the southwest, who are particularly disadvantaged as a result (Sawkins and Dickie, 2008: 79-82). Governmental policies on income support thus exacerbated problems with affordability and consumer water debt in the 1990s (Bakker, 2003: 131-132).

Following privatisation, a degree of intra-regional cross-subsidisation, i.e. cross-subsidisation among consumers in the same operating region served by an undertaker, has continued. This resulted in the use of rateable property values to determine charges for unmetered premises and the unwillingness to de-average regional charges, in order to protect rural consumers (Bakker, 2003: 137). Bakker (2003: 121-144; 2001) illustrates how governmental policy in England and Wales in the last 30 to 40 years has been characterised by a move from the predominance of social equity objectives (e.g. in light of the 'ability-to-pay' principle) to the prevalence of economic efficiency considerations and the 'benefit principle' (e.g. payment on the basis of costs imposed by individual consumers). The return of the Labour party to government in 1997 seems to have led to a limited reintroduction of social equity considerations, with the ban on disconnections for non-payment and the adoption of limited cross-subsidies in favour of vulnerable groups (Bakker, 2003: 136, 138). On the limited effectiveness and limited scope of the vulnerable groups scheme, see section 6.1 'The Vulnerable Groups scheme (WaterSure)'.

5.3. Implications of disconnections and the 1998 ban on disconnections for charging

Service disconnection for failure to pay bills has an obvious impact on access and produces an adverse social impact, particularly on household consumers who cannot afford to pay for their bills. Disconnections are directly affected by two factors: a) the companies' practice, particularly when those prioritising their commercial objectives neglect the social implications of disconnecting low income consumers who cannot pay; and b) governmental policies regulating disconnections, for example banning all forms of outright or partial disconnection.

5.3.1. Post-privatisation disconnections and company policies

Following privatisation there was a sharp rise in the number of households being disconnected. The rate tripled in the first five years, with 18,636 households disconnected in 1994.[14] But there was widespread opposition to this practice on social and health grounds.

The companies were criticised for failing to exercise restraint or social responsibility over their disconnections policies. In the House of Commons, it was reported that:

> *The water companies say that they disconnect only the "won't payers" - those who can afford to pay, but refuse to do so. I shall bring to the attention of the House some recent examples of people I know who have been disconnected: in Southampton a lady with seven children, one aged three who suffers from a heart condition; a family of five, in which the mother suffers from a medical condition which requires a constant supply of water and whose neighbours provided that water via a hose pipe; and a severely disabled elderly lady, whose neighbours brought her water in a variety of containers. In south Staffordshire, a single parent on unemployment benefit was threatened with disconnection for arrears of £60.73. When the local citizens advice bureau contacted the water company to say that there was a child in the house, the company said, "So what?--We'll still disconnect." A young mother with three children, aged two, five and eight, handed over £50--all her family credit for a week--when the company turned up to cut her water off. The water company got its money, but the family had nothing left for food for the following week. In mid-Kent, the water company refused to allow a family with two children under five and a baby on the way to repay £5 a week under an instalment plan and demanded the payment of more than £400 in full. I do not call those people "won't payers", but "can't payers"*[15] (Lobina and Hall, 2001: 18-19).

5.3.2. Disconnections and public health

A constant and powerful strain of criticism was that cutting off water supplies endangered the health of the household and of the public. In 1992 there was a rise in the number of cases of dysentery reported, in all major conurbations other than London. The water companies were further criticised for failing to notify cut-offs to the local authority, despite their statutory duty to do so and the attendant health risks of not reporting.[16]

The policies were criticised by the medical and nursing professions, who argued that a clean water supply was essential for human life, hygiene and health: 'Both the NGOs concerned with child poverty and the medical profession had opposed the disconnection of consumers who did not pay their bill, arguing that there was no reason why the companies should have access to a remedy for non-payment of debt that was not open to other creditors seeking to recover debts' (Green, 2000: 14).[17]

The new Labour government adopted the same position – that disconnection is a health risk:

> *The Government believes that access to water is essential to the maintenance of general good health and well being. Some of the greatest improvements in general public health have stemmed from every household having access to a constant supply of potable water. Good hygiene and effective sanitation are key elements to the maintenance of good health and each depends on having constant access to water. Where the water supply is disconnected, the maintenance of good health and hygiene can only be put at risk. In the light of this, and having considered the available evidence, the Government believes that disconnection does not have to be an integral part of the process of collecting arrears of charges for water supplied to domestic premises*[18] (House of Commons, 1998).

5.3.3. Use of pre-payment meters

By the mid-1990s, disconnections had become so controversial that Ofwat had instructed the companies to find alternative payment strategies for consumers and to reduce disconnection rates (Bakker, 2001: 153). The companies thus started using the 'pre-payment meter' for customers unable to pay their bills. This supplied water when charged with a card: otherwise the household would get no water. They thus operated as self-disconnecting meters. By 1996 over 16,000 pre-payment meters had been installed, according to Ofwat. At the time, Richard Burden MP (Birmingham, Northfield) described this situation as leading to 'a startling increase in the number of hidden disconnections associated with these meters' (Hansard, 8 May 1996: Column 152).

Birmingham city council challenged the legality of the meters and Burden further stated to the House of Commons:

> *The council estimates that, in Birmingham alone, there have been no fewer than 2,489 disconnections associated with pre-payment meters. Those were the disconnections that had taken place by April. As it is estimated that only about 1,500 pre-payment meters have been installed in the Birmingham area, there is clearly a pretty staggering disconnection rate. Those figures do not sit easily with Ofwat's press release yesterday, in which it applauded the fact, as it saw it, that there had been a 42 per cent. reduction in domestic disconnections in one year. Ofwat stated that only three out of every 10,000 households are having their water supply disconnected* (House of Commons, 1996).[19]
>
> *In the Severn Trent area, each installation of a pre-payment meter costs the customer about £26. That could be about 10 to 15 per cent of someone's water bill for a year. For the privilege of having a pre-payment meter, the customer is charged £26. There is another catch in the operation of the vast majority of such meters. I said at the beginning of my speech that they differed in one significant respect from traditional gas and electricity meters. The difference is that the vast majority of water pre-payment meters are not volumetric. Normally, when the customer charges up his water key or other pre-payment device, that does not involve his buying a certain quantity of water; he is buying a certain amount of time during which he is connected to the water supply. His annual water charge is divided by the amount charged up on his card or key. The catch is this. If the customer does not keep the card or key charged up, that will not alter his liability to pay his annual water bill. That means that, even if the customer is cut off, he will be charged for water that he is not receiving. That is a very strange aid to budgeting--a very strange easy payment scheme. The customer is told that the device will be helpful, but if he cannot keep up the payments, he is charged for water that he is not allowed to receive.*[20] (Lobina and Hall, 2001: 19-20).

5.3.4. Disconnections and pre-payment meters made illegal and the uncertain impact of the 1999 Water Act

The 1999 Water Act made it illegal for water companies to disconnect customers' water supply, or to install pre-payment meters or 'trickle valves' restricting the flow of water supplied in case of non-payment. This confirmed a court ruling that prepayment meters were illegal, after a challenge from municipalities (Lobina and Hall, 2001: 20). It is believed by some that the ban on disconnections has deprived the companies of a powerful deterrent against non-payment by consumers who can afford to pay but decide not to do so.

According to the government's February 2008 water strategy, 'bad debt has been an increasing issue for the water industry since privatisation. Household revenue outstanding for more than 12 months increased by £67 million between 2005/6 and 2006/07, from £508 million to £575 million. The industry also wrote off £105 million worth of household debt in 2006/07 – equivalent to 1.7% of revenue billed that year. Water companies' efforts to recover this revenue adds on average £11 onto customers' bills' (Department for Environment, Food and Rural Affairs, 2008a: 78).

In its 2006 review of water management, the House of Lords Science and Technology Committee condemned the practice of failure to pay water bills. 'The current level of unpaid bills is completely unacceptable. The 2004-5 figures show that the total amount of outstanding household revenue, including revenue written off, was £962 million—an increase of £38 million on 2003-04. This is an astonishing amount of debt which can only place pressure on companies' finances and hence water bills. Moreover, pursuing non-payers and taking them to court adds further expense' (House of Lords Science and Technology Committee, 2006a: 35). The Committee was satisfied to hear that the government was considering Australian-style partial disconnection, 'whereby flow restrictors were used to reduce the water supply to non-paying households to a level sufficient only for basic healthy and safety needs', even if partial disconnection had been banned by the 1999 Water Act (House of Lords Science and Technology Committee, 2006a: 35).

Although the Committee's outrage was directed at consumers who could afford to pay their water bills but refuse to do so, two considerations impose. Firstly, the Committee appears unaware of a report on the Victoria, Australia experience with flow restrictors, which showed arbitrary variation in company practices, with one company restricting nearly 2 per cent of all its customers, with many of those restricted being so poor they were entitled to concessionary rates, and one company restricting the water flow for over 14 days in most cases[21] (Hall and Lobina, 2008: 12). Secondly, it is not clear to what extent total figures on bad debt refer to consumers who cannot afford to pay and those who can. Finally, since companies have now been found guilty of exaggerating these bad debt figures, as discussed in section 5.5.2 'Severn Trent and others: deceiving the regulator', the data they offer may be more questionable (Hall and Lobina, 2008: 12).

5.4. Implications of measurement methods for charging and affordability

In its February 2008 strategy for water in England, the Department for Environment, Food and Rural Affairs (2008a: 75) notes that 'unmeasured charging is based on rateable values which have in most cases not been updated since 1973, are only used for water charging, and are not aligned with the actual value of a property or its household size'. Coupled with the recent trend which sees part of consumers switching to metering, this has implications on the affordability of water charges for those households who continue to be billed on an unmeasured basis, including vulnerable consumers (Department for Environment, Food and Rural Affairs, 2008a: 77).

'Households that stand to save money tend to opt for meters, which has an impact on those households left behind without meters, including large families in properties with a low rateable value. As a consequence, these households could be faced with higher bills as bills for unmetered customers grow faster than metered ones' (Department for Environment, Food and Rural Affairs, 2008a: 12). In 2006/07, 30 per cent of households in England were metered. This proportion was increasing by about 2 per cent per year, 'predominantly through customers' own choice' (Department for Environment, Food and Rural Affairs, 2008a: 75; Department for Environment, Food and Rural Affairs, 2004: 37).

The Department for Environment, Food and Rural Affairs (2008a: 78) found that the current rateable value based system of charging implied 'to some extent' the cross subsidisation of poorer households by those with a larger income. This was due to the fact that 'lower income families are more likely to live in homes with low rateable values'. However, Bakker (2001: 147-148) notes that the rateable property value is a poor proxy for income. Also, the 2008 government water strategy does not shed light on how variations in value dictated by the property market in recent years might have affected cross subsidisation among different categories of household consumers.

Nonetheless, the progressive passage of households with low water use to metered charging results in the erosion of the existing cross subsidy as 'the remaining unmetered households start paying a greater contribution to the total water company cost of providing the water and sewerage services they use' (Department for Environment, Food and Rural Affairs, 2008a: 78). The government recognises that this 'could have potentially serious affordability impacts on some unmetered households', with particular reference to large families on low incomes which are not eligible to receive assistance under current regulations as discussed in section 6.1 'The Vulnerable Groups scheme (WaterSure)' below. 'Many households with high water use and/or low rateable values, would lose out by switching and may choose to remain unmetered.' These families would lose out from the breaking down of cross subsidies, while not being able to qualify for reduced tariffs applicable to vulnerable groups. On the other hand, 'some low income householders, such as pensioners, may benefit financially from having a meter installed' (Department for Environment, Food and Rural Affairs, 2008a: 78).

5.5. Implications of price-cap regulation and companies' 'gaming' for charging

Companies' practices resulting in overcharging consumers, or in lower investment than projections used to justify periodic price increases, have a negative impact on affordability. These practices require strengthening governance mechanisms, for example through tighter regulatory oversight, and/or reforming the institutional framework to remove incentives for private operators to abuse of monopoly power at the expense of consumers.

Ofwat is statutorily responsible for ensuring that the companies were profitable, a task which it performed very well, and for encouraging efficiency. As there is no effective competition in the provision of residential consumers, Ofwat compares the companies' performance with each other through the so-called yardstick competition (Lobina and Hall, 2001: 7-8). However, the companies have been able to use the five-yearly price reviews to their advantage and systematically obtain higher price increases than actually justified.

5.5.1. 'Unexpected' savings on capital expenditure

There is strong evidence that Ofwat has been unable to deal with active and persistent 'gaming' by the companies in order to gain higher profit margins. This gaming happens around the price caps set by OFWAT in the price reviews, which effectively set the level of water prices in England five years in advance. The companies submit their projections of expenditure and claim that they need to increase prices to cover this spending. Ofwat then has to try and make its own assessment of the accuracy of these forecasts, and then set the prices. The companies have every incentive to mislead the regulator, by exaggerating the capital expenditure necessary. Companies are then allowed to charge higher prices, but the real expenditure is lower, and so they can pocket the difference as increased profit.[22] The whole process is in effect a game between the regulator and the companies.[23]

The process began to be noticeable in 1994, after Ofwat's first price review was finalised, and the companies' price caps for the next five years had been fixed. Some companies 'discovered' that they had made 'capital efficiency' savings, or that they did not need to spend so much on capital expenditure in future. The companies then made use of this to justify paying extra dividends.[24] Yorkshire Water paid out an extra £50million in dividends justified by savings in its capital programme (Ofwat later suggested that Yorkshire Water PLC's failures to ensure a reliable supply during the drought of 1995, or to control leakage and flooding from sewers, had to be related to the company's dividend policy[25]); North West Water found £400m savings from capital efficiencies, and also increased dividends to shareholders rather than cutting prices.[26] Thames Water likewise passed the benefits of a £350m reduction in forecast expenditure to shareholders rather than customers:

> *Britain's biggest water company is to cut its investment programme by £350 million - but it will not be passing on the savings to its 7 million customers. Thames Water has no plans for early price reductions or rebates. Instead consumers - whose bills have increased by 50 per cent since privatisation in 1989 - face yet another rise in April, by inflation plus 0.5 per cent. The latest price rise was decided by the industry regulator, Ofwat, during the five-yearly price review last year. It was based on a £2.1 billion capital investment plan agreed with the company. But now, six months after the review, Thames says its investment target is only £1.75bn - down £350m, or £70m a year - equivalent to £10 off every domestic bill.*[27]

For the period 1995-2000 as a whole, capital investment totalled £17.5 billion – 10 per cent, or £1,900 million, less than had been assumed when Ofwat set the price limits.[28] This resulted in a corresponding boost to company profits.

The pattern continued in the subsequent period, 2000-2005. This was again obvious after the first year: capital expenditure for 2000-2001 was £700 million below projected levels. The underspend continued during the rest of the period, and capital expenditure for the full period 2000-05 was around £1.7 billion lower than the assumptions underpinning price limits over the five years as a whole. At £17.7 billion, compared with the £19.4 billion assumed, this represented a shortfall of 9 per cent. This again provided a boost to profits. From the last ten years, the companies have enjoyed windfall profits of over £3.4 billion as a result of these underspends. As a result: 'Profits are at the highest levels that we have seen over the last five years.'[29]

The problem became even worse in 2005-2006, when the underspend in a single year reached nearly £1 billion, 22 per cent lower than the level assumed by Ofwat when setting the price limits: the regulator's comment on this shortfall was the mild observation that 'the companies concerned will face a stiff challenge if they are to deliver all the outputs required of them over the five-year period'.[30] Yet the same report notes that the companies managed to increase dividends to shareholders by a total of £700 million (£385million plus £313 million in special dividends), so all the increase in dividends, and more, was made possible by the shortfall in capital expenditure.[31]

Table 1. Using capital underspend to boost dividends 1995-2006

Period	Underspend as percentage	Underspend/boost to profits in £million
1995/96-1999/2000	-10%	-1,900
2000/01-2004/05	-9%	-1,500
2004/05-2005/06	-22%	-960
TOTAL	-9.5%	-4,360

Source: *Ofwat 2000, Ofwat 2005, Ofwat 2006*

The 2005 stakeholder survey contains a scathing summary of views on a key part of the process, mainly from the companies themselves: 'The cost base methodology is widely seen as flawed. It is open to gaming and different companies take different approaches…. Many see it as unlikely that the wide variations in unit costs can be explained by efficiency'[32] (Hall and Lobina, 2007: 13-14).

5.5.2. Severn Trent and others: deceiving the regulator

The recent scandals concerning Severn Trent and other companies also confirm the existence of gaming, which may involve illegal behaviour, and the difficulty for Ofwat in identifying it and countering it. The scandal emerged as a result of whistle-blowing and not as part of Ofwat's regulatory scrutiny. A manager, David Donnelly, said in 2004 that he had been instructed by his bosses to exaggerate figures of debts owed by non-paying customers. Severn Trent denied this, and denied that customers had been overcharged.[33]

A year and a half later, however, Ofwat produced a report on the allegations which 'found that Severn Trent Water had provided regulatory data that was either deliberately miscalculated or poorly supported. This led to price limits being set for the water company that were higher than necessary, which would have resulted in customers paying £42 million more by 2009-10'.[34] In November 2007, the Serious Fraud Office also decided to bring three charges against Severn Trent Water under section 207 Water Industry Act 1991, for providing false information to Ofwat. The three charges related to the leakage data in the June Returns for 2000, 2001 and 2002 (Severn Trent Water, 2007). In April 2008, Severn Trent decided to plead guilty to two offences relating to leakage data supplied to Ofwat in 2001 and 2002 (Reuters, 2008).

The allegations prompted further confessions and discoveries of errors. Southern Water confessed to having made mistakes about its responses to customers, and failure to make payments due to customers; the Serious Fraud Office investigated these too, but finally decided not to prosecute.[35] Thames Water[36] and Severn Trent itself[37] admitted that they had misrepresented data on its response to customer enquiries, which also affects customer bills; Tendring Hundred admitted it had made an 'accounting error' in its estimates of income from metered customers, and overcharged customers £5 per head as a result of this unfortunate mistake[38] (Hall and Lobina, 2007: 14-15).

6. Limitations of current mechanisms to assist low income consumers in England and Wales

The government has adopted as a sustainability indicator the number of households paying more than 3 per cent of their disposable income on water supply and sanitation services (House of Lords Science and Technology Committee, 2006a: 36). Households exceeding the 3 per cent threshold are regarded as being affected by 'water poverty'.

In its 2006 report on water management, the House of Lords Science and Technology Committee found that expenditure on water and sewerage was 'unacceptably high' for some categories of consumers. According to CCWater, in south west England water and sewerage bills may represent up to 7 per cent of the disposable income of a single pensioner receiving Pension Credit, and this was projected to reach 8 per cent of disposable income by 2009-10. The situation was even worse for those on Job Seekers' Allowance, as this was lower than the level of Pension Credit. CCWater also estimated that across England and Wales in 2005-06 an average of 51.7 per cent of non-working families without children would spend more than 3 per cent of their disposable income on water and sewerage bills. This was expected to rise to 55 per cent in 2009-10 (House of Lords Science and Technology Committee, 2006a: 36; House of Lords Science and Technology Committee, 2006b: 142).

Overall, the 2004 cross-government review of water affordability estimated that in 2004/2005 29 per cent of households on the lowest incomes were paying more than 3 per cent of disposable income on water supply and sanitation bills. This was projected to reach 40 per cent by 2009/2010, as a result of charge increases above the rate of inflation (Department for Environment, Food and Rural Affairs, 2008a: 78).

The only systems for assisting those with difficulties in paying water bills resemble nineteenth century approaches. There is a set of highly restrictive rules for special assistance, which are administered by the private companies (vulnerable groups scheme or WaterSure), and the companies themselves may also provide charitable handouts at their own discretion (Hall and Lobina, 2008: 12).

Both practices are inadequate to address the issue of water affordability. There is nothing comparable to the Winter Fuel Payment scheme (Howard, 2008), and the House of Lords Science and Technology Committee stated that 'providing even a fraction of the almost £2.5 billion that the Winter Fuel Payment cost in 2004-05 would be welcome' (House of Lords Science and Technology Committee, 2006a: 38).

6.1. The Vulnerable Groups scheme (WaterSure)

The Vulnerable Groups Regulations (also known as WaterSure),[39] administered by the privatised water companies, represent the main instrument to support households with problems of affordability in England, but do not apply to Wales (House of Lords Science and Technology Committee, 2006a: 36).[40] This is to ensure that certain categories of metered domestic consumers that have to use high volumes of water due to medical or other conditions do not have to reduce essential consumption for fear of increases in their bill.[41]

The scheme was introduced by the Labour government in April 2000 and, according to the National Consumer Council, 'the scheme has been a failure with only a 1.4 percent take up among eligible customers in 2001/2' (House of Commons Environment, Food and Rural Affairs Committee, 2003: 13). In 2004-2005, 9,217 households successfully applied for assistance under the Vulnerable Groups Regulation, a figure that the House of Lords Science and Technology Committee found 'very low'. This appears to be the result of excessively narrow eligibility criteria, as assistance was only available to metered households where someone was a recipient of one of several benefits and tax credits. Furthermore, claimants must 'be in charge of three or more people under the age of 19 in full-time education living in the property, or have someone living in the household who suffers from an eligible medical condition which requires significant additional use of water'. Once eligibility criteria are met, assistance consists in limiting payment to the average household bill for the claimant's region, irrespective of effective consumption (House of Lords Science and Technology Committee, 2006a: 36). The National Consumer Council has claimed that 'the scheme costs more to administer than is paid out to customers' (House of Commons Environment, Food and Rural Affairs Committee, 2003: 13). Governmental estimates put the average yearly cost of cross-subsidies imposed on non-vulnerable consumers by the need to fund the Vulnerable Groups scheme at below GBP 1 per household in England. The then Department of the Environment, Transport & the Regions (DETR) argued that this would be acceptable as it did not represent a 'disproportionate' increase in charges (Bakker, 2003: 137).

In its 2008 water strategy, the government states that, since the 2004 cross-government report on water affordability, the protection available through the Vulnerable Groups Regulations has been extended by widening the eligibility criteria. Furthermore, the government 'identified and encouraged best practice in administrating the vulnerable groups tariff' (Department for Environment, Food and Rural Affairs, 2008a: 78). The 2005 Amendment to the Water Industry (Charges) (Vulnerable Groups) Regulations 1999 does extend the eligibility criteria, for example by adding to the list of medical conditions covered and facilitates a smoother process, for example by removing the need to provide information about treatment received when applying for assistance.[42] However, the 2005 Amendment did not radically extend the take-up of those entitled to claim assistance under the Vulnerable Groups Regulations, nor it did significantly improve the benefits enjoyed by those assisted.

6.2. Charitable schemes set up by the private operators

An example of a charitable fund set up by a private water and sewerage undertaker to assist consumers experiencing difficulties in paying their bills is represented by United Utilities' fund. This was set up in 2003 and provided a total of GBP 15 million up to 2008. In August 2008, United Utilities announced it would donate GBP 5 million per year to the fund, up from the previous annual GBP 3 million. The increase in the donation would be funded out of the company's profits, which in the year to March 2008 totalled GBP 478 million.[43]

6.3. Institutional responsibility for ensuring affordability of charging

The limitations of the Vulnerable Groups Regulations and the absence of more comprehensive and effective mechanisms almost 20 years after privatisation require that the institutional responsibility for addressing affordability for low income consumers be examined.

The Water Act 1989 provides for Ofwat's general duty to protect customers in relations to matters of charges imposed by water and sewerage undertakers. While the Act does not explicitly rule out cross-subsidies between high and low income households, it does require 'that the interests of customers and potential customers in rural areas are so protected and that no undue preference is shown, and that there is no undue discrimination, in the fixing of those charges and amounts'.[44] However, Ofwat has, since the beginning, interpreted its duty to protect customers as one to defend economic equity and the 'benefit principle' according to which individual consumers should be charged in light of the costs they impose on the system, not in view of their ability to pay, irrespective of the implications for social equity and affordability. Ofwat argued in 1990 that cross-subsidies between high and low income consumers aimed at achieving social objectives such as addressing hardship in paying bills would be unfair to the better off. Instead, it demanded that the Department of Social Security or any other governmental agency should intervene to alleviate the social costs of water charges (Sawkins and Vickie, 2008: 83-84). Ofwat has been consistent with its position throughout the years (Bakker, 2003: 127-128) and it has refused to allow one water company to extend their vulnerable groups scheme to customers who were not in receipt of benefits, or to non-metered customers (de la Motte, 2005: 18).[45]

In its February 2008 consultation on draft statutory Social and Environmental Guidance to Ofwat, the Department for Environment, Food and Rural Affairs (2008b: 8) states that:

> *Protecting and supporting vulnerable groups remains a key Government priority. Alongside its general duty to protect the interests of all consumers, Ofwat has particular responsibilities towards certain groups in society: the disabled or chronically sick, pensioners, individuals with low incomes, those in rural areas and those whose premises are not eligible to be supplied by a licensed water supplier (as set out in the Water Industry Act 1991, as amended by Section 39 (2C) of the Water Act 2003). Ofwat is expected to regularly review how it fulfils this duty, taking into account:*
>
> - *information contained in the Vulnerable Groups Regulations;*
> - *the Government's approach to social inclusion and to vulnerable groups expressed in other current policy documents;*
> - *relevant policies on income related benefits; and*
> - *guidance from the Secretary of State on matters to be taken into account in approving companies' charges schemes.*

In this sense, it should be noted that the Labour government's policy since the late 1990s is to 'address unacceptable distributive outcomes within the system of water regulation rather than through the benefits system' (Bakker, 2003: 137; Bakker, 2001: 155). This position remains unchanged to date (Howard, 2008).

The above suggests that, irrespective of Ofwat's statutory responsibility for protecting the interests of all consumers including vulnerable groups, it has failed to take action to adequately address the issue of water affordability by a growing section of society. This contrasts with the robust action that Ofwat has in the past taken to protect the interests of the companies and specifically to ensure their ability to remain profitable (by extending the advance termination notice to 25 years). It suggests that Ofwat has selectively defined its own remit to exclude the protection of vulnerable consumers, either through pricing mechanisms or promotion of additional measures. Ofwat's stance on the growing problem of water poverty can thus be described as principled inflexibility with the weak and accommodating leniency towards the powerful.

6.3.1. 25 year concessions, plus 25 years notice of termination: eternal private monopolies

As noted in section 4.1, competition in the water industry is at best extremely limited. The private water companies hold regional monopolies, created by the act of privatisation in 1989, when the companies were sold to private shareholders complete with statutory rights to enjoy these monopolies. There was thus no competition for these monopolies in the first place. The Water Act 1988 specified that these monopolies are in fact concessions, lasting 25 years from the date of privatisation, and thus due to expire in 2014. Therefore, at least in principle it would be possible to either terminate or invite tenders for the licenses, as happens in France when private concessions come to an end.

The 1988 Act did not provide for what would happen at the expiry of the concessions, but placed some constraints on the ability of ministers to terminate them. The Water Act 1992 introduced a much stronger constraint: government ministers had to give companies at least 10 years' notice before terminating these concessions. In 2002, Ofwat lengthened this period even further, to 25 years. The stated purpose of the proposal was to create stability and security:

> *Ofwat today published proposals to reduce regulatory uncertainty in the water industry by increasing the minimum ten-year notice period for the termination of a company licence to 25 years… Under the current arrangements notice would have to be given by 2004 for licences to be terminated by 2014. OFWAT Director General Philip Fletcher said the approach of 2004 was creating uncertainty for the water industry, which was likely to drive up the costs of raising finance. Mr Fletcher said: "Customers' interests are best served by a stable regulatory environment that keeps costs down. The longer notice period will enable companies and their investors to plan ahead more securely.* [46]

The change was proposed in a consultation document on 30 July 2002 and implemented - without publishing any responses to that consultation - in October 2002 by inserting a new clause into the license of all the water companies.[47] The timing of the consultation effectively minimised the opportunity for public and parliamentary debate because parliament was already suspended for the summer holidays and all comments were required by 24th September, before parliament reconvened. It is not known what representations were made, as Ofwat never published them. Indeed, the consultation paper itself was removed from the Ofwat website by the end of September 2002. All that remains is the press statement issued at the same time.[48] The change was welcomed by United Utilities: 'We welcome the decision to change companies' licences so that the minimum notice period of termination will be 25 years rather than 10 years.'[49]

The change certainly creates greater security for the companies. It means that a decision to submit the current monopolies to tender for the first time ever, or a decision to end the private monopolies altogether, would take 25 years to implement, in which time it could be reversed by any one of at least five different governments. If the clause remains, it effectively provides a government guarantee which protects the privatised companies in perpetuity. This is in sharp contrast to France, which used to permit indefinitely long private concessions, but in the 1990s it changed the law to require the periodic submission of concessions to tendering and limited the duration of concessions to a maximum of 20 years (Hall and Lobina, 2008: 15-16).

6.4. Solutions currently considered to address affordability issues

The House of Commons Environment, Food and Rural Affairs Committee, the House of Commons Environmental Audit Committee, and now the House of Lords, have all argued that 'people suffering from serious difficulty in paying their bills should be helped through the benefits and tax credits system' (House of Lords Science and Technology Committee, 2006a: 36).

The February 2008 governmental water strategy for England does not provide for the introduction of any such benefits and tax credits system (Department for Environment, Food and Rural Affairs, 2008a: 78). In March 2008, Environment Minister Phil Woolas, interviewed by BBC Radio4, stated that: 'We have worked with the water companies and Ofwat to put into place a number of short term measures to ensure there is help, either by budgeting or by benefits checks… I think it is better to address the issue by bearing down on the costs rather than creating new benefits.' (Howard, 2008)

7. Discussion of findings

Since the 1989 privatisation, the accessibility of water supply and sewerage services for low income consumers in England and Wales has been affected by a number of factors. These include the combined behaviour of the private operators and the economic regulator resulting in increasing water charges and the adoption of controversial disconnection practices. Governmental social policy has seen the dismantlement of interregional equalisation payments among operators and reduced support for households through the social benefits system. The negative effect such developments have cumulative produced on affordability have only been more recently marginally contained by governmental decisions to ban disconnections and to provide for cross-subidisation in favour of vulnerable groups. These measures, and the voluntary charitable schemes introduced by some companies, are inadequate to address the resurgent problem of water poverty.

In August 2008, the government announced an independent review of household charging and metering for water and sewerage services, to be chaired by the chief executive of the Healthcare Commission. The review would assess the 'effectiveness and fairness of current and alternative charging methods, considering social, economic and environmental concerns, making recommendations on any actions to be taken to ensure England and Wales have a sustainable and fair system of charging'. This would include looking at: the effectiveness and fairness of charging methods in view of metering trends and use of the rateable property value; the costs and benefits of metering; the effectiveness of different types of innovative tariffs in helping vulnerable households and/or reducing demand; the effectiveness of measures to manage affordability concerns for low-income households; the impact on health and health inequalities of current and alternative charging methods; and the effectiveness of measures to incentivise people to pay for water and sewerage services, with the exclusion of disconnection, and minimise the impact of bad debt on those that do pay (Stedman, 2008).

Pending the outcome of the review, this section discusses the implications of a number of possible approaches to revising the charging system aiming at enhancing affordability for low income households.

7.1. Direct subsidies to consumers through means-tested benefits

This approach is adopted with different effect in a number of countries, including France and Chile, although in different sectors. The system has the advantage of targeting those in need of financial help without dispersing precious resources. However, the case of the Income Support system in England and Wales shows that financial assistance provided through social benefits might be inadequate to address mounting concerns for the affordability of water services.

In France, housing support is high enough to pay most of the rent but may be earmarked for this purpose. Hence separate water, electricity and telephone bills may remain unpaid. Each supplying company will seek reimbursement separately (from social services). Reduced price is already available for the telephone of the poor. Electricity may not be cut off and delays are available for the payment of telephone and water bills. Special social tariffs for electricity are available but a special social tariff for water is not yet contemplated. The total number of beneficiaries of these targeted measures is at most 4% of the population and the actual cost implication is likely to be less than 1% of turn over of the utilities concerned (Smets, 2005: 12).

Interestingly, Bakker (2003: 139) proposes that an alternative policy to address social equity in England and Wales could consist in regionally (rather than nationally) indexing the 'notional value of water in income-support payments, as is already done for housing'. This solution would take into account the considerable regional differentiation of water and sewerage bills.

7.2. Cross-subsidisation between high and low income consumers

This approach implies charging high income consumers relatively more in order to reduce charges to low income households in the same operational area. In principle, it might also envisage cross-subsidies between different categories of users, for example from industrial and commercial users to households. In practice, requirements in the European Water Framework Directive to progressively remove cross-subsidies between different categories of users might limit its applicability. Cross-subsidisation can be implemented through a variety of mechanisms, including lower, 'social' tariffs for entitled consumers. A number of these schemes require metering, although not all, as demonstrated by the Vulnerable Group Regulations and the cross-subsidisation inbuilt in the rateable property value mechanism.

Increasing block tariffs, whereby the unit price of water increases with consumption, consists in applying a lower tariff to the first block of cubic metres consumed and increasingly higher prices to subsequent blocks. This form of progressive pricing is used in many countries and cities, including Brussels and Wallonia in Belgium, and several countries in southern Europe, Japan and South Korea. However, it is more effective at discouraging consumption, and thus promoting water conservation, than at addressing social needs. Large, low income families are in fact likely to be penalised, while high income single household occupiers might benefit (Smets, 2005: 10).

In light of similar considerations, the Consumer Council for Water has recently warned against the possible adverse social impact of an expansion of metering on low income families (Consumer Council for Water, 2008a). As noted in section 5 'Pricing in England and Wales', the government, and more precisely DETR, demonstrated its awareness of such risks and expressed its opposition to the full application of the principle of 'economic equity' in water charging.

In fact, in order to ensure that increasing block tariffs are effective at enhancing access for low income households, it is necessary to adopt more sophisticated approaches:

In a progressive tariff, the size of the blocks of water consumption can be increased in line with the number of people in the household in order to avoid too large a financial burden on large families (a minority of the beneficiaries). This is done in Luxembourg, Barcelona and in Flanders (15 m3 per person per year) but requires that the user applies to the water company to have a special tariff from social services (Smets, 2005: 14).

7.3. Reducing the overall cost of service provision through good governance

Section 5.5 'Implications of price-cap regulation and companies' "gaming" for charging' shows that there is scope for improving the effectiveness of economic regulation. The strengthening of current regulatory mechanism should be aimed at minimising the practice of 'gaming' and underspend, as this amounts to overcharging of consumers. The savings thus obtained from current charging levels could be passed on to all consumers with no differentiation or could be selectively targeted to benefit low income households.

Improved governance can also take place through the institutional reform and restructuring of the water industry. Hall and Lobina (2008: 30) estimate that bringing the private water companies into public ownership and finance investment through bond issues would result in annual savings of at least GBP 900 million.

> *Dividends to shareholders represent a cost of about 8.8% on capital; interest payments on debt represent a cost of about 5% on capital. The total cost in 2004-05 was £2.4 billion. If all this was replaced with public sector debt at 4%, the cost instead would be about £1.5 billion – an annual saving of £900million. If lower cost government debt was used, at 3% or less, the savings could be even greater: long term debt at 2.5%* (Hall and Lobina, 2008: 30).

It should be noted that the estimated GBP 900 million per year of efficiencies thus obtained would allow for a reduction of about 12 per cent off the average household bill for water and sewerage, about £20 per year per person in England and Wales, or an increase of 25 per cent in capital investment (Hall and Lobina, 2008: 30). Again, reductions in water bills could be targeted to particularly benefit low income households. The estimated GBP 900 million efficiencies due to bringing water operations and financing under public ownership would represent a multiple of what current private undertakers seem prepared to donate to their charitable schemes.

At present, proposals are being put forward for the introduction of more advanced forms of competition, for example product market competition such as energy sector-style retail competition. These proposals are aimed at the reduction of overall costs of service provision, the protection of the environment and contributing to the government's social objectives (Ofwat, 2008: 6-7). The proposals provide relatively limited detail as to how the different forms of competition contemplated would work. However, it should be noted that previous attempts to introduce competition for the market and in the market respectively via inset appointments and common carriage, have had limited success (Bakker, 2003: 92-97; Ofwat, 2008: 85). Where inset appointments have been introduced, substantial price decreases for large industrial users were compensated for by price increases for household consumers (Bakker, 2003: 95-96). Furthermore, current proposals on competition in the water industry do not go beyond envisaging guarantees to maintain cross-subsidies in favour of rural consumers and vulnerable groups (Ofwat, 2008: 9-10; 60-63). It thus remains questionable that competition can by itself provide a substantial contribution to fostering affordability for low income households.

7.4. Reducing the overall cost of service provision through enhanced water efficiency

In the February 2008 government's water strategy for England, DEFRA announced a review of the Water Supply (Water Fittings) Regulations 1999 aiming at enhancing the water efficiency of household appliances. The regulations 'cover for example the maximum water use of toilets, urinals, washing machines etc. The review will also consider enforcement issues, advances in technical standards and water conservation, and the case for setting new performance standards for key water fittings' (Department for Environment, Food and Rural Affairs, 2008a: 27). Such measures can be expected to produce positive environmental effects as a result of water conservation, but are unlikely to provide a substantial contribution to social objectives.

Demand for water is in principle derived, but only 30 per cent of households in England are currently metered and metering is growing by 2 per cent per year (see the above section 5.4 'Implications of measurement methods for charging and affordability'). This means that the remaining majority of domestic users would not benefit from reduced bills irrespective of the adoption of water efficiency measures (which in turn might require subsidies or cross-subsidies for those low income families unable to afford the cost of replacing water-inefficient household appliances). Furthermore, it has already been noted that large low-income families or vulnerable consumers with high water consumption levels would stand to lose from switching to metering.

In reality, there is no direct correlation between reduced water consumption and reduced overall costs to consumers. Switching from an unmetered to a metered supply usually implies a reduction in water consumption of around 10 per cent (Department for Environment, Food and Rural Affairs, 2008a: 12; Smets, 2005: 6). It is estimated that fitting water efficient household appliances may save from 20 per cent to 30 per cent of household water consumption (House of Lords Science and Technology Committee, 2006a: 82). However, in a capital intensive sector such as water supply and sewerage cost, reductions would not be proportionate to the decrease in demand. Capital costs would remain unaffected while only part of operating costs would decrease (mainly the electricity costs of pumping water to households). The tenuous correlation between reduced water consumption and reduced costs to consumers is demonstrated by a number of cases where substantial drops in demand, or overestimated consumption, have been followed by compensatory price increases. These were justified by the need to protect the operator from the unchanged incidence of capital costs. Examples include Grenoble, France (Lobina, 2006: 15), Arezzo, Italy (Lobina, 2005: 17) and Rostock, Germany (Lobina and Hall, 2003: 10).

8. Conclusions

In his review of social measures adopted by OECD countries, Smets (2005: 19) observes that ‘in general, countries implement a mix of general and special measures because no measure provides a perfect response to the issue of affordability’. This is also the current situation in England and Wales, although the specific mix of measures appears inadequate to addressing rising concerns with water poverty and affordability. It is the combined effect of all measures adopted that is to be judged.

Ofwat’s reluctance to address social equity issues, for example through more extensive cross-subsidisation in favour of low-income households, has certainly been a contributing factor in financial hardship experienced by domestic water consumers in England and Wales since privatisation. Ofwat’s inaction, however, has been compounded by the Secretary of State’s failure to provide the economic regulator with specific guidance on how more extensive and effective cross-subsidisation should be used to achieve social objectives.

The implications of resorting to cross-subsidisation appear more than tolerable for operators. As noted by Smets (2005: 11) in his international comparison of social practice, ‘as the number of beneficiaries is generally below 15% of the population and the amount of support provided to poor people is generally below one third of the value of the average water consumption, the total cost of targeted support is always smaller than 5% of the price of water and most probably below 2% of the price of water. Such limited financial support should have no significant effect on pricing, water efficiency or resource efficiency’. Interestingly, equalisation payments made pursuant to the 1974 Water Charges Equalization Act amounted to 2 per cent of aggregate revenues.

On the other hand, the rationale for the government’s stance to exclude resorting to the social benefits system could be clarified and strengthened. It is not clear why adequate, targeted subsidies directed at assisting consumers in need cannot be adopted to compensate for ever increasing water charges. Even more so when winter fuel payments are being considered for an increase.

Irrespective of the composition of the range of measures adopted – cross-subsidisation through the charging system, subsidisation through the social benefits system, reduction of overall provision costs – their effectiveness depends on the extent to which resources reach those in need. This requires simple and accurate identification mechanisms, possibly relying on the existing lists of beneficiaries of social benefits. For example, such lists might help identify consumers who are entitled to a reduced, social tariff in case they had a metered supply. Otherwise, measures intended to tackle social issues might end up diverting resources to those who can afford to pay for their bills (Smets, 2005: 7). Furthermore, as recommended by Bakker (2003: 139), measures should be targeted to address regional differentiation in water charges, aiming at assisting hard hit consumers in high charges regions such as the South West.

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[41] Source: www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/ConsIssue_ProblemsPayingBills_VulnerableGroups.

[42] Source: Statutory Instrument 2005 No. 59, The Water Industry (Charges) (Vulnerable Groups) (Amendment) Regulations 2005 (http://www.opsi.gov.uk/si/si2005/20050059.htm).

[43] Source: BBC News, "Water firm expands hardship fund", BBC News Channel, Business, 5 August 2008 (http://news.bbc.co.uk/1/hi/business/7542238.stm).

[44] Source: Water Act 1989, section 7 (http://www.opsi.gov.uk/acts/acts1989/ukpga_19890015_en_2#pt1-pb4-l1g7).

[45] Ofwat, "Tariff structure and charges: 2002-2003 report", June 2002, p21 http://www.ofwat.gov.uk/pdffiles/tariffs_report02.pdf .

[46] See press notice PN 56/02 30 July 2002 Ofwat Proposes 25 Year Notice Period For Water Company Licences http://www.gnn.gov.uk/Content/Detail.asp?ReleaseID=20509&NewsAreaID=2

[47] The relevant section reads: 'For the purposes of paragraph (c) of Section 7(4) of the Water Industry Act 1991, the only circumstances in which an appointment or variation may be made, in relation to the area for which the Appointee holds the Appointment as water undertaker or, as the case may be, sewerage undertaker under this instrument, are where the Secretary of State has given the Appointee at least 25 years' notice to terminate the relevant Appointment in relation to the whole of its area and that period of notice has expired.] [inserted with effect from 15 October 2002].'

[48] At http://www.gnn.gov.uk/Content/Detail.asp?ReleaseID=20509&NewsAreaID=2

[49] United Utilities Interim Results for the Six Months Ended 30 September 2002 Progress In Growth Businesses Offsets Anticipated Reduction In Regulated Earnings 05 December 2002 http://www.unitedutilities.com/?OBH=1477&ID=37

Telecommunications

"In terms of problems faced by low income consumers in this sector, one of the most striking features is the sheer complexity and rapidly changing nature of the services, products, tariffs and deals. While this is a problem facing most consumers, it is likely to have more serious consequences for people without much money if they choose the 'wrong' deal."

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The Communications Sector

This section focuses on fixed and mobile telephony and on access to the Internet via broadband. At their simplest, the three key products/services – namely a telephone (voice) call, text message, or broadband access to the Internet - are standardised. For many consumers there may be little or no conceptual distinction made between a call on a mobile network or on a landline system although, at present, it would be unrealistic to say the same about VOIP calls – simply because it is unclear as yet whether this platform will become anything like as commonplace as the others. Meanwhile, technological and marketing-based bundling is removing distinctions between voice calls, SMS and Internet access, so that the latter is generally becoming less distinctive.

In terms of problems faced by low income consumers in this sector, one of the most striking features is the sheer complexity and rapidly changing nature of the services, products, tariffs and deals. While this is a problem facing most consumers, it is likely to have more serious consequences for people without much money if they choose the 'wrong' deal. People on low incomes are also less likely to have easy and affordable access to the internet and thus to web-based comparison sites. Moreover, people need to possess basic numeracy and literacy skills in order to have much hope of understanding and comparing the various offers.

Although average household expenditure on communications services is relatively modest compared with spending on other sectors, such as energy, there is increasing marketing/social pressure on individuals and families to 'join the digital revolution'. There is a rising expectation that people will have internet access and digital TV services to access information and other services.

Another feature of this sector is that the real costs of entry for service providers have declined and it is also easier for retailers to provide some form of third-party access to communications networks and infrastructures. While this has widened the choice for consumers, the churn of service providers can have adverse consequences, especially for lower income consumers searching for cheap deals. This is illustrated in this paper by reference to the problems experienced by some consumers who have lost out on cash-back deals offered by some mobile phone retailers and who have then been locked into contracts they may not be able to afford.

Despite the existence of universal service obligations on BT as the national fixed line telephony provider (and on Kingston Communications in Hull), disconnection levels for residential consumers continue to be extremely high. It is yet to be seen whether actions taken by Ofcom to reduce the number of disconnections will be adequate, in particular, whether the new BT Basic scheme will be effective to any significant extent, and what action Ofcom may take in the future on this issue.

Need for the service

For the vast majority of people for all or most of the time, 'essential need' can be broadly defined as a product or service which materially aids health, safety, well-being, and economic/social inclusion. To all intents and purposes having access to some form of telephony or other arms-length contact is an essential need for most, if not all, of the time. Also, a critical feature of the telephone service is its two-way nature, which means it is of benefit to other people and organisations for someone to be connected to the network (for instance, to enable a home care assistant, social worker or medical professional to call a client or patient).

In theory there is no *a priori* reason why low income consumers should be different to others regarding these communication needs. Indeed, having less disposable income makes it far less likely that a consumer has private transport and may also mean that they are less able than others to afford public transport. Consequently telephony services in particular (voice calls and text messages) are likely to be more suitable means of communication than the alternatives for many on low incomes.

Similarly, whilst there is some evidence to suggest that older people in particular value highly the opportunity to deal with many matters on a face to face basis, this is not necessarily true for others. Indeed there may not be any alternative option as so many services are wholly or largely interfaced through telephony and/or the Internet. There is no reason to suppose that low income consumers are any different to others in needing or wanting to use telephony in particular to access services. Research carried out for Ofcom found that having a low income, in itself, did not have a significant impact on whether or not consumers used telephony though, as noted elsewhere, the amount and payment methods used by those with lower incomes tended to be different to other consumers. The same research did find that Internet access was affected by affordability among low income consumers, though being older was much more likely to be a determinant of Internet access along with a number of other factors (*Low income consumers and the communications market: An attitudinal study into people living on a low income and their experience of communications services,* Ofcom, 2007).

However, some low income consumers are more likely than others to have a key reliance on affordable telephony. The most obvious example is afforded by those living on their own and having a medical condition or other set of vulnerable circumstances. There have been numerous studies establishing that being a disabled adult, and/or living in a household with one or more disabled members, increases substantially the likelihood of living on a low income. (For a very brief overview see, for example, *www.poverty.org.uk/24/index.shtml?2*). Similarly, being in a single person household almost automatically tends to increase both potential vulnerability and the likelihood of living on a low income, especially among pensioners and lone adults with children (*Households Below Average Income 2005-06*, DWP, 2007).

There is, in addition, an increasing emphasis by the Department of Health and others on the application of 'telecare' products and systems, ranging from simple alarm systems to automated pill alerts – almost all of which require a landline. More than 1.5 million people already access these services, and all or most are likely to regard this connection as a necessity. Also, the telephone is the primary means of contacting services such as NHS Direct.

Some elements of essential need may be more pronounced in rural areas. Recent Ofcom research has found that take-up both of residential fixed line (93%) and broadband services (59%) was higher than the UK averages, suggesting that people living in rural areas use telecom services to keep in contact with others and access information more than those in urban areas (Nations and Regions 2008, Ofcom, 2008).

Finally, losing access, for example because of a fault on a landline, or sudden withdrawal of service because of arrears or a billing error, may be a critical event and create serious consequences. For example, someone may need to contact the emergency services urgently, or they may have relatives or friends in hospital, or they may have social care needs and rely on telephony to access services.

Nature of service/product

The actual and perceived nature of telephony products and services is in many respects contradictory. For those (often older people) whose only interest is in having a landline, relatively little has changed over the years. The exception of course is that, as a result of the opening up of the fixed line market, there are now up to 170 licenced telecoms companies to choose from – though the amount of choice varies from area to area.

BT's share of the landline market in terms of call volumes has declined significantly and fell below 50 per cent for the first time in 2006 (to 48 per cent).

The total number of fixed lines was 33.7 million in 2007, compared to 35.2 million in 2002, according to Ofcom's most recent annual report on the communications market. At the end of 2007, 38 per cent of UK fixed lines were taking a fixed access or call service from an operator other than BT. Average monthly access and voice call revenues were £23.32 per line compared to £28 per line in 2002, primarily due to lower call volumes and lower prices (*The Communications Market 2007*, Ofcom, 2008).

The landline sector, whilst declining gently in absolute terms, is now characterised by a considerable amount of market activity and churn as different suppliers strive to push different call packages and tariffs, so in this important respect the nature of this 'product' has changed substantially. For example, the bewilderingly-wide range of monthly rental charges on offer at any one time, the range of call tariffs and free minutes per month for example, and even the lack of a minimum contract period offered by some, has altered substantially the 'old reality' of call charges versus line rental (though some, mainly older, consumers still complain about the expense of rental charges compared to their light call usage).

While competition has clearly developed in the landline sector, giving consumers choice not only of provider but also between tariff arrangements, it is impossible to be confident that competition is truly effective and that consumers are benefiting as much as they could. The main problem is that it can be very difficult for consumers to draw comparisons and make informed choices that suit their needs.

The other major change is that many of these telecom companies offer packages or bundles which include a landline service, alongside mobile and broadband services. Consequently, in marketing terms, landline telephony is less distinct or distinctive than was previously the case.

Ofcom, and others, have for several years noted not just the enormous growth in the number of mobiles in the UK, but also a significant increase in the extent to which they are substituting for landlines. In 2007, revenues from mobile telephony services were for the first time greater than those from fixed telephony, internet and corporate data services combined. There were around 73.5 million mobile subscriptions in the UK (both contract and Pay As You Go), compared with less than half of that number of fixed line subscriptions.

For some consumers, the mobile phone is an additional communication service, rather than a replacement for their landline. But recent Ofcom research found that 12 per cent of households rely on mobile telephony (*Nations and Regions 2008,* Ofcom, 2008). Other Ofcom research revealed that mobile-only households tend to be in the lower socio-economic groups; for example, Quarter 1 2008, 5% of ABC1 households were mobile-only, compared to 35 per cent of C2DE households. Ofcom argued that this may have been partly caused by the higher penetration of broadband in ABC1 households (63 per cent compared to 38 per cent of C2DE households), but added that other contributing factors include the higher numbers of tenanted and shared accommodation among C2DE groups (which are less likely to have a household fixed line) and the desire among lower socio-economic groups to have greater control and flexibility over spending, as is offered by pre-pay mobile. Moreover, Ofcom has referred to the particular prevalence of mobile-only households in urban areas and among younger people (*The Communications Market 2007 and 2008,* Ofcom, 2007/2008).

It could be argued that this differentiation in behaviour by a considerable proportion of lower income consumers might suggest strongly that, for some consumers, it is access to the service that matters, not necessarily the type of connection.

Furthermore, the increasingly-heavy use of text messaging on mobiles (providing revenues of £2.7 billion in 2008 according to Ofcom) appears at present to be more prevalent than messaging through a PC or other means. Ofcom figures for the first quarter of 2008 found that 44 per cent of UK adults use text messaging on a daily basis, compared to 36 per cent who use the internet (*The Communications Market 2008,* Ofcom). The total number of messages doubled between 2006 and 2007 (*'One billion texts per week in the UK: more of the* *same (amazingly)*,' John Delaney, Ovum news item, 2007). This highly significant feature of the use of mobiles does tend to reinforce the evidence behind a separation of mobile and landline telephony.

In terms of consumer behaviour, there is a clear market separation of contract-based mobile services and products and Pay As You Go (PAYG) arrangements. This distinction is reinforced by Ofcom's finding that the average monthly bill for those on contract was £33.06 in 2007, against £9.10 for PAYG: the available evidence suggests that a considerable proportion of PAYG mobile users are children and young people (who appear to be major users of the, cheaper, SMS facility), and those on low incomes. Other PAYG mobile users seem likely to be those who use a mobile service infrequently.

In addition, the rapid and large scale adoption of 3G mobile handsets and services has introduced a whole new dimension to the mobile market. New functionalities and applications reach, and in some respects reach further, than web-based and other uses of home computing with Internet access. It is as yet unclear whether these enhanced products and services will come to dominate the mobiles market, or be a sub-set of the mobiles market (i.e. with many continuing to use only voice calls and texting). With respect to low income consumers it might be surmised (as there is no independent evidence about this) that they are far less likely than others to buy these more expensive services and products.

On the other hand, the 3G mobile options may, in time, prove to be more attractive for lower income consumers than conventional computer based broadband access and its subsequent applications and uses. The latter usually require a desktop or laptop, often a modem or router, and software may have to be purchased as well.

At present, broadband tends to be a separate product though, as indicated, this distinction may become less evident over time as 3G mobile capabilities and usage increase. It has also rapidly become a fairly 'mature' market. This is not to deny the enormous amount of marketing activity by rival providers - each of which continues to strive for a higher market share and better profit margin (perhaps especially those companies which are financing the costs of acquiring the spectrum used by 3G). The cable infrastructure appears to be more or less fixed (i.e. there is little sign that significant new cabling will be rolled out, though speeds may well increase substantially), and land-line based ADSL delivery systems continue to be rolled out at a reasonably rapid pace – meaning that within a year or two there are unlikely to be many areas in the UK without any form of physical access to broadband.

In addition, it is reasonable to assume that 'conventional' email and web-based activities will continue to experience innovations in applications and uses, and that many consumers will still use computer-based access for a wide range of uses – even though they also have a 3G mobile, a PDA, Blackberry, etc.

Therefore, broadband accessed by means other than mobiles and PDAs etc., seems set to continue to be a distinctive product/service. But like telephony services, broadband is sold through a vast array of schemes involving different rental prices, at different speeds and differing download limits (or none at all). For instance, among the current top ten ADSL sellers are AOL Broadband Wireless with a speed of up to 8Mb and a 10Gb monthly limit on an 18-month contract, starting at £4.99 per month (prices can vary according to area), to O2 Broadband Standard with a speed of up to 8Mb and unlimited downloads for £12.50pm (£7.50 for existing O2 customers) on a 12-month contract. (for example, see comparison site:
www.top10broadband.co.uk/types/adsl_broadband/).

Bundling of services

The multitude of broadband deals currently available feature not only different speeds and download limits, but also a wide range of bundles of free or cheaper phone calls, VOIP calls, and various TV and/or mobiles services. Consequently, this ever increasing convergence and bundling further undermines the distinctiveness of broadband as a specific product/service.

Bundled services are usually cheaper than buying services separately, especially broadband (*The Communications Market 2007*, Ofcom, 2007). Another Ofcom research report highlights the fact that those in lower socio-economic groups are no more nor less likely than those in higher groups to switch bundled services (Consumer decision making in the telecoms and TV broadcast markets, Ofcom, 2007). It may be that some low income consumers prefer bundled services (note: this usually includes TV services) because it is less hassle than having to deal with a number of different providers and, for some, there is the perception and possibly the reality of obtaining some additional services and/or cheaper deal. However, although consumers can choose between bundled packages, they do not normally have any choice about what specific services are included: it's a matter of take it or leave it. Providers also can and do unilaterally change the make-up of packaged services.

Although in general the single most important reason for switching cited by consumers as a whole is affordability and/or the price issue, those who say they are not interested in changing supplier are more likely to consist of low income consumers (and over-55s). It may be that people on low incomes and in other vulnerable situations find it too much hassle to deal with on top of other problems they may have.

An important underlying theme, which may be of particular relevance to low income consumers, is substitutability of different services and products. There is, in theory, some degree of substitutability across the three, with the most likely exception being the non-contract status of pay-as-you-go mobile phone calls and texts, to which might be added the small number of non-contract based broadband services. Obviously, this distinction is not based on the product/service in itself, but on the terms through which the consumer accesses and uses the product/service.

As indicated previously, it could be argued that Internet access through newer generation mobile phones might lead to complete substitutability between ordinary voice/text telephony and email, blog, VOIP and other 'Web 2.0' communications media or formats. On the other hand, there are at present likely to be some significant cost barriers for some consumers associated with 3G(+) mobile use, and perhaps other barriers such as the technical knowledge to be able to use new applications, or the size of mobiles' screens for those with a wide range of sight 'deficiencies', etc.

Moreover, some types of communications packages are also being tied into store card loyalty and voucher schemes (e.g. for discounts on everything from food to holidays), and these may be of particular importance to some low income consumers. For example, low income consumers who already do most of their shopping through one of the big supermarket chains may consider that also buying their communications service(s) there represents best value for money. In this instance there is unlikely to be much substitutability.

Indeed, there is considerable activity, especially in the mobiles sub-sector, involving 'add on' services, and special 'extra' deals. Some of these could be of particular interest to low income consumers, though they are not necessarily targeted by the companies. For example, Vodaphone UK recently made exclusive tracks from Madonna's 'Hard Candy' album available to its customers for a week. The relatively new ad-funded mobile network, Blyk, gives members free texts and minutes every month, with no contract, hidden costs or fees, in return for receiving up to six highly targeted advertising messages per day from brands including Xbox, Adidas, STA Travel, Penguin, Brylcreem, Boots, COI and RSPCA. Meanwhile, 02 UK has announced the launch of a

Mobile Broadband service, offering 3GB of data per month for £20, plus free access to 7,500 wi-fi hotspots on The Cloud, UK-wide network (*On Your Marks, Get Set…*', Mobile Marketing Magazine, 29 April 2008 *http://mobilemarketingmagazine.com/*).

Substitutability

The rapidly expanding nature of convergence, combined with differentiation and segmentation in telephony and broadband, makes it particularly difficult to define and identify what substitutability means. At its simplest, a 2G mobile phone can often be substituted for a landline, or vice versa – unless the consumer needs to send text messages, in which case this may not be possible through fixed line handsets, although some newer handsets now have texting capabilities. Some 3G mobiles and associated applications can substitute for 'conventional' broadband access at home, and vice versa – there are even some mobile-based applications which enable the consumer to use instant messaging, for instance.

But beyond these obvious types of examples, so much depends on what the consumer wants and needs of telephony and broadband, at any one time, and over time, and also on what 'deals' suppliers and retailers roll out and over what period (many are time-limited, or only apply for the first three months' use for example).

It is conceivable that mobile networks could become close substitutes for fixed networks, particularly in voice services. There is some evidence to show that for substitution to develop to the point where mobile companies exerted effective competitive pressure on fixed services, the differences in prices between these services would need to decline significantly. Furthermore, this appears to be happening – though depending, of course, on a customer's patterns of use, and on their willingness or motivation to switch from a 'conventional' phone to a new one (e.g. one which will only work if its batteries are charged).

Transparency

One way of looking at the issue involves the choices that face consumers, basically the ease and affordability of switching to another service or product and, particularly in this sector, of having confidence that the new product or service and the attached terms and conditions are advantageous or not disadvantageous (switching is discussed in more detail later in this section). Ofcom research concluded that, *'although the majority of consumers perceive it is easy to find information about suppliers, they also believe it is difficult to make comparisons' (Consumer decision making in the telecoms and TV broadcast markets,* Ofcom, 2007).

Other research has tended to confirm that transparency and straightforward comparisons can often be a problem in large parts of this, admittedly-complex, sector. For example, a recent Onecompare.com customer service rating report on the six major mobile network providers concluded from its mystery shopping research that: 'Many staff were unable to give correct information meaning customers would incur unnecessary costs.'

Onecompare added:

> *The mobile company with the least knowledgeable staff were O2 (35%) followed by Vodafone (20%) and Orange (15.4%). O2 was particularly startling as it boasts about service standards in its exclusively British call centres, sliding further down the table from last year's survey. In fact, O2 staff were unable to provide correct answers or solutions to over a third of the questions asked. O2 and Virgin scored particularly poorly on the international roaming rates question with O2 answering almost four in ten questions (39%) incorrectly and Virgin answering over three in ten(35%) incorrectly. (2006/2007 Customer Service Rating Report,* Onecompare.com)

Staying with mobiles, Moneysupermarket.com states that users often do not know how many minutes or texts are included in their monthly package, or how many they actually use. It added that this leaves them prone to incurring extra charges, which could add up to £130 each per year. In addition, it said that many users did not know the terms of their deals.

In general, mobile tariffs and deals can be complex and untransparent for consumers. For instance, *Which?* recently recommended Tesco's 'Value' pay-as-you-go basic mobile tariff. At the time of writing, texts cost 5p per message and calls 15p per minute, with no extras or frills. But Tesco also offered other PAYG tariffs: for example the Extra tariff, where texts cost 5p and calls 10p but you have to top-up the card by at least £15 per month; the Standard tariff featured texts at 10p, calls at 20p, plus half price calls to a customer's favourite three numbers; the Standard Plus deal offered texts at 10p, calls at 20p, plus a free monthly bonus of either 500 UK texts or 150 UK call minutes (excluding calls to premium rate numbers), and half price calls/texts to three favourite numbers, but again dependent on minimum £15 per month top up. Customers can also collect Tesco's Clubcard points when the phone is topped up, especially if it's done in a Tesco store (which is a fixed term offer at the time of writing). It should be noted, of course, that other retailers offer a range of tariffs and deals that may be similarly difficult for consumers to compare to work out the best one for their own situation.

Tesco, like other providers, also features a wide range of deals on many different handsets, which can make price comparisons even more complex. The Moneysupermarket website says that it compares over 30,000 separate deals on contract-based mobiles, and over 500 PAYG deals.

For some, especially consumers with little disposable income, the detail of terms and conditions will also be important when trying to compare costs. But again, this is not necessarily a simple exercise.

For example, see the box below regarding BT's mobile terms and conditions, from BT's website:

Most calls will be rounded up to the next minute. Unlimited Weekend Plan customers will receive free Weekend calls to all UK geographic numbers beginning with 01, 02 and 03, excluding the Channel Islands. Pence-per-minute charging applies in the day and in the evening. A 6p (incl. VAT) call set-up fee applies to most calls except zero-rated (inclusive) calls and fixed price calls for the first hour. A 3p call set-up fee applies to BT Fusion, Light User Scheme, In-Contact Plus and BT Basic customers. In order to benefit from free UK Weekend calls, Unlimited Weekend Plan customers must make at least one chargeable call a month with BT. BT reserves the right to move customers from the Unlimited Weekend Plan to the Line Rental Plan if they make less than one chargeable call a month. Unlimited Weekend Plan zero-rated calls apply at weekends (Friday midnight – Sunday midnight) only. Unlimited Evening & Weekend Plan zero-rated calls apply in the evening (6pm – 6am) and at weekends (Friday midnight – Sunday midnight) only. Pence-per-minute charging applies in the daytime and evening for Unlimited Weekend Plan customers, and in the daytime for Unlimited Evening & Weekend Plan customers. Pence-per-minute charging also applies at evenings and weekends after one hour on each zero-rated call. Zero-rated calls apply to voice calls only. Free calls apply to UK geographic calls of up to one hour in duration. Calls beyond one hour are charged at 4 pence per minute. No set-up fee applies. Redial before an hour to avoid call charges.

Landline terms and conditions are usually no less detailed and complex, though there are fewer deals (i.e. when compared with both 2G and the ever increasing 3G services and applications).

There is, of course, a large number of broadband-only deals. The 'thinkbroadband' site lists nearly 70 prime suppliers (some of whom operate through more than one brand or in association with another supplier, such as a supermarket chain). Each prime supplier has anything from three to 15 deals. Some, though by no means all, of these may or must be purchased as part of a bundle.

As with mobiles, some deals are on offer for a limited period only. Some (like Sky Broadband Base) are only available to existing customers of the company, terms and conditions may be changed and, as the various broadband discussion groups testify, what actual broadband speeds are delivered is a fraught and often quite technical issue. These sorts of features, and the sheer variety of products and services, make comparisons difficult unless a fair amount of time is devoted to the subject.

Low income consumers may also be more affected than others by early termination fees. Costs and terms vary across services and suppliers, and can be quite difficult to find out about.

It is worth noting that, according to the latest OFT report on consumer detriment, telecommunications are among the top three goods or services for which consumers have reported the highest proportion of problems, alongside domestic fuel and personal banking. In terms of the type of problem experienced, poor service quality and defective goods are the most common causes of detriment (*Consumer detriment,* Office of Fair Trading, 2008). Complaints about mobile phone service agreements came second in the total number of complaints received by Consumer Direct in 2007, after second-hand cars. This was a rise of 49 per cent on the previous year (Consumer Direct press release, 14 January 2008).

Mis-selling

Mis-selling continues to be a significant problem, particularly regarding mobile phones. Complaints to Ofcom about mobile mis-selling have risen sharply since 2006. Problems experienced by consumers include being given false or misleading information when purchasing services and 'slamming' where consumers found themselves with a new contract without their knowledge and consent. Ofcom worked with the companies and introduced an industry code of practice in July 2007 aimed at tackling misleading sales and marketing practices, including the fairness of the terms of cashback deals being offered.

However, it became clear that the voluntary code was not working. Following a review, Ofcom concluded that, in light of the continuing levels of complaints, the varying levels of monitoring and enforcement of the code by the mobile service providers and the extent of consumer harm involved, reliance on the code did not provide adequate protection for consumers. The result is that Ofcom is proposing to introduce formal regulation through a new General Condition on sales and marketing practices that will apply to all mobile service providers (Protecting consumers from mis-selling of mobile telecommunications services, Ofcom, 2008). Among other matters, mobile service providers will be required to adhere to the following rules:

- not to engage in dishonest, misleading or deceptive conduct and to ensure that those selling their products and services do not mis-sell;
- to make sure the customer is authorised to, and intends to, enter into a contract;
- to make sure customers get the information they need when they buy the product;
- to ensure that the terms and conditions of all sales incentives offered by their retailers are not unduly restrictive; and
- to carry out due diligence and a number of checks in respect of their retailers to ensure the soundness of the company and its directors.

Independent retailers must comply with contract terms stipulated by mobile service providers. This means that, although these retailers cannot be directly regulated by Ofcom (where they are not a provider of electronic communications services or networks), the regulator can indirectly influence their actions by regulating mobile service providers.

These Ofcom proposals also include measures relating to a number of 'cashback' schemes which are sold by independent retailers of mobile service providers' services. In these schemes, an independent retailer undertakes to pay an amount of money to the customer when they take out a mobile phone contract from a mobile service provider. According to Ofcom – and numerous press articles - problems have arisen where the consumer has been unable to obtain the cashback, typically either because the terms for claiming are too onerous or because the independent retailer has gone out of business. These practices have been described as *'… the Wild West antics of the cowboys currently infecting the mobile phones sector'* (Site Editor, moneysupermarket.com website).

As Ofcom's consultation stated:

> *Consumers who are mis-sold services can suffer significant anxiety, distress and inconvenience. Financial harm can also occur if consumers find themselves on inappropriate price or service packages. Where the consumer is unable to redeem the cashback deal, significant financial loss can occur, particularly if the consumer isstill bound by the separate monthly contract for the mobile service.*

Although Ofcom's research into cashback deals found the majority of consumers were happy with the offers and ease of claiming, a significant minority of customers have experienced problems with certain deals where making claims is complex or where the retailer has ceased trading. In many of these cases, the amount the customer has not been able to redeem has been large resulting in a significant level of overall harm, according to Ofcom.

Ofcom's consultation on the above proposals ended on 29 April 2008 and its final statement is awaited. It remains to be seen to what extent its proposed action is effective in protecting consumers' interests with regard to mis-selling and cashback deals. However, at least the regulator has decided to intervene and introduce formal regulation, instead of continuing to rely on a voluntary industry code that was clearly ineffective.

Tied into insurance

Meanwhile there continues to be a significant level of concern about the practice of some suppliers (and separate retailers) of pressing consumers to take out specific insurance against the theft or loss of the mobile phone. For instance, Mike Naylor of *Which?* concludes that: 'This insurance tends to be expensive and complicated, and the level of cover varies widely' (Quote from 'Mobiles: is cover worth it?', Helen Loveless, *Mail on Sunday,* 25 September 2006).

The author of the article added that: 'Retailers such as The Carphone Warehouse often offer three months "free" insurance when you take out a phone, but consumers need to sign up for direct debit payments first, and the retailers count on the majority of users forgetting to cancel this after the initial period is up and you start paying.'

In 2006-2007 the CAB service estimated that it received 88,000 enquiries about problems with utilities, of which 23,000 related to communications (including landline and mobile phones plus cable and satellite TV). While all communications areas have witnessed a rise in the number of enquiries dealt with by CABx, certain areas – such as mobile phones – have seen a dramatic rise. Specifically, enquiries about landline telephones for 2006-07 were up by 31% on the previous year, enquiries about mobile phones had increased by a worrying 93% and those relating to satellite and cable TV had increased by 29%. (Citizens Advice Press Notice, October 2007)

Extent and ease of switching

As outlined previously, for most consumers there is in theory a considerable degree of choice of product and service (including tariffs and terms and conditions). In practice, there is more choice in some areas than in others, and none at all for landlines in those areas where local loop unbundling has yet to be enabled and there is no cable coverage.

In practice, choice is also highly conditional on the existence or otherwise of a contract, and on the length and terms of contracts; for example, substantial penalty charges associated with early termination of a contract may well restrict or eliminate choice for many, especially low income consumers.

Research for Ofcom found that the majority of landline consumers considered it difficult to compare and choose between different providers, and felt there was some considerable risk attached to switching (*Consumer decision making in the telecoms and TV broadcast markets,* Ofcom, 2007).

According to the same research, a slightly lower proportion of mobile consumers considered it difficult to compare and choose, and a slightly smaller proportion considered that switching constituted a big risk. By comparison, a much lower proportion of single broadband consumers considered it difficult to compare and choose, but a much higher proportion considered that there could be a big risk in switching. An even lower proportion of consumers with bundled services considered it difficult to compare and choose, but a higher proportion considered that there was a big risk in switching.

Obviously, these were perceptions or judgements and, as with most such attitudinal surveys, they do not represent an ‘objective’ measure of just how easy or confusing it was to navigate through product and service markets. In addition, there could well be a difference in perceptions between those with easy access to switching websites and those without any access.

Evidence about the exercise of effective choice, for instance from the same Ofcom research outlined above, indicates that, although the majority of consumers perceive it to be easy or fairly easy to access information about suppliers, the majority also believe that it is difficult to make comparisons. Broadcast media, magazine and other print media, and the Internet all provide consumers with a great deal of advertising-based information, as do retail outlets, but it can take some effort to distinguish between what is on offer in terms of features and functionality. This task may be particularly challenging for consumers who experience problems with literacy and/or numeracy, and/or for consumers who find it difficult to cope with pressure from sales staff. In addition, much of the sector is likely to be difficult to negotiate for consumers with sight or hearing impairment, for example.

This Ofcom research highlighted the fact that in the landlines sub-sector there continues to be a substantial minority (28 per cent at present) who exhibit no interest in changing suppliers. Some of this may be because some are genuinely satisfied, some because switching is perceived too difficult or not worthwhile, some because they are generally unaware of alternatives. Low income consumers are slightly less likely to have switched landline provider than those in higher socio-economic groups.

There has been little change in recent years in the proportions of consumers who have switched between mobile operators or are interested in switching, and those that are not – though the proportion evincing absolutely no interest in switching has increased to a third. Again, any of the above reasons may apply. There is no significant difference between lower socio-economic groups; there is, however, a marked increase in switching interest among higher-use consumers.

In general, according to an attitudinal study for Ofcom on people living on low incomes, switching activity was somewhat limited due to a general lack of interest, rather than problems relating to financial status; only a tiny minority of those on the lowest incomes had avoided switching due to potential difficulties with credit checks (*Low income consumers and the communications market,* Ofcom, 2007).

Probably because of Local Loop Unbundling (LLU) and exchange enhancements, there has been a marked increase in the switching interest rates for broadband, though there remains a significant minority (25 per cent) who evince no interest in broadband. (LLU is the process whereby BT and Kingston make their local networks available to other companies.) Those in lower socio-economic groups who are not interested in broadband or switching are only slightly less interested proportionately than those in higher groups. As with mobiles in particular, lack of interest is quite strongly associated with age (older consumers tend to be less interested in doing so).

There is a higher proportion of consumers interested in bundled packages, and the proportion evincing no interest at all is smaller, at 21 per cent of the sample surveyed by Ofcom. Age, rather than socio-economic group, is the primary determinant of whether consumers say they are interested or not.

Some low income consumers find it difficult to access any of the services, particularly those on very low incomes and those very heavily reliant on social security benefits according to other Ofcom research (*Low income consumers and the communications market: An attitudinal study into people living on a low income and their experience of communications services,* Ofcom, 2007). Issues included not just affordability, but also the lack of a bank account, having a poor credit history, the lack of a regular wage (making household budgeting very difficult). Ofcom also came to the unsurprising conclusion that few such consumers felt able to pay bills by direct debit. However, low income consumers surveyed by Ofcom tended to evince little interest in switching per se, and not just or solely because of issues like credit checks – though this was undoubtedly an issue for some.

The research report also found that: *'In general* (low income) *consumers appeared to be relatively well informed about the details of their package (free calls and texts) but were very poorly informed about the details of their contract, the implications of missed payments and where to go for help if there was a dispute with an operator.'* And: *'Overall, the most visible effect of low income status appeared to be an avoidance of contract mobile phones.'*

Contract terms and additional charges

Contract terms, especially early termination charges, can obviously restrict consumers' ability to switch to alternative suppliers and can particularly affect people on low incomes. Ofcom has recently consulted on proposals to address problems that have arisen for consumers regarding early contract termination charges as well as non-direct debit charges (*Ofcom review of additional charges,* Ofcom, 2008). The proposals mainly focus on the need for greater transparency for consumers and fairness in levying charges; for instance, the need for suppliers to do more to ensure consumers fully understand their contractual commitment and that consumers understand what they will be charged if they terminate a contract early. On contract periods, Ofcom highlighted the need for suppliers to adhere to the requirements of the Unfair Terms in Consumer Contracts Regulations.

The types of problems consumers can experience with contract periods were highlighted in the response by Citizens Advice to Ofcom's consultation, which included a number of illustrative cases – see examples in box below.

A CAB in Gloucestershire reported that their client originally entered into a contract for landline phone services in April 2007. In August 2007, he moved house and kept his number. In October the client transferred his landline phone to another provider since they offered a better and cheaper service. The client then received a bill from his previous supplier for £161.14, of which only £7.24 is for calls. The client had been charged for line rental up to August 2008 and a £70 early termination 'one-off' fee, and charges for line rental up until the scheduled termination date. The client contacted the previous supplier who stated that he had a minimum 12 month contract running from 16 August when he moved and he has incurred a charge for leaving this contract early.

And: A CAB in Nottinghamshire reported that their client was a customer of her telecoms supplier for several years. When she moved house previously she even moved contract with her. In April 2008 she moved again but her telecoms supplier informed her that they do not operate in the new area. The client is unable to cancel the contract as she has been told that she is in a 12 month contract. The client feels very angry that she was not made aware of this clause at the time the contract was renewed. (Response to Ofcom consultation on additional charges, Citizens Advice, 8 May 2008)

The consultation also covered issues relating to other additional charges (for example, for consumers who receive paper bills and do not pay by direct debit). Such charges are a very live issue in this sector as elsewhere, for instance in the energy sector. Numerous and continuing complaints about additional charges have eventually prompted Ofcom to investigate such charges, though so far it has only proposed to require telecoms suppliers to do more to make sure consumers are properly informed and that additional charges and other contractual terms are set fairly and clearly explained at the outset.

One point of detail may be of interest as well: in terms of the fairness of additional costs, only direct costs can be included. Ofcom does not consider this can include additional costs relating to bad debt.

Ofcom is proposing to issue Guidance about additional charges and expects suppliers of communications services to review their conditions in light of the Guidance and to amend or remove any unfair terms. It remains to be seen whether this approach will be effective. According to Ofcom, although this Guidance does not have binding legal effect, it sets out the approach Ofcom expects to take in performing its obligations and exercising its powers. The regulator states that it expects to take an active role in enforcing the principles set out in the Guidance, and will monitor complaint levels and examine suppliers' standard terms to ensure compliance. Where suppliers do not comply with the Guidance, Ofcom says that it will take the necessary enforcement action, using its powers under the Regulations and/or the Enterprise Act 2002. (Ofcom's consultation on its proposals regarding additional charges closed on 8 May 2008 and a final statement is awaited.)

It is clear that Ofcom regards wider questions relating to distributional effects as a matter for government. In the consultation, Ofcom said that it recognises that there are broader concerns about the fact that low income consumers often pay more than higher income groups. But it considered that the extra amount paid by low income groups in non-direct debit charges in the communications sector is relatively small compared to the extra amounts low income groups may pay in other sectors, and referred to practices of charging different amounts according to payment method in the energy sector among other examples. Ofcom said that it would be happy to engage with government in looking at these wider distributional issues.

It is far from simple to determine whether new customers in the communications sector are likely to get a better deal than existing customers. The evidence on this is primarily circumstantial, and even anecdotal – which in part reflects the dynamic and rapidly-changing nature of the products, services, packages and deals. So this aspect of actual or potential discriminatory pricing is impossible to characterise at present – for instance some broadband deals favour new customers in terms of price and performance, while others (especially some bundled deals) favour customers which already take a service from the supplier (e.g. subscription TV).

Switching and ease of use

Ease-of-use can be a barrier to access and may also influence the extent to which consumers are active in the communications market. Whilst this can affect any consumer, it is of particular significance to consumers with sensory impairments, physical disabilities and cognitive impairments who may find 'mainstream' communications products and services to be inaccessible, unusable, or very difficult to use. Furthermore, there is generally a high correlation between disability and having to live on a low income.

In general, there is some realistic, and usually affordable, choice in relation to landline products – from appropriately designed handsets to enhanced features and functionality (culminating in various 'telecare' and assistive technologies).

Equally, the 'end-product' of broadband access (primarily web-based sites and services, and specialist applications to enhance usability) has received some consideration in order to help access and usability. However, there continue to be many arguments about the adequacy or otherwise of websites, for instance, and of keyboards, screens, readers, voice recognition hardware and software, and about the affordability of such 'enhanced' application software and hardware. Here, there is a degree of choice, though switching remains a problematic issue.

The least developed sub-sector in terms of usability is mobile telephony. For example, there is a clear drive by most of the industry towards loading more and more functions into ever-smaller handsets in order to persuade consumers to keep 'upgrading'. This can make it more difficult for people to work their way through on-screen menus and physically press the right buttons, especially if they have dexterity or sight problems or large fingers! Although there are some handsets on the market that offer larger buttons for example, they are in the minority and can be more expensive than others.

According to a research audit carried out last year for Ofcom on ease-of-use, there are significant numbers of people who are at risk of exclusion due to accessibility barriers. These include those living at home with a limiting long-term condition or disability and those living in care homes. Those with literacy and/or numeracy problems are also at risk, as are those who have little confidence or skill in using new technology (*Ease of use issues with domestic electronic communications equipment, research audit for Ofcom,* George M and Lennard L, Ofcom, 2007). Ofcom has formal duties in this respect which broadly consist of encouraging others to ensure ease-of-use, but it has no powers. Consequently, the regulator is currently considering the most effective ways of proceeding to ensure greater usability and wider access to easy-to-use equipment.

Finally, it is worth highlighting some findings from recent research published by the Scottish Consumer Council into switching behaviour across a range of sectors, including telecommunications and energy. This concluded that:

> *although many people say that they find it hard to compare products and services on offer, the amount of time that they actually spend on making these comparisons is very short. In the energy and telecoms markets in particular, the majority of switchers generally spend only a few minutes in deciding. This raises concerns about whether consumers are really choosing the cheapest and best option for themselves, and it is especially worrying as people on low incomes can least afford to miss out or make the wrong choice. (Making markets work for Consumers in Scotland – everyone benefits,* Scottish Consumer Council, 2008

Market characteristics

There are various estimates of the size of the sector, partly dependent on how many sub-sectors are included.

One report put the overall turnover of the UK's telecommunications services industry (excluding radio and broadcasting, and telecommunications equipment) at £47 billion in 2006. Of this, over £38.6 billion was attributable to end-user (retail) spending - the remainder being wholesale services. Growth was concentrated in mobile services, which grew by £900 million over the previous year, offsetting a decline in fixed voice market revenues of £400 million.

There is still some growth overall in revenues across telecoms. As some sub-sectors flatten off or decline, others grow; for example, the mobiles sub-sector is commonly regarded as having reached saturation point with an estimated 71.7 active subscribers, yet the introduction of various new functionalities and services may mean that total mobiles revenues will not flatten off (*United Kingdom – Market Intelligence Report,* September 2007 *http://www.itireports.com/cma_uk.htm*). It is far more difficult however to estimate both the size and trajectory of profitability or of other key financial performance indicators.

In most parts of the sector there has been and continues to be a substantial amount of industry restructuring and reorganisation. For example, during 2005/06 there were major deals involving ntl and Telewest, which went on to acquire mobile virtual network operator Virgin Mobile later in the year and the rebranding of the whole operation as Virgin Media. Then, for example, BskyB acquired fixed-line broadband operator Easynet; Cable & Wireless acquired corporate services provider Energis; Carphone Warehouse acquired Tele2 UK and Ireland as well as One.Tel, and then went on to acquire AOL Time Warner's Internet access business in the UK.

There have also been many changes in the mobiles sub-sector, with new entrants and deals between existing suppliers. At least some of industry changes have been driven by the bundling of products, as many companies are increasingly seeing this as their main way forward (alongside longer-term customer contracts).

The UK landline market was worth £9.3 billion at the end of 2006, with just over 34 million total voice connections including VoIP. Industry analysts anticipate a continued decrease in fixed-line connections as consumers and businesses continue to replace usage of fixed-line telephony with that of mobile and VoIP telephony. They expect a surge in take-up of VoIP connections amid growth in broadband connections which, they maintain, will more than offset the decline in fixed-line connections. Here, too, there have been many new entrants (*UK Fixed Telecoms Market Statistics,* 2001-2010, Centre for Telecoms Research Ltd., Jan 2007 *http://www.researchandmarkets.com/reports/c52873*).

Pricing and costs

Fixed line telephone services

The average price of like-for-like telecom services has been declining. Ofcom estimated that, in 2006, costs to consumers were 13 per cent less than they were in 2005, and 38 per cent less in real terms over the past five years (*The Communications Market 2007,* Ofcom). The average weekly household spend increased by 6.6 per cent between 2002 and 2006, while the consumer price index increased by some 10.5-11 per cent. Obviously, both service type(s) and usage have a big impact on the final bills for consumers, but in general it seems that Ofcom's contention that competition is driving prices down (in the short to medium term) is correct.

However, some prices have gone up recently, but the overall effect is difficult to ascertain because of changes to companies' pricing packages. These developments emphasise the problems for customers who are trying to choose the cheapest option that will suit their needs, and also highlight the increasing difficulties when attempting to track price changes over time.

For instance, from April 2008, the cost of daytime calls under BT Together Option 1 - renamed as its Unlimited Weekend Plan – increased by 23 per cent according to uSwitch.com. But customers receive free evening and weekend calls if they sign up to a 12 month contract, otherwise evening call charges have also been increased. Line rental charges increased by 7 per cent (uSwitch.com press release, 1 February 2008). On the other hand, the cost of BT Together Option 3 (renamed Unlimited Anytime Plan) is going down by 25 per cent. Changes to Virgin Media's charges made in October 2007 adversely affected customers who are not on an all-inclusive pricing package for their fixed line phone.

No direct retail price controls now exist, following Ofcom's strategic review of telecommunications in 2005. This concluded that there were enduring economic bottlenecks, that is, parts of the network where effective and sustainable competition was unlikely in the short to medium term. Ofcom adopted the principle that regulation should promote competition between competing infrastructures as deep in the network as such competition was likely to be effective and sustainable. However, companies who wished to compete on this basis had to rely on BT for access to parts of the network where competition was not sustainable. Consequently, Ofcom concluded that in order for competition in fixed telecoms to be effective, BT needed to make such access available on the same terms as it made it available to itself through equality of access.

Ofcom's decision was underpinned by a key principle of the EU regulatory framework, that downstream markets should not be subject to ex ante regulation where remedies imposed in upstream wholesale markets are sufficient to ensure effective downstream competition. Ofcom has stated that this principle is significant because it means that, once equality of access to upstream bottlenecks has been achieved, steps can be taken to remove ex ante regulation in downstream retail markets, according to Ofcom (*Final statements on the Strategic Review of Telecommunications, and undertakings in lieu of a reference under the Enterprise Act 2002, Statement, Ofcom 2005*).

Ofcom decided to allow retail price controls on BT to lapse on their expiry on 31 July 2006. These controls had been in place since BT was privatised in 1984. Ofcom's reasoning was that retail price regulation can have an impact on the wider market (e.g. possibly restricting tariff innovation). BT will be in a similar position to all other communications providers and will have the ability to set the price of their services in response to competitive conditions in the retail markets. (Previously, the retail price controls for fixed line phones had, since 2002, regulated the price of local, national and international calls, calls to mobiles, operator assisted calls and exchange line rental. The controls were arrived at by a weighting process based on the expenditure on these different call types by the 'bottom' four-fifths of customers as determined by their total phone expenditure.)

Ofcom has also looked at the future of BT's geographical pricing and has concluded so far that, although competitive conditions may vary between different parts of the UK, such variations have not been considered sufficient justification for the identification of separate markets. Many regional and national authorities expressed concern that such a move could accentuate the digital divide, and that those areas with lower customer densities would end up with less competition and higher prices. Interestingly some service providers pointed out that it was essential that they could cover the whole of the UK with the same product, and they pointed out the practical difficulties of gathering sufficient information to define such geographic markets correctly, and thereafter to investigate any anti-competitive behaviour. Ofcom has stated that it will continue to adopt a case-by-case approach to market definition based upon geography.

Mobile phone services

Price controls continue to exist on charges for wholesale call termination on mobile phone networks (there are no controls on retail charges for mobile services).

Wholesale call termination relates to the service provided for a network operator to connect a caller with the intended recipient of a call on a different mobile network. The service is sold and purchased by mobile network operators (MNOs) rather than retail customers. The UK operates a 'calling party pays' system, which means that the cost of the call is paid for by the calling party. Mobile call termination charges are paid in the first instance by the originating network operator to the terminating operator, and are an element of final charges for consumers.

The price controls have been periodically reviewed over the years. The last review and consultation in 2007 resulted in Ofcom deciding that:

- There are separate markets for the provision of wholesale mobile voice call termination in the UK to other communications providers by Vodafone, O2, Orange, T-Mobile and H3G.
- Each of the five MNOs has significant market power (SMP) in the market for termination of voice calls on its network(s)
- Charge controls should be imposed on the supply of mobile call termination by each of the five MNOs, and those controls should apply without distinction to voice call termination whether on 2G or 3G networks.
- The charge control should apply for four years from 1 April 2007.
- The charge controls were reduced year-on-year (implemented in four equal percentage steps across the four years).

(*Mobile call termination Statement, Ofcom,* 2007)

Other conditions imposed by Ofcom cover the provision of voice call termination on fair and reasonable terms and conditions (including contract terms), prohibiting undue discrimination, and charge transparency.

In 2008/9, Ofcom is assessing its approach to the mobile sector with two main objective. First, it will consider possible approaches to the future regulation of the mobile communications sector, including scope for the promotion of competition and the reduction of regulation. Secondly, the assessment will aim to define the principles that will inform Ofcom's work for the next phase of the market's development (*Ofcom Annual Plan 2008/9, Ofcom,* 2008).

From the consumer standpoint, the fundamental point is that there is no consumer choice about the mobile network that a call terminates upon: there is no alternative if someone has to call another person on a mobile number. In some instances, consumers may get together and decide to use the same mobile network, but this is hardly a solution to the issue as they may still have to phone someone who uses a different network. A key issue for consumer organisations is the lack of transparency regarding the composition of mobile phone charges, particularly the justification for the levels of wholesale call termination.

Extent of problems for low income consumers

The Government's latest figures on household spending show that, whilst prices have tended to fall, there is still a considerable difference in what is spent by lower income consumers, compared with those on higher incomes (*Family Spending 2007 Edition,* Palgrave Macmillan, 2008). Under the COICOP category of 'communications', the average household spent, in 2006, £11.70 per week, 3.1 per cent of total COICOP spending.[1]

'Household expenditure by gross income decile group, 2006 based on weighted data and including children's expenditure' (Table 3.2) showed the following:

£5.70pw in lowest decile,	3.7% of total expenditure
£6.80 next "	3.4%
£8.50	3.1%
£9.40	2.8%
£12.10	3.2%
£12.00	2.7%
£13.80	2.7%
£14.80	2.5%
£16.70	2.3%
£17.80 among highest decile,	1.8%

'Household expenditure by gross *equivalised* income decile group, 2006 based on weighted data and including children's expenditure' – showed the following (Table 3.2E):

£8.20pw among lowest decile,	3.6% of total expenditure
£7.50 next "	3.3%
£9.20	3.0%
£10.50	3.0%
£12.70	3.0%
£12.60	2.9%
£13.30	2.5%
£13.60	2.4%
£14.40	2.3%
£15.40pw among highest decile,	1.7%

1 'COICOP' (Classification of Individual Consumption by Purpose) is the new classification system which was designed for the Retail Prices Index (RPI). It is an internationally agreed classification system for consumer expenditure and prices, so bringing the UK in line with many other countries.

Whether or not the equivalised adjustment is made, it is clear that the average household spend on communications reflect in some part income differences. But it also reflects, in part, some degree of inelasticity in demand for communications services. In this complex and rapidly changing sector it is near-impossible to estimate a realistic price elasticity of demand. For example, low income households may well not access some types of product or service, or only do so to a minimal extent - yet some high income consumers behave in the same way. Equally, some degree of access to more than one or two services may be deemed essential by some low income consumers, though possibly with great care being taken to minimise variable costs through minimal usage. So whilst communications services are cited frequently as essential services, what one consumer may regard as an essential product or service, another may not.

The situation is complicated further by technological and marketing driven changes in people's expectations. For example, in September 2007, the 'Dare to Care' campaign (to end child poverty) presented the results of a survey of children aged 7-16 on their understanding of what being poor means. A fifth of children thought having a mobile phone was just as important as having a book to read at home, the lack of either being a sign of poverty. Forty-seven per cent of children from East Anglia and 37 per cent of children from London thought that not having a mobile phone makes you poor (UK average - 19 per cent).

There is, of course, the big issue of the 'digital divide', which is often viewed by Government and others as an indicator of social inclusion or exclusion. Obviously, the pressures to roll out universal access to digital media – of which broadband is a critical element – have affected people's expectations, not just their aspirations. Not being digitally connected has increasingly taken on quite negative connotations. This cultural shift no doubt places extra pressure on many low income consumers (especially households with children and teenagers, as Ofcom's research shows) to find some way of being able to access services other than voice calls and SMS.

The disconnect between these sorts of current expectations and what the industry and, indeed, Government do to assist low income consumers is profound. Suppliers in the mobile market point to the fact that many lower income consumers find that their PAYG deals suit people's needs, though they are more coy about the higher tariffs usually associated with PAYG. At the same time, these and other suppliers are continually pressing consumers to buy on contract, to buy products and services with additional functionalities, and to 'take advantage' of all kinds of bundled deals.

Ofcom has expressed concern that, while take-up of digital technologies continues to grow, there remain differences in take-up levels between different consumer groups. Its current annual plan states that Ofcom will need to analyse carefully any existing barriers to take-up and ways of encouraging use, especially for vulnerable groups including older people and disabled consumers. Ofcom also intends to consider the availability of new platforms and services, such as next generation access broadband services and mobile TV, and the implications for accessibility and take-up of services among all consumer groups (*Ofcom Annual Plan 2008/9,* Ofcom, 2008).

Help for low income consumers

There is no direct State help available through social security benefits to assist people on low incomes with the cost of telephone bills. The only mechanism at present which seeks to address the issue of reasonable access to affordable telephone services is through the universal service framework.

Regarding regulatory protection for consumers, Ofcom's principal duty is to further the interests of citizens in relation to communications matters, and to further the interests of consumers in relevant markets, where appropriate, by promoting competition (according to the Communications Act 2003). In performing these functions, Ofcom is also required to have regard to 'the needs of persons with disabilities, of the elderly and of those on low incomes'.

Universal service obligations

The legislative and regulatory frameworks for electronic communications include provisions for a basic level of universal service in telecommunications, based on the EU regulatory framework (see below). This is limited to fixed line telephony, although there are ongoing debates about whether universal service obligations (USO) should be extended to include mobile or broadband services. Ofcom has described Universal Service as providing 'a safety net that ensures basic fixed line services are available at an affordable price to all citizens and consumers across the UK' (*Review of the Universal Service Obligation,* Statement, Ofcom, 2006).

Following the adoption in recent years of EU directives on electronic communications, BT has continued to be the national universal service provider, as it is deemed by Ofcom to have Significant Market Power (SMP) for the provision of certain electronic communications services in the UK. (The Kingston Communications Group has similar obligations for its sphere of operations in the Hull area of East Yorkshire; this report focuses on BT's obligations as the national USO provider.)

The UK legislative context is contained in the Communications Act 2003, the framework for which is derived from the EU directives on electronic communications that include universal service and users' rights. The Secretary of State for BERR specifies the services that must be provided throughout the UK in the Universal Service Order, which is implemented by Ofcom through specific conditions on BT and Kingston Communications.

Looking at what the USO currently provides, a key aspect is the requirement on BT to provide a connection upon reasonable request and at uniform prices, irrespective of geographical location. There is a degree of leeway for BT to set non-uniform prices for new connections: where installation of a new line costs £3,400 or less, BT sets a standard charge, but Ofcom has agreed that BT can charge non-uniform prices above £3,400. Ofcom has published guidance which, amongst other things, suggests BT applies the standard charge when costs exceed £3,400 for particularly vulnerable customers.

The obligation to provide a connection upon reasonable request includes the provision of a narrowband connection capable of 'functional internet access' at a benchmark minimum speed, which remains at 28.8 kbit/s following Ofcom's universal service review in 2006. Ofcom also looked at how the USO might need to evolve in response to changes in the telecoms market, through its Telecoms Review.

At the time, Ofcom concluded that there was not a strong case for extending the USO to include broadband services. Whilst the regulator recognised that low income consumers may have difficulty affording broadband services (or indeed a PC to receive them on), Ofcom maintained that lack of access does not currently result in social exclusion sufficient to warrant universal service measures being introduced to address affordability issues (*Final statements on the Strategic Review of Telecommunications, and undertakings in lieu of a reference under the Enterprise Act 2002, Ofcom,* 2005).

Similarly, Ofcom looked at whether a separate USO should be imposed regarding mobile services and concluded against doing so. However, Ofcom did acknowledge that a universal service obligation defined in terms of access to voice services could be delivered via a mobile connection once issues are addressed around the affordability of calls to and from mobiles and the provision of functional internet access. But, in terms of affordability, the regulator argued that the market was already delivering service packages, typically in the form of pre-pay, affordable by lower income consumers.

Other aspects of the USO include reasonable geographic access to public call boxes, and services for disabled people such as the provision of a text relay service for people with hearing impairment, free itemised billing, and the provision of bills and contracts in alternative formats for any customers whose disability prevents them from reading the bill or contract.

The USO is currently funded by BT (and Kingston) as Ofcom, and previously Oftel, have not considered that the obligations represent an unfair burden on the companies. Ofcom periodically examines the costs and benefits to BT of providing USO and estimated in 2006 that the USO cost BT around £57 million to £74 million and the benefits to BT were £59 million to £64 million. Ofcom concluded that these estimates were reasonable and that there was unlikely to be an undue financial burden currently on BT as a result of USO.

Ofcom plans to carry out a net cost assessment of the extent of the 'burden' of USO at some stage, although it is not currently scheduled for 2008/9. There may be an Ofcom consultation later this year on how a universal service fund might operate (this could arise if it was decided that the net costs for BT were higher than the net benefits). It is also worth pointing out that Member States can ensure that additional USO services are provided, but these cannot be funded by a levy on the industry.

Help with affordability

The ability to obtain a telephone service, and to remain connected, are meant to be integral aspects of Universal Service. Article 9 of the EU Universal Service Directive says that Member States may require universal service providers to provide tariff options or packages to consumers that depart from those provided under normal commercial conditions, in particular to ensure that those on low incomes or who have special social needs are not prevented from accessing or using publicly available telephone services. (This is reflected in the UK through the Universal Service Order and the Universal Service Condition.)

Consequently, BT has an obligation to provide one or more schemes for consumers who have difficulty in affording fixed line telephone services. These currently consist of the Light User Scheme (LUS) and In Contact (IC). Around 60 per cent of current LUS and IC members are from low-income households according to Ofcom, and around 1 million consumers are estimated to be on LUS. These schemes are not means tested and theoretically employ a proxy of low use to attract low income customers.

For LUS, normal line rental charge and installation costs apply, but users receive a rental rebate if call charges are less than a specified amount per quarter. IC combines post and pre-pay and has around 55,000 customers. Calls are pre-paid using cards available at selected retailers and cost a flat rate of 10p per minute, plus a set-up fee of 3p. But the connection charge and line rental are billed for and are post-paid. In Contact Plus is intended to offer a low cost alternative to the standard telephone service, and allows people to receive calls and to make emergency calls. They can make calls if they buy the BT In Contact Card. It costs £10.97 a quarter (including VAT). If people are not already connected, BT will install a telephone line for £9.99. People who are already BT customers also have to pay £9.99 as a 'conversion fee'.

One of the main drawbacks of In Contact is the somewhat tortuous process for making calls. To do so, customers have to dial 14257 and then also enter their nine digit pin number, a voice prompt then tells them how much credit they have and, assuming they have enough and wish to continue, they can then enter the number of the person they are calling.

BT has developed a new scheme, known as 'BT Basic', with the intention that this will eventually replace the existing LUS and IC schemes. The background is that BT and Ofcom do not consider that the current schemes are properly targeted at consumers on low income. In particular, concerns have been raised that LUS is used by some better-off consumers with second homes.

An income-based approach was originally proposed to determine eligibility for BT Basic, but Ofcom felt this would be intrusive as it would require BT to establish customers' income and also raise difficulties in choosing appropriate income levels. The end result is that eligibility for BT Basic depends on receipt of income-related benefits: Income Support, Pension Credit and Jobseekers Allowance (the criteria were extended to include

Jobseekers Allowance following consultation). BT and the DWP have agreed a consent statement on the application form which will allow BT to share with the DWP the information that the customer has provided and, in turn, for the DWP to confirm back to BT whether this information matches their data. BT states that the information will only be used for this purpose and the DWP will not provide any data to BT that has not already been provided directly to BT by the customer (e-mail from BT, 22 May 2008).

The launch and roll-out of BT Basic have been much delayed, and the scheme had not been launched at the time of writing. However, information on it is available on BT's website, which describes BT Basic as:

> *a social telephony scheme for customers who are in receipt of certain state benefits and who meet the criteria set out in the eligibility criteria. A customer has to make an application for the service which will be verified by the Department for Work & Pensions. If an application is refused for any reason a customer will not be able to re-apply for BT Basic for a minimum period of six months.*
>
> *BT will periodically verify with the Department for Work & Pensions a customer's continuing receipt of these benefits and may withdraw BT Basic or transfer the customer from BT Basic to Unlimited Weekend Plan when they are not eligible. If BT does this it will give the customer 30 days notice.*
> (Source: http://www.serviceview.bt.com/list/public/current/Cust_Opts_Res_boo/FrameworkImpl55289.htm)

Apart from the main criteria that people have to be in receipt of qualifying benefits, there are other factors that will prevent people from being eligible for the scheme. For instance, BT Basic will not be available if the consumer or anyone else in the household has a fixed telephony service from another supplier, or if the household has more than one line at the same or different address. There will be some exceptions, for example when the customer is paying for a line at the home of a family member. Also chronically sick and disabled customers (BT's terminology) who have a second line within the property, which is used or registered for their carer, will be exempt from this exclusion). The scheme will also not be available if the customer or anyone else in the household has a contract mobile phone or a mobile phone with high 'pay as you go' usage (defined as more than £10.00 per month on average!).

How much it costs

Line rental: £13.50 per quarter (including VAT). This includes a quarterly call allowance of £4.50, which roughly equates to about 45 minutes of national/local calls.

BT Basic is only available with quarterly billing.

Call charges: The charges will be 10p per minute (inc VAT), plus a 3p set-up charge per call, for local and national calls; BT Unlimited Weekend Plan charges for other calls.

A connection charge will only apply to new BT customers where a line does not exist, payable over five separate payments.

Ofcom is keen to promote take-up of the new scheme and has said that, to allow BT to focus its marketing on the new scheme, the existing LUS and IC schemes will not be available to new customers when it is launched. Moreover, in order to give BT an incentive to promote the new scheme, access to LUS or IC schemes for existing customers will continue until BT Basic has at least 600,000 customers. Ofcom has said that it intends to monitor take-up, customer reaction and the impact of the new scheme.

BT also has a pre-pay scheme, known as 'Pay&Call', aimed at helping customers in payment difficulties, but is not part of their formal USO. Around 50,000 customers are currently on this scheme. Customers pay into a 'moneybox account' to pay for their calls and for line rentals, so money will be deducted periodically even if they do not make any calls. Their account can be topped up with a debit or credit card, or through the BT Pay&Call Payment Card, which can be used at PayPoint outlets but not at Post Offices. Calls are charged at the BT Together option rates.

If a customer's account, or 'moneybox', is empty they cannot make outgoing calls (except to emergency or freephone numbers) but they can receive incoming calls. If they don't top up the account and a rental payment or debt repayment is deducted, then they have 21 days to top up the account. Otherwise they will no longer be able to receive incoming calls and BT will add an Administration Fee to the debt. After a further 14 days, they will be disconnected if they fail to make a top-up.

Effectiveness of tariff schemes

Although in theory the recognition of the need for affordable tariffs in the universal service obligations is welcome, in reality what is on offer is extremely limited. The Light User Scheme crudely equates low income with low use. LUS provides limited assistance that is of some help to some people with very low telephone usage, but clearly it does not help consumers who are on low incomes and whose calling pattern takes them over the LUS threshold. The call charges for In Contact are expensive and the only benefit is the availability of a pre-payment option for call charges. It should also be noted that there are practical barriers to using the scheme as customers have to put in a lengthy pin number before dialling each call.

Eligibility for LUS and In Contact does not depend on income-related benefits in contrast to the new BT Basic scheme. Although the eligibility criteria are wider than originally proposed by BT as a result of lobbying by consumer bodies and advice agencies, BT Basic suffers from the flaw of being based on means-testing. This crucial aspect is likely to exclude a number of people on low incomes who experience problems with the affordability of telecomm charges. For instance, there are enduring take-up problems with benefits such as income support and pension credit, which mean that many people who are eligible do not apply. In addition, many people fail to qualify for income-related benefits even though they are on low incomes, for example because their income is just above the threshold.

It remains to be seen whether BT Basic makes a significant difference to the affordability of fixed line telephone services for those who are eligible and decide to apply for the scheme. In certain respects, the scheme offers some advantages as there will be no additional non-direct debit charge and it will be open to consumers who have prepay mobile phones (albeit with a usage threshold) and/or broadband services.

However, it is questionable whether the quarterly call allowance for BT Basic will be sufficient to meet some consumers' needs without them having to pay high call charges beyond the threshold that has been set. Concerns also arise about how easy it will be for consumers to make informed decisions regarding whether they should apply for the scheme in the first place. People will need to have some idea of their calling patterns and future needs, which may be particularly difficult if they are a new customer, or be able to compare the scheme with any current arrangements if they are already have a fixed line phone. Moreover, it is extremely difficult – if not impossible – to make meaningful comparisons between the cost of the BT Basic scheme and PAYG mobile tariff deals, due to the complexity of the latter.

Another concern is that the scheme still requires a quarterly payment for line rental, which some consumers will regard as a standing charge and resent paying, according to Age Concern. In addition, the exclusion clauses could potentially place consumers at a disadvantage, for example a consumer on a low income who has a non-dependent child living with them who has a mobile phone on contract.

The agreement that BT has reached with the DWP to verify that customers are in receipt of qualifying benefits appears to be inevitable because of the way that the criteria have been drawn up. However, this raises questions about whether it is acceptable for a private company to be able to check an individual’s personal information, even if the consumer has given prior consent.

Protection against disconnection

The Universal Service Directive puts an obligation on Member States to authorise specified measures to cover non-payment of bills. This is also reflected in the USO Order and implemented via General Condition 13 on providers. This states that when providers take steps relating to disconnection they should be: proportionate and not unduly discriminatory; give due warning beforehand of service interruption or disconnection; and confine any service interruption to the service concerned, as far as technically feasible, except in cases of fraud, persistent late payment or non-payment. Providers have agreed a voluntary code of practice with Ofcom which explains how they will deal with customers who may be liable to disconnection.

Despite the existence of these provisions, BT’s disconnection figures have remained high over the years. Its disconnections are reported according to two measures: 'temporary disconnection' where the customer cannot receive or make calls but remains a BT customer; and 'permanent cessation', which follows a few weeks later if payment is still not made or a payment plan agreed. For a number of years, BT’s rate of residential disconnections has stayed at around 1 million temporary disconnections per year, with around 680,000 permanent disconnections.

According to BT’s voluntary Code of Practice (for residential customers and small businesses), BT encourages customers to contact the company as soon as possible if they are in payment difficulties and says it may be able to arrange repayment plans or access to schemes such as ‘Pay&Call’. However, the code is voluntary and it is not at all clear what efforts BT makes in practice to find out customers’ circumstances and offer them appropriate and affordable means of dealing with payment problems and staying connected.

During its last consultation on universal service, Ofcom said that BT’s disconnection levels could be significantly reduced if BT promoted its special schemes, in particular its pre-pay products, more effectively. BT had set itself a target to have 180,000 customers on Pay&Call during 2006. Ofcom stated that if this target was not met and similar growth not sustained in subsequent years, Ofcom would consider proposing, as part of the next universal service review, that BT puts in place alternatives to disconnection, such as placing customers on prepay instead of disconnection, or restricting service rather than fully disconnecting (*Review of the Universal Service Obligation,* Statement and further consultation, Ofcom, 2005).

In the final statement following the consultation, Ofcom reported that BT had recently reviewed its credit management procedures and increased its marketing of schemes such as prepay to help customers in payment difficulties (*Review of the Universal Service Obligation,* Statement, Ofcom, 2006). However, the latest indications are that, instead of being reduced, disconnections of residential customers have risen slightly.

People with a disability who are reliant on a fixed line service, and are eligible for the free priority Fault Repair Service or the third party ‘protected service’ scheme (whereby bills are sent to someone nominated to act on the person’s behalf), should not be automatically disconnected. However, disconnection can still take place if a customer persistently fails to pay their bill.

Public call boxes (PCBs)

Under the USO, BT is required to ensure the adequate provision of PCBs to meet the reasonable needs of end-users in terms of numbers, geographical coverage and quality of services. When consulting for the USO review in 2006, Ofcom's research showed that over a third of adults used PCBs at least occasionally and 7 per cent used them regularly. The most frequent users were younger consumers, consumers from lower income groups, and people with a mobile phone only or those without a fixed or mobile telephone.

The review of universal service also reported that revenues from BT's PCBs have been falling and that, according to BT, about 60 per cent of its PCBs are now unprofitable. However, Ofcom also reported that BT Payphones was a cash positive and profitable business: the contrast between the continuing profitability of the business overall while revenues are declining reflected BT's success in maximising the profitability of parts of its PCB network. Many PCBs in city centres are highly profitable, while others primarily in rural areas are highly unprofitable (*Review of the Universal Service Obligation,* Statement, Ofcom, 2006).

BT has undertaken a 'rationalisation' programme aimed at reducing the number of unprofitable PCBs and has removed about 28,500 between 2002 and 2006. BT and Kingston have to follow Ofcom requirements regarding notification and representations before they remove the last PCB from a site. The way that a 'Site' is defined is clearly critical. It was originally defined as any area within a walking distance of 100 metres from a PCB. This meant that if there were two PCBs within 100 metres of each other, one PCB could be removed without consultation. Ofcom subsequently decided to increase the definition of a site to 400 metres, which it described as about five minutes' walk at normal walking pace.

Also, BT and Kingston were allowed greater flexibility to use cashless PCBs - up to 30 per cent of PCBs can be cashless. Ofcom has published guidance on procedures for PCB removals, including factors to be taken into account by public bodies when considering requests for PCB removal.

European Commission review of universal service

The EU framework for regulation of electronic communications services, including the directive on universal service and users' rights, is under review by the European Commission. The Commission's proposals are currently under discussion in relevant Committees of the European Parliament, and include:

- Measures to increase the transparency of information on tariffs and offers available in the market. BEUC (the European consumer organisation) has welcomed this proposal but expressed concern about the Commission proposal for more extensive transparency requirements for 'universal services' than for other services, which could, for example, be broadband services and mobile telephony.

- New provisions intended to facilitate change of suppliers and, in particular, that number portability has to be executed in one working day. BEUC has pointed out that this provision does not address the issue of long term contracts, which can prevent consumers switching. BEUC has proposed that the universal service directive should be strengthened to ensure that the duration of contracts does not act as a disincentive to switch operators, and that the maximum duration of contracts should not exceed 12 months.

- The establishment of a European Electronic Communications Market Authority (EECMA). According to the Commission, the intention is that it would complement at European level the regulatory tasks performed by the national regulators and to take over the work of the existing advisory European Regulators Group (ERG). However, the prospects for this proposal appear to be slim. (At the time of writing, a counter-proposal had been suggested in the European Parliament of a independent advisory Body of European Regulators in Telecoms (BERT).)

- Alternative dispute resolution: the Commission is proposing to amend the requirement for Member States to ensure the availability of out-of-court procedures (that are transparent, simple and inexpensive) so that ADR bodies provide relevant information for statistical purposes to the Commission and to EECMA.

(*Proposal for a Directive of the European Parliament and of the Council amending Directive 2002/22/EC on universal service and users' rights* COM(2007) 698 final, 13.11.2007, European Commission)

BEUC has also proposed that consumers should be able to limit the amount they are willing to spend on a service in any given time period. Their proposal is that this service should not only be available through prepayment but it should also be offered to users of subscription-based mobile, broadband and landline services. Consequently, operators would have an obligation to alert/notify consumers in case they exceed their limits or if abnormal calling patterns occur. Also, as consumption patterns may change over time, BEUC has suggested that, as is the case in theory in Belgium, operators should be obliged to present, at least once a year, a 'best offer' advice to consumers, based on the consumer's consumption patterns the previous year (*Towards a Neutral, Secure and Consumer Friendly Telecommunications Sector, BEUC's views on the Commission's proposals to review the regulatory framework,* BEUC, 2008).

In parallel with the review of the universal service and other electronic communications directives, the European Commission is looking at the scope of services that should be included; for instance, whether USO should include access to broadband and the internet. It is possible that a Communication on this issue will be published towards the end of 2008, but its timing and nature are uncertain, especially because of the impending European Parliament elections next year.

Lessons for the energy sector

The evidence is very clear, that almost all consumers regard access to and use of communications services as essential for everyday life. However, average household expenditure on communications services is lower than that for other sectors, such as energy (less than 4 per cent of weekly household expenditure). This does not, of course, detract from the essential nature of communications services, particularly telephony. For some low income consumers, expenditure on telephony may be higher as a proportion of their total household spending. Moreover, although there is not a firm evidence base, it is very likely that some consumers limit their spending on communications for reasons of cost.

Compared to most other sectors, the communications sector – including broadband services – has been transformed in many ways through rapid and substantial technological developments which have resulted, not only in new types of service and equipment, but also an expansion in platforms and models of service delivery. Many of these developments did not originate from competitive pressures but from technical advances, although competition has clearly had an impact, especially in more recent years. Consequently, it is extremely difficult to separate out the effects of competition from those of technological change, and the benefits for consumers in general and low income consumers in particular.

No direct assistance measures currently exist to help consumers with the costs of electronic communications services through the social security system. However, there is an overt recognition of the essential nature of communications services in the universal service framework at EU and national level but only with regard to fixed line telephony. The framework aims to ensure that all consumers have access to affordable landline telephony services and that all reasonable requests for connection can be met by at least one provider.

It is important to note the explicit and quite eminent inclusion of the term 'affordable' in the USO framework. In addition, national regulatory authorities are meant to monitor the evolution and level of retail tariffs, which come under the USO, in particular in relation to consumer prices and income. Another key aspect of the USO framework is that Member States are able to require USO providers to employ geographical averaging across their territory.

Consequently, BT – as the national USO provider – is still required to provide geographically averaged prices. Otherwise, although some specific schemes are currently offered by BT as part of its universal service obligations, their scope and effectiveness are highly restricted. The launch and roll-out of their proposed replacement – the new BT Basic scheme – has been much delayed and is also quite limited in scope. It is doubtful – as this paper outlines – whether the existing schemes or the new BT Basic scheme will make a significant difference to the affordability of landline telephony for many people on low incomes.

It should be pointed out that, whilst the cross-subsidy entailed in USO tariff schemes is accepted in principle by the EU and UK legislative and regulatory frameworks, in practice this has led to an assumption that the cost of such schemes should be restricted in order to protect the interests of consumers in general. As a result, the effectiveness of these schemes is likely to continue to be limited unless this approach to cross-subsidy changes fundamentally.

A related point is that the regulator has consistently concluded over the years that BT derives a net benefit from being the national USO provider. If Ofcom decides in the future that this is no longer the case, there is the theoretical possibility under EU framework for levies on other undertakings (possibly through a universal service fund) and/or for the costs to be recovered from public funds.

Ostensibly the communications sector appears to be highly competitive and is offering the consumer extensive choice between providers, and between service and product options and bundled/packaged deals. However, marketing-led business strategies dominate the sector and have resulted in a plethora of deals and offers for consumers. The resulting complexity and lack of transparency can make it difficult for consumers to reach an informed decision. This point is particularly important with regard to low income consumers who, for example, may not have access to comparison websites.

Ofcom's duties do include the need to have regard to the interests of low income consumers among other groups, and it is aiming to develop a better understanding of the experiences of people on low income with communications services. A crucial point that needs to be borne in mind is that, compared with other regulators, Ofcom has a very wide remit which encompasses citizen as well as consumer issues, and broadcasting as well as other electronic communications services. This gives rise to questions about the adequacy of its resources in covering a complex sector that is not only vast, but subject to rapid change and which has many industry players.

Ofcom is becoming more exercised about the need for greater clarity regarding tariff structures and related deals. In its first couple of years, Ofcom was much more wedded to the notion that all problems would be solved by competition. In the last year or two, however, Ofcom has been demonstrating a greater recognition that there are barriers and other problems facing consumers that require some form of regulatory action, such as mis-selling.

Ofcom has become more pro-active in seeking to gain a better understanding of consumers' needs, circumstances and concerns, including those of low income consumers. At the time of writing, it is understood that Ofcom is looking at providers' disconnection practices, including their use of debt collection agencies. The regulator is also currently looking into the causes of consumers receiving unexpectedly high bills and what can be done to reduce the impact on consumers.

In terms of substitutability, it is difficult to draw straightforward conclusions as people have different needs and expectations regarding communications services. For some people, mobile phones have replaced fixed line telephony. For others, they may have both services, whilst some may not want to have a mobile at all. It is clear, however, that pay-as-you-go mobiles provide some low income consumers with a potentially affordable service where usage and bills are more under their control and there are no standing charges such as line rental. However, as with energy PPMs, some may be forced to restrict or ration usage on cost grounds. It is also the case that pay-as-you-go services tend to be more expensive than contract mobiles – another parallel with energy.

In the short to medium term, prices have appeared to be static or declining in this sector. But this needs to be qualified by the fact that some consumers might find their bills increasing because of providers, such as BT re-packaging and re-configuring their 'deals'. As a result of the complexity and ever-shifting nature of the marketing of communications services, it is difficult to ascertain whether new customers are getting better deals than existing customers. This is also exacerbated by the drive by many providers to lock both existing and new customers into longer-term contracts, and sometimes to offer better terms to existing customers who may be subscribing to a particular service.

The sector is also increasingly characterised by the bundling of multiple services and sometimes equipment such as mobile handsets, which can make it very confusing for consumers to choose the best deals for their needs. This can include not only communications products and services but also, for example, supermarket voucher and discount schemes, which may be especially of interest to low income consumers.

Consumers also have to chart their way through some quite complicated and detailed terms and conditions linked to the different deals, when choosing between providers and/or packages. Of particular concern to low income consumers is the very high likelihood of having to meet early termination penalty charges if they want to switch during a contractual period.

Problems with mis-selling continue to be significant in this sector, especially in relation to mobile phone services. There are also problems with related retailing practices, notably cashback deals which have given rise to many consumer complaints and have led to regulatory intervention.

Finally, it should be noted that direct retail price regulation has ended on the basis that competition upstream should ensure effective downstream competition. Ofcom decided against breaking up BT and instead went for the option of requiring BT to ensure that access to its network operates on fair terms: 'equality of access'. Price controls remain at present for mobile network operators with regard to wholesale call termination charges. However, there are questions about the adequacy of these price controls and there is little or no independent scrutiny of their effectiveness from the consumer viewpoint.

Public Transport

"The past decade has seen an increased awareness of the links between social exclusion and public transport services. A lack of access to public transport services can influence an individual's access to employment, education, leisure activities and health services."

Jane Lethbridge

Principal Lecturer,
Public Services International Research Unit,
Business School, University of Greenwich

Public transport plays an essential role in enabling people from low income and other disadvantaged groups to access employment and services. It also contributes to the development of social networks and social capital, by helping people to visit friends and relatives and take part in community and other social activities. Public policy makers have begun to recognise that adequate public transport provision can play an important role in reducing social exclusion.

In 2006, the Family Spending Statistics showed that household expenditure on public transport, for the lowest income decile, was £1.70 per week, of which the majority was spent on bus fares (National Statistics, 2008). The highest income decile spent £13.70 per week, with most of this expenditure spent on rail fares, probably commuting. If personal and public transport costs are combined, then the lowest income decile spent 10% of their income on transport as compared to the highest income group, which spent 17%.

Table 1: 2006 Household expenditure on transport

(£ per week/percentage of total household expenditure)

	Lowest 10%	Second decile	Third decile	Fourth decile	Fifth decile	Sixth decile	Seventh decile	Eighth decile	Ninth decile	Highest 10%	All households
Purchase of Vehicles	4.60	4.00	12.00	12.30	14.10	19.30	21.60	32.80	44.90	68.70	23.40
Operation of Personal transp	6.40	9.10	15.60	18.80	25.00	28.30	33.60	40.80	47.60	61.10	28.60
Vehicle insurance	2.10	3.00	4.60	5.80	7.20	8.10	10.10	11.40	12.20	15.20	8.00
Total personal Transport	**13.10 8**	**16.10 8**	**32.20 12**	**36.90 11**	**46.30 12**	**55.70 13**	**65.30 13**	**85.00 14**	**104.70 15**	**145.00 15**	**60.00 13**
Rail & tube Fares	0.60	0.30	0.70	0.60	0.70	1.30	2.30	2.80	4.00	8.20	2.20
Bus & coach fares	1.00	1.00	1.20	0.80	1.50	1.80	1.90	1.30	1.40	1.20	1.30
Total public Transport	**1.70 1**	**1.50 1**	**2.30 1**	**1.50 -**	**2.60 1**	**3.90 1**	**5.00 1**	**6.00 1**	**7.20 1**	**13.70 1**	**4.50 1**
Other travel & transport	**1.30**	**2.30**	**3.20**	**7.80**	**4.90**	**4.00**	**5.10**	**5.10**	**7.70**	**13.60**	**5.50**
Total transport	**16.10 10**	**19.90 10**	**37.70 14**	**46.20 14**	**53.80 14**	**63.60 15**	**75.40 15**	**96.10 16**	**119.60 17**	**162.30 17**	**70.00 15**

Source: *National Statistics (2008) 'Family spending: 2007 edition' Palgrave MacMillan, London*

Notes

1. *Total public transport includes combined fares*
2. *Vehicle insurance is also included in the financial services table*

Bradshaw *et al* (2008), in a study to establish a minimum income standard, found that people felt that minimum transport needs could be met by public transport services. An allowance for a weekly bus pass for each family member, except for pre-school children, was an integral part of the household budgets drawn up as a result of the study.

This section deals with public transport services and how the needs of low-income users are addressed by government, public transport providers and the regulator. There are several groups within the population, which include large proportions of people with low incomes. These are:

- Older people;
- People with disabilities;
- Young people;
- Single parents;
- Low paid workers;
- Unemployed people.

Low income can result from (a) low pay; (b) not being active in the labour force; and c) being in full-time or part-time education.

These categories will be used to analyse the extent to which low income groups are a specific target group of public transport services, whether in terms of types of services, fares or concessions. The paper examines the characteristics of public transport services, market structure, policy context and specific initiatives for low income users.

Characteristics of Public Transport Services

As an introduction to public transport services, the current organisational and regulatory arrangements are outlined followed by a profile of public transport services.

Organisational arrangements

Public transport services have undergone several organisational changes as a result of the deregulation of buses and the privatisation of the rail system. Buses were deregulated in October 1986, as part of the 1985 Transport Act (SERA, 2007). The rail system was privatised in 1993, with the first rail franchises issued in 1995. Although the provision of public transport services has been transferred to private sector operators, the strategic management of both buses and rail is the responsibility of local or national government.

The role of local authorities and central government in planning transport services has increased in the last decade. The requirement for local authorities to draw up Local Transport Plans was set out in the 1998 White Paper on Integrated Transport (Titheridge, 2004:8). One of the aims of local transport plans is *"widening travel choices"* to improve the quality of provision of bus, rail, community transport, car and cycling. Each local transport plan has to show how the travel needs of different social groups are addressed and how these groups have been involved in the development of the plan (Titheridge, 2004).

Local authorities and passenger transport executives (PTEs) are responsible for planning local bus services. Bus services are provided by bus operating companies. The introduction of statutory Quality Partnership schemes, Quality Investment Contracts and Quality Bus Partnerships, through the 2000 Transport Act, aims to increase the role of local authorities in the planning and management of local bus services. This was an acknowledgement that the deregulation of bus services had not resulted in improvements to services; rather, it had led to the creation of monopoly operators in many areas, with no incentive to improve services (TAS, 2007a).

The three types of bus partnership outlined are attempts to involve the local authority/passenger transport executives in the process of commissioning local bus services, by inviting bus operating companies to bid to run local services.

1. Quality Contract Schemes have been used in London, but not outside London. Each local authority or passenger transport authority is responsible for monitoring performance.

2. Statutory Quality Partnership schemes have been adopted by several authorities and constitute a bus strategy as part of their local transport plan. The Quality Partnership scheme:

   > *"represents a* commitment *on the part of the authority to provide certain facilities to improve local bus services, and to maintain them throughout the life of the scheme; and an* obligation *on the part of participating bus operators to meet the quality standards prescribed in the scheme when using the facilities in question"* (Department for Transport, 2008)

3. Quality Bus Partnerships draw local authorities and bus operating companies together in a non-statutory arrangement. They are defined as:

   > *"Agreements (either formal or informal) between one or more local authorities and one or more bus operators, for measures to be taken up by more than one party to enhance (mainly commercial) bus services, in a defined area, to meet the strategic objectives of the partners"* (TAS, 2007a)

Regulation

The Transport Act (1985) set out the framework for a deregulated market. Local authorities and central government were not allowed to plan services, set minimum service frequencies, fares or bus routes. Bus operating companies were not allowed to coordinate provision of services. The 1985 Act required the Office of Fair Trading to *"consider these practices a distortion of the market"* (SERA, 2007:3). The bus industry is monitored in terms of how the market is operating. Recent legislation has attempted to define the role of local authorities in planning bus services, but the requirements of competition legislation are still influential in bus service decisions.

Traffic Commissioners are responsible for monitoring bus services. Seven Traffic Commissioners cover England, Scotland and Wales. The 2006-7 Annual Report provides insights into some of the barriers that the Commissioners have faced in fulfilling their role effectively. Traffic Commissioners have several responsibilities. These cover the licensing of the operators of Heavy Goods Vehicles (HGVs) and of buses and coaches (Public Service Vehicles), the registration of local bus services and disciplinary action against drivers of HGVs and PSVs. The aim of the Traffic Commissioners is to see that "bus services are reliable" (Traffic Commissioners Annual Report, 2006-7: 5).

In 2006-7, the Senior Traffic Commissioner, Philip Brown, reported that *"very few cases dealing with bus punctuality and reliability were referred to the Traffic Commissioners"* (Traffic Commissioners Annual Report, 2006-7:10). He attributed this to the lack of resources and statistics gathering as well as changes in the management structure of the Vehicle and Operator Services Agency (VOSA), which has recently had a new management structure introduced by government. VOSA provides bus compliance officers, who are responsible for local monitoring of bus services. The Traffic Commissioner reported that the number of bus compliance officers for Wales had recently increased from 1 to 3. This was considered an improvement. The Traffic Commissioners also reported that VOSA is unable to deal with complaints because of the extensive responsibilities it has for vehicle licensing. The dependence of the Traffic Commissioners on the VOSA shows that the structure of regulation does not appear to be adequate to monitor local bus services.

In 1994, a new structure for the railways was introduced. What had been a single nationalised industry was restructured into over a hundred different companies (Bolt, 2008). It became an industry that was vertically separated between infrastructure, which included the track and signalling, and the train operation. The ownership of the infrastructure was transferred to Railtrack. The train operations, rolling stock, track maintenance and other services were transferred to private companies (Bolt, 2008).

Rail regulation has undergone several changes since 1994. Initially, the Office of Passenger Rail Franchising (OPRAF) was set as a regulatory agency but its functions were taken over, in 2000, by the Strategic Rail Authority (SRA).

Railtrack went into administration in 2001 and was replaced by Network Rail, a company limited by guarantee (Bolt, 2008). This change also led to the abolition of the Strategic Rail Authority. Its regulatory functions were divided between the Office of Rail Regulation (ORR) and the Department for Transport. The 2004 White Paper *The Future of Rail* (Cm6233) outlined the new functions of the ORR, which combined *"safety, performance and cost"*.

The Office of Rail Regulation (ORR) was set up on 5 July 2004 under the Railways and Transport Safety Act 2003. The 2005 Railways Act transferred the consumer protection functions of the Strategic Rail Authority to the ORR (Railways Act, 2005). The ORR is responsible for the economic and the safety regulation of the sector and the enforcement of licence conditions in relation to consumer protection issues, for example timetabling and 'through ticketing'. The ORR Competition Act Guideline (2005) sets out how the ORR will expect to apply the provisions of the 1998 Competition Act (Articles 81 and 82).

The Department for Transport is now responsible for the strategic management of the rail industry, which covers the management of the bidding process for rail franchises. The Department for Transport (DfT) is responsible for the Ticketing and Settlement Agreement, which all train operating companies sign up to as part of the franchising agreement, as well as being responsible for *'regulated'* fares. Issues relating to *'unregulated'* fares are dealt with by the ORR and the Office of Fair Trading (OFT).

In 2006, the Transport Select Committee was critical of the rail regulation arrangements. One of the main criticisms was the lack of clarity in the shared responsibility of the ORR and the Office of Fair Trading for *'unregulated'* fares.

Differentiation of public transport services

Table 2: Public transport services

Level of operation	Bus	Train	Tram/light railway/metrolink	Community transport services
Local	Local services	Local/regional services	Local services	Local services meeting specific needs e.g. disabled people
National	National inter-city services	National inter-city services		

The two main standardised products involved in public transport services are bus and rail services. Rail services operate as local, regional, inter-city and international services and are run by rail franchises. Buses operate as local and inter-city services, delivered by bus operating companies. New light rail, tram and metrolink services have been introduced, which complement local bus and rail services. They are run by either train or bus operating companies.

Community transport services are run by the voluntary/ social enterprise sector and provide a range of more tailored services, for disadvantaged groups, within the population. Community transport services are run locally and there is no national provision, although the extent of community transport services is expanding. The Community Transport Association is the national organisation that links local community transport services. It promotes *"the safe and efficient use"* of community and other accessible transport services, by providing training and other capacity building measures (Community Transport Association, 2008).

Range of public transport services

The range of both bus and rail services is mainly differentiated by distance, with local bus and rail services and long distance coach and rail services. Access to these services can vary, with local services being more immediately accessible in terms of cost as well as physical access. Long distance travel may depend on access to information about the available services, as well as having to anticipate the need to travel in order to purchase a cheaper ticket.

Community transport services provide a wider range of products, in the form of more individualised transport services. These services may cover transport services for people who have difficulties using public transport, subsidised door to door transport for people with mobility problems, group transport mini-bus services, low cost taxi and vehicle hire services. These services are not available in every local authority area.

Availability of substitutes

The process of identifying substitutes to public transport for low income groups involves looking at two dimensions of provision. Firstly, how different modes of public transport compete with each other and, second, how private forms of transport, such as private cars and taxis, compete with public transport services.

Since the 1970s, apart from London and Brighton, there has been a decline in the use of local buses, which the deregulation process may have slowed, but has not changed significantly. The trend within in the London region has been different, with an increase in bus usage, after 2002 (TAS, 2007a). Since 1997, bus fares have risen more rapidly than rail fares (TAS, 2007a).

There are variations between different areas in the pattern, type and level of public transport services and the demand for them. The biggest difference is between rural and urban areas. In rural areas, the use of cars is higher and the demand for public transport services is lower, resulting in a much reduced public transport provision (Paulley *et al*, 2006).

At a local level, bus services often compete directly with local rail services, especially where fares are competitive. For some low income and disadvantaged groups, access to community transport services may be an option, if they fit the criteria to be users of community transport services. Many local community transport services are targeted at people with disabilities and older people. For longer journeys, long distance coach and rail may be considered in competition, with the private car being a weaker competitor (TAS, 2007a).

The price of taxis has kept in line with inflation. Local authorities control fare increases and maintain them in line with inflation, even though taxis have experienced similar cost increases to buses, in terms of increased costs of fuel, labour, and insurance. For people on low incomes and/or people with no car, taxis may be the only way of travelling to *"out of town"* supermarkets (TAS, 2007a:43).

There are also other forms of transport, often provided by specific services. For example, supermarket courtesy buses are organised by local supermarket stores (DfT, 2003). Social services and health services transport is provided for people using day centres, hospitals and other facilities. These services are often provided by the institutions, local authorities or community transport services. Costs of these services vary from area to area (DfT, 2003).

For children and young people, local education authorities have a duty to provide transport *"where they consider this necessary to facilitate his/her attendance at school or further education college"* (DfT, 2003:69) Local education authorities also have the power to pay all or part of the costs of travelling expenses for any pupil not entitled to free transport. This provision varies between local authorities.

Are public transport services essential?

In the last decade, there have been several policy documents from the European Commission and the UK government that have presented transport, especially public transport, as being essential for social inclusion. The European Commission (EC) communication *Cohesion and Transport* states that *"transport policy plays a major role in strengthening the economic and social cohesion of the European Union"* (EC COM (1998), 806). Public transport services contribute to labour market and economic development as well as reducing the isolation of rural and peripheral urban areas (European Commission, 1998).

In the United Kingdom, the Social Exclusion Unit published a report *Making the connections: final report on transport and social exclusion* in 2003. This report recognised that there were clear connections between transport, social exclusion and location of services. Several reports were commissioned by the Department of the Environment, Transport and the Regions (DETR) to explore the relationship between social exclusion and transport. These reports have contributed to raising awareness among local, regional and national policy makers that public transport services can play a significant role in promoting social inclusion.

In 2003, a report published by the Department for Transport found that the social exclusion of groups, such as unemployed people, families with young children, young people, older people and those on low incomes, was significantly affected by their access to public transport. Lack of access to public transport impacted on social exclusion by making people unable to:

- Travel to another place;
- Arrive at a place at a specific time;
- Afford to travel;
- Use the existing forms of mobility (DETR/TRaC 2000; Titheridge, 2004).

In rural areas, and in many peripheral urban areas, lack of access to transport can result in exclusion from public services, leisure services, employment, and education. As well as the practical access to services provided by public transport services, affordability can be a significant barrier to use.

Monk, Dunn and Fitzgerald (1999) in a study of two rural areas, found that difficulties in travelling to work and the cost of travel were barriers to employment. The study also found that employers felt that people, who had to travel long distances or were dependent on public transport, might be unreliable. When employers provided transport, this could trap a worker in poorly paid or unsuitable work (Monk, Dunn & Fitzgerald, 1999).

Frequency of choice and ease of switching

Mode of travel, journey time and cost are three variables that influence transport decisions. Hine and Mitchell (2000) looked at the extent to which the cost of fares presented an obstacle to travel. Some people, who would have preferred to travel by train because it was quicker, actually travelled by bus because it was cheaper. Some people had to walk because they did not have money to pay a fare. People, who were unemployed, felt that there should be fare concessions that they could use when attending job interviews. Access to taxis was also limited by whether people could afford them. However, people used taxis when public transport services were poorly integrated and involved long walks to bus stops (Hine and Mitchell, 2000:330).

Grieco (1995) found that the lack of available information about existing transport routes and services affected the use of these services, by low income households. Social networks were the main source of local information about public transport services. Lack of information about public transport services was identified as a barrier to making unfamiliar journeys (DfT, 2003).

Can demand for public transport services be postponed?

Low income households use public transport for a wide range of reasons. Access to school, employment, health and social services and shopping are often difficult to postpone. The Social Exclusion Unit (2003) reported that one in four job seekers reported that the cost of transport was a barrier to getting to interviews. One in four young people had not applied for a particular job in the previous year because of transport problems. In 2003, over 1.4 million people said *"that they have missed, turned down, or chosen not to seek medical help over the last year because of problems with transport"* (SEU, 2003:2).

The use of public transport for social networking, leading to the development of social capital, may be less constrained in terms of time, but the longer the postponement, the less effective the social interaction that may result.

Do residential consumers compete with large consumers?

Public transport services are aimed at individual, residential users but are reliant on their aggregation to be viable. There is no direct competition with large consumers.

The Public Transport Market

This section examines the market structure for bus and rail services, pricing mechanisms, and cost structures.

Market structure

Table 3: Five largest companies operating bus and train services

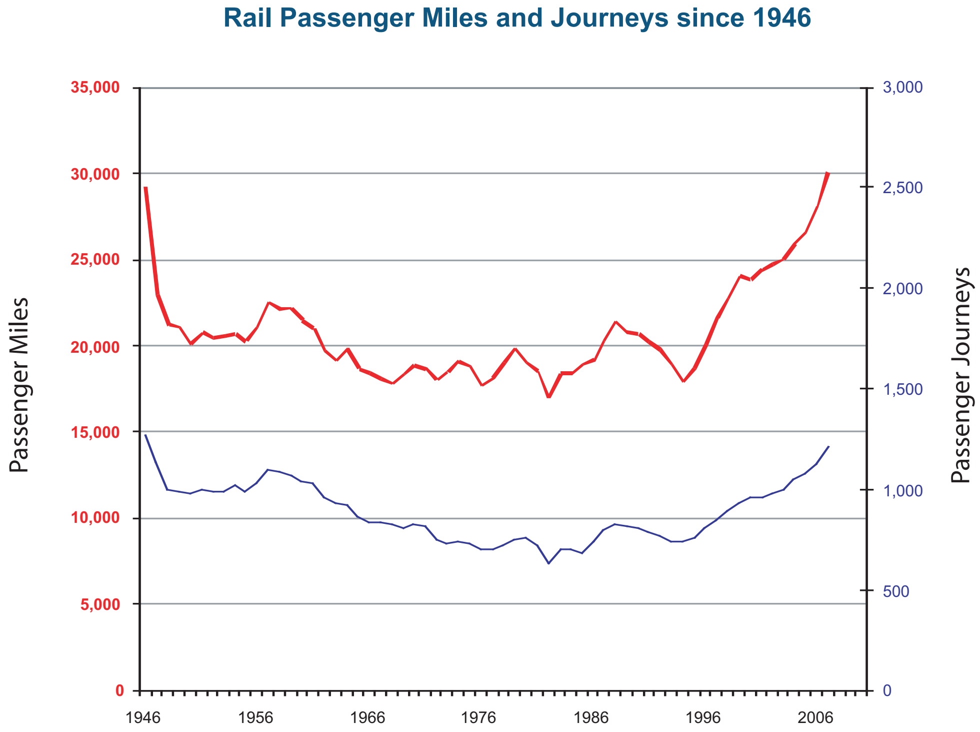
Company	Total 2007 Revenue £ million	2007 Operating profit £ million	Total 2006 Revenue £ million	2006 Operating profit £ million
First Group	3,706.8	203.6	3.030.9	210.7
National Express	2,614.3	205.6	2,525.5	141.6
Arriva	2,064.6	142.8	1,769.0	130.8
Go Ahead	1,826.0	102.0	1,463.0	89.5
Stagecoach	1,504.6	180.9	1,343.9	112.5

Source: *First Group plc Annual Report 2007; National Express plc Annual Report 2007; Stagecoach plc Annual Report 2007; www.arriva.co.uk;*

There are five main transport operating companies that run both bus and rail services. In 2007, First Group had an annual revenue of over £3,700 million, with an operating profit of £203.6 million. Of the five companies, National Express Group recorded the largest operating profit of £205.6 million, with an annual revenue of £2,614 million. The names of these companies are not well known because both bus and train services have different brand names.

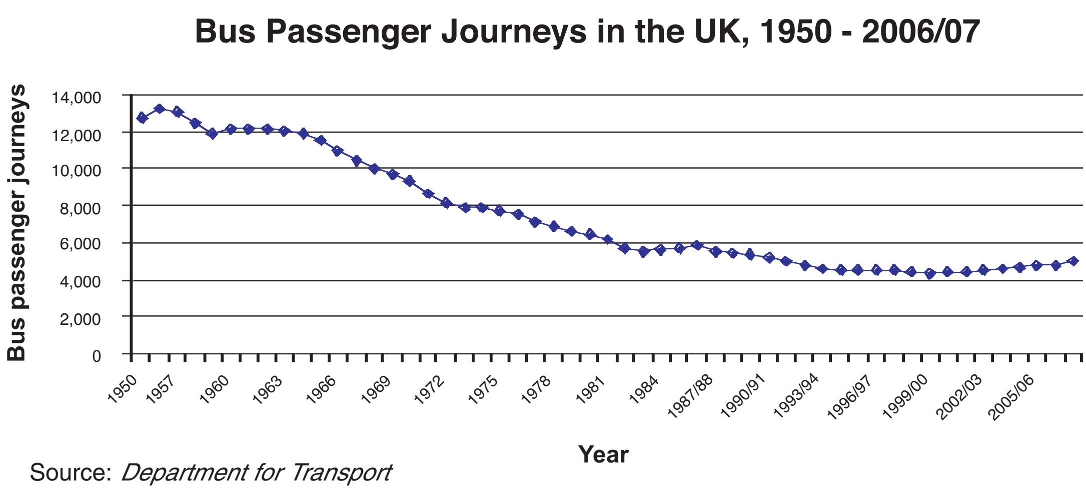
All five companies originally ran local bus services but have diversified into running rail services. There are several possible interpretations for this expansion into rail services. At the time of rail privatisation in 1995, there were no rail companies, and so expanding bus companies took up the opportunities offered by the new rail franchises. Companies started by taking on one or two rail franchises after 1995, with consolidation over the last decade.

Figure 1: Rail passenger miles and journeys since 1946



Source: *Association of Train Operating Companies*

Figure 2: Bus passenger journeys in the UK, 1950-2006/7



Source: *Department for Transport*

The number of rail passenger journeys has expanded consistently since 1995. In contrast, bus passenger journeys have been in decline since the 1950s, with a very slight increase in the last decade. The increase in bus passenger journeys has been recorded in London and Brighton but not in the rest of the UK. This is in contrast to the increase in rail passenger journeys, which is more widespread.

Rail franchises

The current rail franchises are set out in the table below.

Table 4: Rail franchises

Company	Rail franchise	Contract term
To be decided	South Central *	Out for tender
First Group	Scotrail	2004-2011
First Group / Keolis	Transpennine Express	2004-2012
First Group	Hull Trains	2000-
First Group	Great Western	2006-2016
First Group	Thameslink/GN	2006-2015
Arriva plc	Cross Country	2007-2016
Arriva plc	Arriva Trains Wales	2003-2018
Go Ahead plc 65% /Govia 35%	Integrated Kent	2006-2014
Go Ahead plc 65% /Govia 35%	West Midlands	2007-2012
Go Ahead plc 65% /Govia 35%	Southern	2000-2009
Stagecoach	East Midlands	2007-2015
Stagecoach	South Western	2000-2006; 2006-
Virgin- Stagecoach joint venture	West Coast Mainline	2008-2012
National Express Group bought Prism Rail in 2000	C2C	2000- 2011
National Express Group	Intercity East Coast	2007-2015
National Express Group	East Anglia	2004-2011 (with option 3 more years)
Serco plc /Ned Railways (NS) Dutch railways	Northern	2004-2012
Serco plc/ Ned Railways (NS)	Merseyrail	25 year concession from 2003
Concession - Joint venture Deutsche Bahn AG and MTL – Hong Kong based	London Overground Rail Operations Ltd (LOROL)	2007-2014
M40 Trains now owned by Deutsche Bahn AG	Chiltern Railways	2002-2021

* South Central will include Southern and Gatwick Express after 2009
Source: *Association of Train Operating Companies, 2008*
http://www.atoc-comms.org/franchised-passenger-services.php

There are 20 franchised train operators with 17 awarded by the Department for Transport. The three train operators not awarded by the Department for Transport are:

- Merseyrail – awarded and managed by Merseytravel on behalf of Merseyside PTE;
- First Scotrail – awarded and managed by the Scottish Executive;
- Arriva Trains Wales – managed by the Welsh Assembly since July 2006 but awarded by the Department for Transport.

There are six non-franchised services that operate under the *'Open Access'* scheme. After privatisation in 1993, the concept of *'Open Access'* referred to companies which had not won a rail franchise and which were expected to introduce competition into the rail system. There are now six *'Open Access'* lines, with three operating services between English regions and London. Clark (2006) comments on the small number of companies operating as *'Open Access'* schemes and identifies some of the opposition to the development of new routes.

Table 5: 'Open Access' routes

Company	Rail company	Routes
Eurostar (UK) ltd, SNCF (French Railways), NMBS/SNCB (Belgian Railways)	Eurostar	London - Paris, Brussels
BAA – owner and operator	Heathrow Express	Paddington-Heathrow Airport
Joint venture First Great Western and BAA	Heathrow Connect	West London – Heathrow
80% owned by First Group	Hull Trains	Hull- London
Equishare Partners	Grand Central	Sunderland – London
Jointly owned by shareholders of Renaissance Trains and Laing Rail which was bought by Deutsche Bahn AG Jan 2008	Wrexham Shropshire	Wrexham/ Shropshire- London

Source: *Association of Train Operating Companies, 2008*

Apart from the five largest public transport companies, there are also three UK-based companies and four international companies involved in providing rail services in the UK.

Renaissance Trains was set up by four shareholders, all of whom were former train managers, to identify and develop new Open Access routes in the UK. The company is involved in the Hull Trains and the Wrexham Shropshire company.

Serco Integrated Transport is one of the largest divisions of the Serco Group plc, which provides management services to government and industry globally. It also runs the Docklands Light Railway and Manchester Metrolink (Merseyrail, 2008).

Equishare partners is a private equity group which bought Grand Central railway in 2007.

International rail companies

Deutsche Bahn AG

In October 2006, the German insurance company Allianz Infrastructure Holdings bought the shares of Laing Rail, from John Laing. These were sold to Deutsche Bahn AG (DBAG) in early 2008 and this company now operates Chiltern Railways (Railfaneurope, 2008). Deutsche Bahn AG is part of DB Regio, Deutsche Bahn's local and regional service provider (Chiltern Railways, 2008).

Keolis

Keolis is a French company that is involved in managing public transport systems in eight countries. It is part owned by SNCF. In partnership with national companies, it manages train systems in Sweden, Denmark, Germany, France, the Netherlands, Belgium, the United Kingdom and Canada. In the United Kingdom, Keolis has partnerships with Go-Ahead and First Group.

MTR

MTR runs railways and rapid transit systems in Hong Kong. Founded as the Mass Transit Railway Corporation in 1975 to build and operate the Hong Kong metro system. It was owned by the Hong Kong Government. In 2000, the company was re-established as the MTR Corporation Limited after the Hong Kong Special Administrative Region Government sold 23% of its issued share capital to private investors. MTR Corporation shares were listed on the Stock Exchange of Hong Kong on 5 October 2000. MTR became a partner in London Overground Rail Operations Ltd (LOROL) in 2007 (MTR, 2008).

Nederlandse Spoorwegen

Nederlandse Spoorwegen (NS) is Dutch rail provider. It is a partner, with Serco, on two franchises, Northern and Merseyrail.

The presence of four international companies shows that there is a slow expansion of international ownership and management of rail services in the UK. This process complements the international expansion of the five main UK public transport companies, showing that there is a gradual internationalisation of public transport companies.

Bus services

All of the five major companies operate local bus services but they have many different brands. First Group operate one in five local bus services in the UK, with services in Aberdeen, Bradford, Bristol, London, Leeds, Glasgow, York and Manchester. National Express runs local bus services in West Midlands, Coventry, Dundee, London and the Midland Metro. Arriva runs bus services in London, Liverpool, Leeds, Leicester, Glasgow and Newcastle. Stagecoach runs local bus services throughout England and Scotland but, in 2006, Stagecoach sold its London bus services to Macquarie Bank Ltd in order to concentrate on expansion outside London. Go Ahead operates bus routes in the North East, West Midlands, South East, Southern regions and in London. Both National Express and Stagecoach operate long distance coaches.

International expansion

Four of the public transport companies have some international bus operations, with further international expansion planned. First Group runs school and intercity bus services in the United States and has recently bought a small bus service in Germany. National Express also runs school bus services in the United States and coach services in Spain. Stagecoach runs commuter, tour and charter, sightseeing and school bus services in North America. Arriva has operations in the Czech Republic, Denmark, Germany, Netherlands, Poland, Portugal, Spain, Sweden and Italy but does not operate in North America. Go Ahead runs support services for national and international aviation services, but does not operate bus or train services outside the United Kingdom.

Pricing mechanisms

Most bus operating companies aim to make a 15% margin on commercial bus operating activities. There is a greater degree of risk associated with bus services than rail. Bus operating companies have to make their own direct capital investment if they purchase new buses. A bus operating company can face competition at any time and this will lead to a reduction in profit margins. Bus operating companies often respond to increasing costs by raising fares or cutting unprofitable routes. This leads to more restricted public transport services (TAS, 2007:4). The average income per bus passenger has increased for all areas, except for London, where there has been a decrease.

Table 6: Average income per passenger 1994/5 – 2004/5

Year/ area	London	English PTE	Non PTE areas	England	Scotland	Wales
1994/5	£0.55	.64	.84	.68	.74	.77
2004/5	£0.49	.78	1.12	.75	.82	.97
Change	-10.9%	+21.9%	+33.3%	+10.3%	+10.8%	+26.0%

Source: *TAS, 2007a:29*

Since deregulation, daily bus ticketing has become more complex. Most companies offer day and weekly tickets that can be purchased on the bus. These tickets were often launched at competitive prices in an attempt to retain market share. There is a tendency for single fares to rise at a level above the rate of retail price index, with fares for short distances rising most. In many urban areas, less than 25% of passengers travel on a single ticket. Weekly tickets have increased at a lower rate, at either the level of the retail price index or below. There are some differences between companies (TAS, 2007a:28-9).

With rail services, the risk is reduced for train operating companies because, once the franchise has been agreed, many of the costs, such as subsidy payments, are fixed. The Department for Transport has the power to regulate prices of certain rail fares in the interests of rail users. There are two types of fare regulation: a) commuter fare regulation; b) protected fares regulation.

The Department for Transport controls the regulated fares. The price limit is applied to each train operator. Annual fare increases are limited to the retail price index plus 1% per year. With unregulated fares, operators can set fares according to commercial considerations. Train operating companies can also set their own restrictions for some of the regulated fares.

The evidence of the Transport Select Committee (2006) showed how two of the, then, rail operating companies – Virgin and GNER – approached the setting of fares for two routes: London–Manchester and London-Glasgow. They reported that lower rail fares were designed to compete with long distance buses and the higher rail fares were designed to compete with airlines. Distance was also an important factor in influencing fares. The London–Manchester route has a higher rate per mile and so maximises its revenue. The London–Glasgow route has a lower rate per mile in order to compete with airlines. Airlines have the advantage of a shorter journey time (Select Committee on Transport 6th report, 2006).

The 2007 TAS report, for the Commission for Integrated Transport, found that bus and rail fares had increased by about 30% more than the retail price index in the period 1987-2006 (TAS, 2007:32). Fares have risen in England and Scotland by 10% in real terms, in 10 years. In Wales the increase has been 26%, with a more rapid increase since 2000.

Barriers to entry

There are relatively low entry barriers to the local bus market. The market is highly competitive, although the number of bus passengers has declined in areas outside London and Brighton (TAS, 2007a).

In the rail industry, the main barrier to entry is the cost of bidding for a rail franchise, which is estimated to be about £28 million per bid, whether successful or not (TAS, 2007b).

Cost structure

The costs associated with running buses and railways are slightly different and will be analysed separately.

Table 7: Costs for the bus industry 2006

Direct costs (hours or mileage based)	Semi-variable costs (hours based)	Fixed costs (bus-based)
Driver costs (per bus hour)	Administration	Vehicle ownership or leasing costs
Fuel per km	Supervision	Ticketing and revenue systems
Oil, tyres and mileage based maintenance (per km)	Time based maintenance	Depot, garaging and cleaning systems
		Other overheads e.g. head office costs

Source: *TAS, 2007a):45*

Bus industry direct costs

Costs in the bus industry are rising over time. The costs of bus operators are rising ahead of the retail price index. A shortage of staff has resulted in wage increases to attract more workers. The expansion of bus passengers in London has also resulted in increased costs.

Bus companies can either raise fares or reduce services to maintain a profit. If bus routes become unprofitable, local authorities have, in the past, often subsidised uneconomic routes but the scope for local authorities to do this is becoming more limited, with reduced budgets (TAS, 2007a:9). Tender prices are often related to levels of revenue taken previously. Local authorities tend to prioritise supported services, which either fulfil social need or are best value for money. In London, there has been an increase in local authority expenditure on buses but, outside London, budgets have only kept up with the rate of inflation and so support fewer services.

Direct costs

The main factor contributing to higher costs are wages, which account for 70% of bus operating costs. Recent wage rises have contributed to higher costs, although there have been regional differences. London bus drivers received increases above the rate of inflation. Outside London, wage rises have been the same as the general level of wage increases, with some reduction in the length of working week. This has resulted in more drivers.

EU regulations and social legislation have also contributed to higher labour costs. Companies have raised their contributions to pension schemes by using reserves or proceeds of sales (TAS, 2007a:7).

Fuel price increases have also contributed to higher bus running costs. Levels of congestion also influence the costs of bus operators. Bus operators have to expand resources to maintain levels of services or take away sections of the route to maintain the timetable, in areas of high congestion.

Semi-variable and fixed costs

The costs of management and supervisory services have decreased due to rationalisation of depots and management structures. The costs of headquarters and corporate services are passed down by bus operating companies. Corporate costs have increased. There is continuous pressure to produce profits and dividends for shareholders. Each bus operating company pays its share of group overheads. It is not clear how these costs are allocated in companies that are also involved in rail franchises (TAS, 2007a:54).

Insurance and accident costs have also increased, with employer's liability insurance rising four or five times.

The cost of tendering for bus contracts is lower than for rail franchises. The complexity of the tendering procedure varies according to each local authority. The costs associated with tendered bus services take place after the contract has been awarded. These are registration and publicity to explain changes in contracts, contract compliance (vehicle type and special ticketing), and operational changes (TAS, 2007a:85).

The cost of new buses is also increasing, with bus operating companies responsible for this capital expenditure. There is some evidence that large companies, First Group and Stagecoach, have pushed down the price of new buses by placing large orders (TAS, 2007a:121).

Table 8: Factors influencing rail industry costs

Direct costs (hours or mileage based)	Semi variable	Fixed costs
Drivers/staff	Off-train staff e.g. platform and booking staff	Vehicle leasing charges/ ownership
Fuel	Administration	Track access costs
Oil & mileage based maintenance	Supervision	Ticketing & revenue systems
Incentive and penalty payment	Train based maintenance	Depot rentals and station access charges
Rail replacement bus services		Depot & train cleaning
		Other overheads

Source: *TAS, 2007b: 48*

Costs in the rail industry are also rising above the rate of inflation. Track renewal and construction costs have also increased due to improvement and upgrading of the rail infrastructure.

<table>
<tr><th colspan="5">Table 9: Revenue and costs 1996/-2004/5</th></tr>
<tr><th>Year</th><th>Revenue</th><th>% Increase</th><th>Costs</th><th>% increase</th></tr>
<tr><td>1996/7</td><td>2.9</td><td rowspan="2">67%</td><td>£4.7 million</td><td rowspan="2">32%</td></tr>
<tr><td>2004/5</td><td>5.0</td><td>£6.2 million</td></tr>
</table>

Source: *TAS, 2007b:15*

Table 10: Analysis of train operators costs 1996/7 and 2004/5				
	Labour	**Rolling stock**	**Infrastructure**	**Other**
1996/7	18.4	19.7	41.3	20.6
2004/5	24.4%	24.0	21.7	29.9

Source: *TAS, 2007b*

Both revenue and costs have increased over the period since privatisation, but revenues are showing a higher rate of increase. The structure of costs has also changed since 1996/7. There have been some changes in rail costs since 1996-7. The proportion of labour costs has increased from 18.4% to 24.4%. Rolling stock has also increased from 19.7% to 24.0%.

Rail industry direct costs

Wages are a significant cost for rail operating companies, although not quite as large as for buses. Labour costs influence the cost of infrastructure maintenance and renewal and rolling stock maintenance. Wage increases have been above the rate of inflation, especially for skilled workers. Contributions to pension funds, as with buses, have come from reserves or proceeds of sale.

Many train operators have been affected by the increased costs of fuel and the duty paid on heavy gas oil.

Rail industry fixed costs

Track renewal and construction costs have increased as part of improvement to rail infrastructure although, as a proportion of total train operator costs, there has been a decrease.

Track access charges are a significant cost for all train operating companies, at about 93%. Access to stations, depots and other buildings accounts for 7%. Track access charges consist of a variable and a fixed element, which cover capital costs of running the network and the "wear and tear" caused by the train services being operated. The fixed charge is paid by the franchised train operators and the variable charges are paid by both passenger and freight rail operators. Rail fixed charges are under review by the Office of Rail Regulation (TAS, 2007b:20).

Rolling stock costs constitute about 24% of the costs of the train operators. The majority of this cost is paid by the Rolling Stock Companies (ROSCOs) which lease vehicles to the train operating companies. Very few train operating companies own their own trains (TAS. 2007b:20). Rolling stock costs have increased since 2000 due to the introduction of new rolling stock.

Management and supervisory staff costs, infrastructure maintenance and headquarters' overheads are passed down to the train operating companies. As with bus operating companies, rail operating companies are under pressure to increase profits and shareholder dividends.

The costs of preparing a franchise bid have been estimated to be about 1% of franchise costs. First Group reported tender preparation costs of £28 million in 2005 (TAS, 2007:53).

The costs of insurance have increased. The Office of Rail Regulation requires insurance as part of the franchise contract. Employers Liability Insurance has also increased.

There is a lack of transparency in the information about the rail industry that is made publicly available. The Office of Rail Regulation holds large amounts of data, but this is only available to train operating companies, for example, the data on train operators' costs (TAS, 2007:13).

Although car drivers face similar costs to bus operators, most car drivers assess the cost of a journey in relation to cost of fuel, which is a marginal cost, and passengers travelling "free". The perception of public transport, especially buses, is often considered in relation to the highest fares. There are increased costs if a passenger has to change to a different route, especially if there is a change of operator (TAS, 2007b:36). Cheaper fares often require pre-booking or pre-payment. Passengers often have problems accessing information on public transport services and fares.

Recent Official Investigations

There have been several official investigations into public transport services, which have implications for low income groups. These are in addition to the reports on social exclusion and public transport published by the Social Exclusion Unit and the Department for Environment, Transport and the Regions in 2003.

The Audit Commission and the National Audit Office published a report on Delivery chain analysis for bus services in England, which assessed the feasibility of the government's Public Service Agreement target (PSA3) to increase bus and light rail usage by 12% in the 10 year period from 2000-2010. The growth was to be achieved in every English region. The Audit Commission and the National Audit Office examined whether the delivery chains for achieving this target were *"fit for purpose"*. They concluded that, although the target would be met in the country overall, it would not be met within each English region. The main reason that the target would be met was due to growth in London, which resulted from Transport for London's influence and commitment to introducing measures which supported the increased passenger growth (Audit Commission/NAO, 2005).

The Audit Commission/National Audit Office recommended that if concessionary fares were more closely linked to transport objectives, then there could be some efficiency savings for local authorities and other gains for local bus operators. Efficiency gains would also be realised if socially necessary bus services were contracted by packaging smaller contracts, using longer contract periods, and joint procurement with other local authorities.

The Audit Commission recommended that, outside London, the market could be made more effective if more information was made available to local communities. Transport Commissioners also needed to receive more information to enable them to monitor services more effectively.

The House of Commons Transport Committee undertook an investigation into rail fares in 2005. In a report entitled *How Fair are Fares*, the Select Committee was critical of the current management arrangements for rail fares. It concluded that they did *"not provide value for money for passengers or tax payer"*.

Several problems were identified. The fare structures are fragmented and complex. Each train operating company has slightly different types of tickets with different conditions. Train operators have made walk-on fares expensive and, for many low income groups, these fares are unaffordable. In addition, companies have increased the restriction on the cheaper Saver fares.

The Select Committee concluded that the train operating companies had *"exploited the complacency of the Government"*. It recommended that the Government had to develop a better system of regulation of prices, fares and conditions of travel. The system of fares had to be simplified. Types of tickets should be consistent between train operators. The Select Committee also recommended that the Office of the Rail Regulator should become stronger.

Over the past decade, advance purchase fares have been introduced, which sometimes offer value for money. These require prior booking, sometimes weeks in advance. This effectively limits access for people who are unable to plan ahead and who require flexible travelling arrangements. In mid-2008, as a response to criticism from the Transport Select Committee, advance purchase fares were simplified so that there is now one basic advance purchase fare. Although this provides a simpler system, it appears to have restricted the range of cheaper fares. Advance purchase fares continue to have a range of different prices which can change according to the number of seats already purchased and the time of journey.

The Commission for Integrated Transport was set up in 1998 to provide advice to the Government on integrated transport policy. It has commissioned extensive research, from the TAS consultancy group, into the prices and costs of public transport services. The reports provide important evidence about prices and costs in both the bus and rail industries. They have been drawn on extensively in the sections on prices and costs in this report.

Extent of Problems for Low Income Households

Grieco and Raje (2004) argue that there has been a failure of public transport services for low income communities, through the deregulation of public transport services and the fragmentation of services. Public subsidies are the lowest in Europe, but bus operating costs are also the lowest in Europe. Increased fares have led to a reduction in journeys and use of bus services. These factors have affected housing estates at the edge of large cities which, when they were built, were near to employment and other services. In the last two decades, economic decline, the closure of local shopping centres and the restriction of local transport services has led to these neighbourhoods becoming physically and socially isolated.

Grieco (1995) examined decisions about travel decisions and travel behaviour of low-income households in Merseyside. Developing the concept of *"inter-household dependency"*, she outlines three types: the provision of shopping services, where one individual does shopping for two households; providing escort services for someone crossing a dangerous space; and child care services, where children of one household are looked after when a journey is made by another adult. Some of these arrangements were used when a medical emergency involved taking a child to hospital and leaving remaining children with the care of a neighbour/friend.

Government Support Schemes

Government support schemes for low income users of public transport services can be considered in two ways. The increased awareness of the links between access to public transport and social inclusion has led to the development of new planning mechanisms. These mechanisms are aimed to increase the participation of low income/disadvantaged groups in the planning of local transport services and to ensure that their needs are addressed in existing public transport services. A second and more direct measure has been the introduction and expansion of concessionary fares.

Accessibility planning

Lucas (2006) examines the use of an accessibility planning tool, which defines access in a wide sense, including physical, social and economic access. The tool aims to provide information on areas where access is poorest and the barriers to accessibility, as seen by local people (Lucas, 2006). It will also make clearer the transport implications of service planning.

Dibben (2006) examines some of the problems of involving local communities in transport decision-making. There were several factors that influenced the response of local authorities to people from disadvantaged groups, asking for changes in bus services. One factor was the lack of responsiveness of the bus operating companies, who often withdrew routes without consultation. The lack of coordination between departments of transport, planning and social exclusion, within local authorities, also made decision-making by the departments difficult. A third factor was the existing deregulation framework, which enable bus operating companies to demand a subsidy before providing a service. Even the groups that were involved in campaigning on transport issues were not necessarily representative of all disadvantaged communities. Campaigners and bus operating companies also used different criteria in arguing for the provision of services. Campaigners focused on social 'needs' whereas bus operating companies were concerned with costs and efficiency (Dibben, 2006:667).

Farrington and Farrington (2005) argue that accessibility has to include more than just transport planning if accessibility and social justice are to be addressed. Church et al (2000) argue that factors influencing level of skills, child care facilities, level of welfare benefits and informal social networks have to be addressed as well as providing improvements in transport facilities.

These studies show that the government policy of increasing transport accessibility through increasing the role of local authorities in planning local bus services will take time to be implemented effectively. Although there is an increased recognition of the needs of low income and other disadvantaged groups within public transport services, the processes whereby these needs can be recognised and addressed are complex and long-term.

Concessionary fares

Concessionary fares have been focused on older people and people with disabilities. These two groups include many people on low incomes. Although the:

> *"proportion of pensioners living on low incomes in Great Britain has fallen over the past decade, from 26 per cent in 1995/96 to 20 per cent in 2003/04…the proportion of working-age people on low incomes in 2003/04 was substantially lower at 14 per cent"* (English Longitudinal Study of Ageing, 2002).

This shows that older people on low incomes are still a significant proportion of low income groups. There are 11 million people in the UK with some form of disability (Grewal et al, 2002). People from lower social classes are also more likely to be disabled. In 2001, 8% of people in the lowest social class (I) were disabled, and 24% of people from the highest social class (V) (Department of Health, 2001).

The 1985 Transport Act established provisions for local authorities to provide discretionary concessionary fares schemes, for older people and people with disabilities. Although national legislation was introduced in 1985, local authorities retain the power to provide concessionary rail travel and taxi tokens (Transport Committee, 2007-8).

The 2000 Transport Act introduced a minimum standard across England and Wales for concessionary travel. District and unitary authorities had to provide half-fare travel on buses, within the council area, between 9.30am and 23.00pm and all day on Saturdays, Sundays and Bank Holidays. A concessionary travel pass had to be issued with no charge. In 2002, the Fares Concessions (Eligibility) Act 2002 introduced the same age of eligibility for men and women at 60. This age will increase between 2010 and 2020 in line with women's retirement age.

In 2006, the minimum standard was extended to free off-peak bus travel in the Concessionary Fares Bill 2006/7. The 2006 Budget announced that free travel would be available for all people throughout England, aged 60+, and people with disabilities from 1 April 2008, from 9.30am to 11pm (Transport Committee, 2007-8:24). The new measure for widening access to the whole country is anticipated to increase the number of bus passengers (Transport Committee, 2007-8:13).

There are different provisions in Scotland and Wales, as concessionary travel is a devolved issue. Wales and Scotland introduced free national off-peak bus travel for older people and people with disabilities in 2002 (Wales) and 2003 (Scotland). Since April 2007, all people living in Northern Ireland and the Republic of Ireland, aged 65+, are eligible for free bus and rail travel in both areas (Transport Committee, 2007-8).

The cost of the additional free local concessionary travel introduced in 2006 is £350 million for England and £450 million for the United Kingdom. The reciprocal arrangements for the concession schemes in the whole of the United Kingdom will cost an additional £212 million.

Travel concession authorities are responsible for issuing concessionary passes. These authorities are Passenger Transport Executives, London boroughs, district councils, and county councils. They are not transport authorities.

Concessionary bus travel costs about £1 billion per year. As the table below shows, these costs are covered by central government, which operates a system of reimbursements to local authorities.

Table 11: Reimbursement of concessionary bus travel costs

	2006-7	**2008-09**
Local authorities	£712 million paid to bus operators	
Special grant given to local authorities		£223 million
National government paid to local authorities for new national concessionary travel passes		£31 million

Source: *House of Commons Transport Select Committee (2008): 25*

The introduction of free concessionary fares has led to an increase in the use of buses. However, bus industry costs and bus fares are rising faster than inflation. The government will continue to provide funding for local authorities for concessionary travel, 2008-9, based on a formula that includes:

- Eligible population;
- Bus passenger journeys;
- Overnight visitors;
- Retail floor space.

Some travel concession authorities receive more than they spend, while others spend more than they receive. Some district councils are finding concessionary travel obligations a financial risk. The Transport Committee suggested that travel concession functions should be transferred from district councils to the larger county councils. This would make the transport authority and the travel concession authority the same body.

There are several unresolved disputes between local authorities and bus operators about the costs of reimbursing bus operators, being *"no better and no worse off"* than if the concessionary fares did not exist (Transport Committee, 2007:13). They are reimbursed for the *"fare revenue foregone and for any additional expenses incurred"* (Transport Committee, 2007:26). There are continuing problems with the way in which reimbursements are calculated. This requires data on the actual level of concessionary travel, the numbers of passengers and an estimate of travel generated by the concessionary travel scheme. Further assumptions have to be made about the type of fare that would have been paid. It is difficult to work out what would happen if concessionary travel was not in place and how much revenue has been lost as a result.

In Scotland, local authorities base reimbursement on a specific fare, and bus operators are reimbursed for 73.6% of an adult single fare. The amount was capped at £63 million in 2007-8. This was part of a three year agreement between the Scottish Executive and the Confederation of Passenger Transport. In England, local authorities are encouraged to use a *"basket"* of fares (Transport Committee, 2007:27).

In 2002, the Commission for Integrated Transport proposed that *"greater benefits would be achieved at lower cost by extending held-fares to young people and those on low incomes, rather than free travel for those over 60"* (Commission for Integrated Transport, 2002). This is a sign that the policy of providing concessionary fares for older people and people with disabilities is not without contention.

Local authorities already have a responsibility to promote local health and well-being. This responsibility is being extended to Passenger Transport Executives. There are already some examples of local authorities introducing concessions for young people, for example Transport for London.

A review of the major Passenger Transport Executive authorities showed that older people and people with disabilities are the major recipients of travel concessions. There are a growing number of initiatives that target young people, whether at school, college or work. There are far fewer initiatives for people who are unemployed or are on low incomes. Table 12 shows some examples of these initiatives.

Table 12: Fare concessions for unemployed and low income groups in the main Passenger Transport Authorities

Authority	Unemployed	Low income
Greater Manchester	–	–
London	Half price bus and tram fares for people on New Deal and income support (until September 2008)	
Northern Ireland	–	–
Scotland		Full time volunteers aged 19-25 may travel free
South Yorkshire	Off Peak TravelMaster £13.50/week for use after 9am on week days and all day Saturdays and Sundays Those eligible are: • unemployed and available for work; • receiving Incapacity Benefit; • receiving Severe Disability Allowance; • receiving Working Tax Credit or Child Tax Credit and qualifying for free prescriptions and other NHS services because of low income; • receiving Income Support; • spouse claims Incapacity Benefit or Severe Disability Allowance. Also New Deal – eligible for weekly/monthly TravelMaster at half price	
Tyne & Wear	–	–
West Midlands	–	–
West Yorkshire	FreeCity and FreeTown bus routes are designed to connect bus and rail stations with shopping centres, hospitals, colleges and universities, and key business and leisure locations. Family DayRover for groups of up to five people (up to two adults and up to three children or one adult and up to four children) on both buses and trains.	
England		Family & Friends Railcard Railcard £24 which allows adults 1/3 off rail travel and 60% for children. Up to 4 adults and 4 children can travel together

Sources: *South Yorkshire PTE, 2008; West Yorkshire Metro, 2008; Transport for London, 2008*

South Yorkshire PTE has the most extensive concessions for people who are unemployed, on income support and low incomes, by making an Off Peak TravelMaster available at £13.50 per week, which can be used after 9am and all day on Saturday and Sunday. People who are part of the New Deal for unemployed people schemes can also buy a weekly/monthly TravelMaster at half price.

Transport for London has offered half price bus and tram fares for people on New Deal or income support since 2007. This initiative was funded though a deal which allowed Transport for London to buy cheap oil from Venezuela for buses, which saved about 20% of its fuel costs. Savings were used to subsidise travel for people on income support or the New Deal. This was negotiated by the previous Mayor, Ken Livingstone, in 2007 (Webster, 2007). In May 2008, the new major, Boris Johnson, announced that this arrangement would cease in August 2008. He has not made any other provision for low income users of public transport in London (Carroll, 2008).

West Yorkshire does not target unemployed people or people with low incomes specifically, but has a scheme of free routes that connect buses and railway stations with key points in the city – shopping centres, hospitals, schools, universities and other business and leisure facilities. This is an example of how environmental priorities can be combined with measures that benefit low income groups.

Railways in England offer a family rail card scheme that encourages adults to travel with children. This could benefit low income families, even though it is not targeted at specific groups.

Job Centre Plus has a *'travel to interview'* scheme, for people who are out of work and on benefit. A recipient has to be invited to go to an interview in the United Kingdom, for a specific job, outside of the area in which they are living. The job has to be for more than 16 hours a week and to last for more than three months. A candidate has to apply for help with travel costs before attending the interview and to apply for a refund within four weeks of the interview (Job Centre Plus, 2008). This is a complicated arrangement which, although targeted at unemployed people, is not particularly accessible.

This limited range of initiatives shows that unemployed people or people on income support are not targeted in the same way as older people or people with disabilities, by Passenger Transport Executives. In light of the recognition of the links between public transport and social inclusion, this is an area which requires more attention. It raises questions about the nature of the relationship between poverty and access to public transport and whether specific measures are needed to provide people with direct access to public transport by providing free or low cost travel concessions. There may also be other groups that experience the effects of limited access to public transport because of where they live, rather than through lack of income. Passenger Focus reported the case of people unable to use travel concessions, for example, in Central Wales or North of Scotland, because of lack of buses, but where rail companies operate non-remunerative services. It recommended that local authorities resolve these issues (Passenger Focus, 2007).

Conclusion

The past decade has seen an increased awareness of the links between social exclusion and public transport services. A lack of access to public transport services can influence an individual's access to employment, education, leisure activities and health services. At the same time, the limitations of the deregulation of bus services have become more apparent, with the loss of uneconomic routes and bus operators demanding more subsidies from local authorities. For bus travel, deregulation in 1985 does not appear to have provided improved access for people on low incomes. In many areas, their access to bus travel will have become more limited because uneconomic routes often include isolated neighbourhoods at the edge of cities.

Since the rail system was privatised there has been a consistent increase in the number of rail passenger journeys. More evidence is needed to argue that rail privatisation has led directly to increased rail travel. The rail industry has experienced more re-regulation than deregulation. Cheap rail fares are not always accessible for people on low incomes because of the complexity of booking cheaper fares ahead of travel, often involving use of the internet.

Central government has responded by expanding the role of local authorities in the planning of local transport services. This is part of a new set of responsibilities for local authorities to promote health and well-being of their local populations. It has strengthened their role in developing partnerships with bus operating companies, but ultimately their power is limited in influencing transport company decisions.

Central government has also expanded the scope of travel concessions for older people and people with disabilities, so that they can now travel free throughout England, rather than just their local area. Travel concessions have led to an increase in the use of buses.

The costs of fare concession schemes are high, with a complex process of reimbursement from central government to local authority and from local authority to bus operating company. There are no clearly agreed mechanisms for calculating the amount to be reimbursed to the bus operating company in England. Until this is agreed, the future of fare concessions will be subject to dispute. There is already some questioning of the long term costs of the scheme. As this is the most significant provision to encourage people on low incomes to use public transport, the resolution of problems in relation to reimbursement must be a priority for central government if it is committed to expanding access to public transport services.

For older people (60+) or people with disabilities, it is recognised that access to free travel contributes to well-being and improves the social inclusion of these groups. Children and young people are also recognised as needing access to public transport for travelling to school or college. It is difficult to see why people who are unemployed or on income support are not considered to have a similar need to access free travel. This could be administered in the same way that receipt of the disability living allowance - higher level mobility component - makes an individual eligible for free travel.

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Financial Services

"Despite the existence of alternative sources such as the Social Fund and Credit Unions, the sources of commercial credit available to the poor are massively more expensive than mainstream credit sources."

Robin Simpson

Senior Policy Adviser,
Consumers International
(chapter written in personal capacity)

Stijn Claessens (World Bank)2005: Banking systems and capital markets are often skewed towards those already better off catering mainly to large enterprises and wealthier individuals…This raises the questions whether more general availability of financial services should be a public sector goal, and if so what the best means of achieving this are.[1]

Marx (Groucho not Karl): *Banks will only lend me money when I don't need it.*

Introduction

The Financial Services (FS) sector is too vast and too varied to lend itself to a brief analysis, which attempts also to be comprehensive. This paper therefore concentrates on those sub-sectors which are most pressing in terms of detriment suffered by poorer consumers. According to the OFT (2008): *'Consumer detriment is defined as a measure of the financial losses suffered by consumers as a result of unsatisfactory purchases of goods and services.'*[2] Concentrating on the low income groups means not only identifying detriment as defined above, but also a further detriment: non-receipt of the service, perhaps the most difficult pattern of all to evaluate, and one which is not easily comparable with other sectors in this study. This analysis tends to focus on banking and credit services with wider reference and context where appropriate. It attempts to answer the following set of framing questions:

1. Is the market delivering for low income consumers?
2. Is competition and choice limited for low income consumers?
3. What are the particular challenges facing the sector regarding low income consumers?
4. To what extent are assistance measures succeeding in addressing the problems which have been identified?
5. What alternative policies might be pursued to assist low income consumers?
6. Have regulatory arrangements helped or hindered?

Market characteristics

There is no doubt that there are major dysfunctions in the FS market. According to the OFT study of consumer detriment referred to above:

> *The goods or services for which consumers have reported the highest proportion of problems are telecommunications, domestic fuel and personal banking. The highest average financial detriment per problem is found in the insurance category followed by home maintenance and improvements and personal banking… When categorised in terms of the type of product or service, the greatest proportion of total detriment was found among the group covering "Professional & Financial services" at some 45% of the total.*[3]

In 2006, the above mentioned OFT omnibus survey made contact with 10,000 respondents and conducted 2,000 face-to-face interviews followed by 982 second stage interviews in greater depth (the first stage of the survey gave data about incidence of problems, while the second stage gave data about the amount of detriment per problem, e.g. costs of repair, advice, time of work, consequential losses). Sectors were initially divided into six broad categories (Professional & Financial Services in this case) and subsequently into 60 sub-sectors, e.g. personal banking, insurance.

Detriment was by no means confined to the poorer consumers, indeed the survey found little overall variation by social group, such as gender or social grade. The highest propensity to report problems came from the 'parental' age group of 35 to 54.[4]

Of problems listed in response to the question regarding the 60 categories: *'Which goods & services you have had a problem with where you have had a genuine cause for complaint',* personal banking was joint second with 7 per cent of all problems, the same as domestic fuel and second only to telecoms with 8 per cent.[5]

But 55 per cent of problems involved less than £5 and so this is a very partial picture. Only 4 per cent of problems resulted in more than £1,000 of detriment, but these accounted for 79 per cent of the total detriment found.[6] In answer to the Question: *'We would now like you to estimate the total value of financial losses to you as a result of this problem"*, among the second tier (60) categories, the highest average detriment was found in insurance (£1,033), while personal banking was in third place with £234.[7] Likewise, in terms of average detriment per problem, Professional & Financial Services (P&FS - one main tier category out of six) showed the highest losses with £691 per problem.[8]

Turning to the resolution of problems, when it came to *'succeeding in putting things right'*, the OFT also found that P&FS had the worst level of net satisfaction among the six basic categories: minus 25 per cent (for comparison, the average was minus 14 per cent; and for personal goods and services the score was plus 18 per cent). P&FS also had the lowest level of consumers assenting to the proposition that the sector was *'treating you fairly'*: 24 per cent compared with the average of 34 per cent.[9]

In brief, financial services have the particular and dubious distinction of both a high *frequency* of detriment and the highest *volume* of detriment in individual cases.

This is an important context for the more detailed analysis that follows and, it is suggested here, goes some way to explaining the caution which poorer consumers express towards FS, a caution which is sometimes seen as undue conservatism. In fact, given the high cash volume per problem, such caution may, in academic parlance, be 'economically rational'.

Need and demand for the service

The need for financial services (FS) is not absolute in the sense that applies to housing, food, water and energy. It is the classic instance of a 'participation' service, without access to which consumers are barred from many conventional activities, such as purchase of goods on credit (including houses) or protection from risk through insurance. It is possible to survive without FS, but with considerable risk of losses and within a narrow range of activities deviating from what most of us would regard as normal.

Hence it is of concern that the National Consumer Council (NCC) reported that, in 2004, 7.8 million consumers had to borrow in the sub-prime credit market.[10] In their more recent report (2008) they warned that *'more consumers could be pushed into the non-prime or non-standard lending markets where prices are higher.'*

The reasons for this are complex, more so than might be suggested by a simple and inexorable extrapolation of the 'poor pay more syndrome'. As is reported below, some consumers **not** on low incomes nevertheless become over-indebted or run the risk of doing so.[11] In a 2005 survey of 5,328 households nationwide, Kempson and Atkinson, for example, found that almost one in ten were *'showing signs of financial stress'*, being always overdrawn and with the highest levels of borrowing among the five broad groups which they identified:

> *Yet as a group they seemed to be burying their heads in the sand as many of them considered they were living well within their means…relatively young but well qualified and quite well off…they tended to be spenders who bought things on impulse using credit rather than saving up.*

A slightly smaller group were *'clearly struggling financially'* but split into two subgroups. The larger one, 6 per cent of the survey sample, did not use overdrafts or credit and one third of them did not even have a bank account. Their problem was simply lack of income, with 60 per cent of such households having no-one in work. In contrast, another group, 2 per cent of the total, were *over-indebted*, being similar to the 'financial stress' group above but with greater preponderance of trigger factors such as dependant children and high housing costs. This sub-group consisted mostly of families below the age of 40 with dependent children, and occupied the middle of the income range. They had heavy credit commitments and no savings;[13] the report describes them as: *'The most financially profligate of the five groups.'*

These findings suggest two conclusions which are highly relevant to the discussion of income or expenditure as generators of over-commitment:

Firstly, the group *showing signs of financial stress* (almost 10 per cent) are tomorrow's *over-indebted*. The latter came to only 2 per cent of the total in the summer of 2005, and many might subsequently have shifted from the one category to the next. Furthermore, the problems of these two groups cannot reasonably be attributed to low income, although they may well have social pressures which lead them to over commitment.

Secondly, many consumers *struggling financially* on low incomes studiously avoid financial commitments and thus stay out of the sub-prime sector, but remain poor as a result of their limited resources. This group considerably exceeded (by about three to one) the over-indebted who were not generally on low incomes.

Kempson and Atkinson concluded that a *great majority* of the 'strugglers' on low incomes or over-indebted had fallen into arrears of one kind or another following a drop in income, and a significant number had multiple arrears. So, while the survey clearly indicates some over-commit for reasons other than low income, what may throw people into unsustainable commitments will often be the unforeseen disruption: those on lower incomes have less margin for adverse contingency or commitments made in the past. This lack of a margin of error means that misjudgements, which might go unnoticed among the better off, attract criticism when committed by the poor, because the consequences are more visible in terms of arrears, cut-offs etc.

Framing Questions:

Q.1. Is the market delivering for low income consumers?

This is not an easy question to answer, because the FS market is multiple; even sub-sectors, such as credit, are highly segmented. It is easiest to proceed by discussing first those consumers who are without bank accounts (or 'unbanked'). Discussion of FS needs not only to go into the avoidance of over-commitment, it also needs to address the consequences of *denial* of service, as this pushes consumers into the sub-prime sectors, where commitments will be still harder to honour.

According to the latest Family Resources Survey, there were two million adults living in 1.3 million households without access to a bank account in 2005/6. This compares with 2.8 million adults living in 1.9 million households in 2002/3, an approximate decrease of 30 per cent in both measures and 800,000 adults.[14]

There is a clear social skew in the underlying figures. The Financial Inclusion Task Force (FITF - meeting under the auspices of the Treasury) found that low income families were more than twice as likely to be unbanked (13 per cent) as the average (5 per cent). They were also more likely to have no savings (55 per cent compared with 33 per cent).[15]

Those in the social rental sector were three times more likely to be unbanked (for example 24 per cent of Housing Association tenants have no bank account[16]); benefit recipients were twice as likely; similarly, those with incomes below £20,000 per year. The same differentials were found regarding households with no savings. The National Consumer Council (NCC) reported in 2004 that 28 per cent of British households have no savings at all, a figure unchanged from four years earlier. The level reached 46 per cent for households with weekly incomes of less than £200 (2003).[17] Perhaps even more ominous is the 2008 calculation that *'nearly half the households in the UK don't even have savings of one month's salary to fall back on.'*[18] Generalised vulnerability of this extent is bound to close down options.

It is a matter for debate as to what extent consumer choice enters into this pattern. The Financial Services Authority (FSA) divides the population up into three broad groups in terms of their readiness to take out new financial services.[19] These groups are: 'Active', 'Reasonably active' and 'Inactive'. The latter consists of those who had not considered or taken out 'products' (jargon for specific service agreements) in the last five years and amounts to 14 per cent of consumers.

The methodology of the analysis leads to some ambiguity and is not discussed further here. The point is to consider whether it is helpful to judge consumers by the extent of their activity. For the goal of FS activity in the real world is not to be a protagonist in a market place, rather it is to provide security. A senior civil servant with a generous pension in prospect has the luxury of complete inactivity in the pensions market place. Likewise, an extreme level of activity may well indicate market malfunctions rather than constructive activity. So it may well be that the true sign of a well-functioning market is *lack* of 'activity'. There are serious dangers in classifying (even stigmatising) the 14 per cent 'inactive' consumers. The FSA research found that the least receptive were likely to be in social grades DE, on low incomes and disproportionately in the 18 to 24 group and not working. Undoubtedly, some of this pattern may be due to lack of understanding. But whether a flurry of 'activity' is going to resolve the issue should not be blithely assumed.

The language of 'receptivity' suggests that blockages to access exist only at the level of the consumer, who exercises a greater or lesser degree of choice. However, the reality is rather more subtle, as the following tabulation of types of exclusion indicates.

Kempson *et al.* some years ago (2000[20]) identified five types of exclusion of the poor:

1. Access exclusion: e.g. through risk screening.
2. Condition exclusion: product design inappropriate for needs.
3. Price exclusion: too costly.
4. Marketing exclusion: exclusion from marketing and sales.
5. Self-exclusion: not applying in the belief that they would be refused.

Low income consumers are widely reported as finding regular credit services to be inaccessible because of such factors as high minimum loans, lack of a bank account to receive the loan, inflexible monthly payment systems, financial penalties, or poor credit scoring. Refusal can be a humiliating experience, and so it is not surprising that some consumers prefer to avoid the process altogether (a feeling that may have been reinforced by the move towards open-plan bank layouts with the fear of less privacy).

So some are excluded from access, and the anticipation of that exclusion may lead to a kind of self-exclusion (which we could perhaps call the *not for us* syndrome). Much analysis seems to exclude the possibility that 'non-receptivity' among low income consumers may actually be rational. As the mis-selling scandals of the past decades in the pensions field have indicated, and as the OFT analysis with which this chapter began suggests, some complex products are indeed risky. So, given the sums of money involved, one should not fall into a casual assumption that somehow the poor are acting perversely against their own interests by remaining outside various FS markets, where they choose to do so.

Explanations for non take-up of service, must include the fact that FS are intrinsically complex and many consumers suffer from very low levels of numeracy and literacy. Research by MORI in 2003 for the Basic Skills Agency showed links between poor basic skills, financial exclusion and social disadvantage.[21] This leaves the most vulnerable people open to paying more or making poorer choices. In their survey, 6 per cent (of 2,089 adults) could not identify the numbers *'seven, eight, three, nine'* (when read to them), written out in words, whilst 12 per cent could not work out which was the better deal - ten pounds off, or 10 per cent off a £300 TV.[22]

Regardless of the reasons for non-service, the pattern is reasonably plain. However, the details have changed in recent years: there is a decline in unbanked households which is particularly marked among the bottom three deciles, and among households with a female 'reference person' (the term which has replaced what in the past would have been referred to as the 'head of household'). Among 'unbanked' reference persons, the female proportion fell from 52 per cent in 2002/3 to 45 per cent in 2005/6, indicating less female preponderance among the unbanked population. But this does not mean that males became more unbanked, simply that they became more prominent within a reducing unbanked population. So the proportion of male reference person households which were unbanked fell, but at a slower rate than females.

Lone parents also fell as a proportion of the unbanked, as did black and Asian families. In contrast, the elderly rose as a proportion of the unbanked population despite, in this case too, the same long term decline in numbers without a bank account. By 2005/6, unbanked households were far less likely to be in receipt of benefits than in 2002/3 due to a rise in banking among benefit recipients due in parts to the government's payment modernisation programmes. It is important to record that the *decline in unbanked status cross the board does not conceal any absolute increases within specific demographic or socio-economic groups.* These are remarkable trends which indicate some success for the policy goals expressed by government and put forward by the Financial Inclusion Task Force (FITF). The unbanked are becoming fewer but, in some ways, more typical of the general population. **In brief, the unbanked population is shrinking in total and ageing in composition.**[23]

One might say then that there appear to be significant market failures but these failures have been diminishing. Whether that diminution will persist through the current difficulties on the credit market remains to be seen. There are three levels of market failure to consider:

- The first was dealt with in the introduction and is the high degree of detriment in the sector as a whole, compared to other sectors.

- The second, dealt with in the preceding paragraphs, is a failure of inclusion.

- The third is dealt with below, and refers to the 'consequential losses' of market failure, which are particularly pervasive in the case of FS.

For the true impact of the market failures in FS detailed so far is to be found in its leading on to market failures in other sectors, whether in sub-sectors of FS or elsewhere. According to HM Treasury (2007): *'A small but significant minority of people are unable to access even the simplest of financial services. For these people, financial exclusion means significant additional cost and loss of opportunity.'* Being unbanked can even be a barrier to employment.[24] Consumers pay more for many services if they cannot pay by direct debit. The current differential between standard quarterly credit and direct debit for dual fuel gas and electricity is currently estimated by Energywatch as £83 on average, even more if consumers are on pre-payment meters[25] (see also S. Thomas, this volume).

Some practical consequences were spelt out by the National Consumer Council in its publication *Why do the poor pay more?* [26]

> *Almost half of those with annual incomes under £10,400 have no savings at all. Insufficient savings mean that about eight million people cannot afford one or more household essentials, such as a washing machine, or to repair electrical goods or furniture when needed. (2002)*
>
> *Over half of the poorest fifth of the population lack home and contents insurance, even though they are twice as likely to be burgled. (2003)*

A further consequence of restricted access is that some of the unbanked population are forced by circumstances into reliance on FS providers which they would rather not use. For example, as will be seen below, some home credit companies charge in excess of 300 per cent APR for loans,[27] while the Competition Commission reported rates varying from 150 to 500 per cent. Charges for cashing cheques for non-banked consumers come to 10 per cent of their value.[28] For the National Housing Federation, Niall Alexander reports that some three million people borrow at 164 per cent and, of those, 70 per cent rent their homes from a social landlord.[29] According to HM Treasury, people without access to conventional credit use doorstep sellers or loan sharks, some of whom are known to resort to intimidation.[30]

This said, it should be borne in mind that a large number, the majority in fact, have access to FS and generally proceed without undue difficulty. Kempson & Atkinson reported in 2005 that most people surveyed managed well with credit:

> *…keeping up with bills and commitments, not constantly in overdraft, nor were they using a credit card they did not repay in full to buy food, pay bills or get cash. However a minority of people were exhibiting at least one of these strains, some of whom showed two or more.*[31]

In the cluster analysis carried out for their study, they found that 6 in 10 households were *'financially sound'*. They found that levels of unsecured borrowing were at their lowest among this group. Fewer than one in twelve of them were spending more than 10 per cent of their income repaying unsecured credit.[32]

A further one quarter were *'managing reasonably well'*, with one fifth of their disposable income spent on repayments **including** mortgages. Two thirds of households had no payments to make on unsecured credit, and half had neither unsecured credit nor mortgages to pay off.

> *Although levels of borrowing have increased appreciably over the last 15 years, the proportion of income devoted to paying unsecured credit and mortgages in 2005 was very similar to that found in the late '80s, (just before the economic downturn and rapid rise in arrears) when interest rates were far higher.*[33]

It is therefore important not to draw excessively pessimistic generalisations about the general picture, while concentrating on the plight of those for whom there are problems in this domain, problems that are likely to have intensified during the last year.

One should bear in mind not just those households that were struggling financially, but also those at risk of doing so. For example, Kempson *et al.* found that 6 per cent of households surveyed had repayments on unsecured credit (i.e. excluding mortgages) equivalent to 20 per cent plus or over of net family income. Five per cent paid over half of net family income on unsecured credit/mortgage payments.[34]

The most heavily committed groups were those *showing financial stress* and, in particular, those who were *struggling and over-indebted*. Almost all the first group had some unsecured credit, with the average amount being £3,345 each (the highest of all the groups), six in ten had regular payments to make and 16 per cent spent more than 20 per cent of their income repaying unsecured credit. Three quarters had regular mortgage and/or unsecured credit payments and in three in ten cases this amounted to 30 per cent or more of disposable income. One in ten spent over half their income in this way.

The small group that were *struggling and over-indebted* all owed money (£3,200 on average) and one fifth paid over 30 per cent of disposable income on unsecured credit. Four in ten spent over 30 per cent on unsecured credit and mortgages, and one in five over 50 per cent.

This indicates evidence aplenty of over commitment not necessarily related to low income. But conversely, the group that were *'struggling on a low income'* were **not** heavy users of unsecured credit. Two thirds of them owed money, but the average amount came to only £805, compared to an average of £2,000 for all borrowers .Three quarters of them were paying 10 per cent or less of disposable income on repayment of unsecured credit, and for the 8 per cent of the group for whom repayments accounted for 30 per cent and over, this was mainly due to low income rather than heavy borrowing. Average repayment rates as percentage of income were higher than among the 'financially sound' group, but about the same as those 'managing reasonably well' and was lower than the other two groups.

Therefore, the concern here is not so much about over-indebtedness; given their incomes, many of this group would not have passed the score cards for conventional sources of credit such as credit cards or overdrafts. There is a major concern, however, about how such households will cope with increases in fuel and housing costs. These services, rather than the financial institutions, will become the real creditors of this low income group and that has implications for the rest of this report.

Verdict: So the answer to question 1 is that the market generally delivers for the broad mass of the population to the extent of 'over-delivering' for some. Banking services are extending further towards lower income consumers than in the recent past, although significant numbers remain excluded with serious consequences, including being pushed to more expensive forms of credit. There is not a simple correlation between poverty and overcommitment in terms of credit; the problems may emerge in other forms of arrears.

Q.2 Is competition and choice limited for low income consumers?

The market for credit is particularly varied and segmented, while characterised by acute consumer detriment for those on low incomes. In competition theory, this appears as something of a paradox. What are the reasons for this?

The recent Competition Commission enquiry distinguished the following varieties of high cost service used by consumers on low incomes.

- *Home credit companies* (doorstep lenders) lent £1.3 billion to 2.3 million customers in 2004.[35] Repayments are usually weekly and the loans generally come to several hundred pounds in total with Annual Percentage Rates of charge (APRs) of 150-500 per cent. In practical terms, typically a £100 loan gets a £40-80 extra pay-back.[36]

- *Agency mail order:* 20 per cent of low income households used this service in 2004,[37] and the Competition Commission enquiry found that 14-21 per cent of all home credit users availed themselves of this service.[38] The loans purport to be 'interest free' but the prices of the goods for sale were typically higher than would be the case in retail shopping outlets.

- *Pawnbrokers:* used by about 600,000 customers per year, charge around 7-12 per cent interest per *month*, which works out mathematically at 110 per centper annum in the case of a £200 loan over four months, which would exact a £56 charge. Twenty-nine per cent of consumers fail to recover the pawn.[39]

- *Cheque cashers:* There are about 1,500 outlets, with charges of about £6-14 for a £100 cheque. One would expect demand to fall as bank accounts spread further.[40]

- *Sell and buy-back:* This is a service offered by many pawnbrokers under which a borrower sells an item to a lender and then buys back at a higher price after a short lapse of time. The CC reported the existence of 100 outlets nationally in a single firm.[41]

- *Rental purchase:* Goods are technically rented rather than purchased and can be repossessed if payments are missed (it is also a feature of house purchases in the North West of England in particular). Typically there is an APR of 30 per cent plus a higher price for goods, which can be repossessed when payments are missed.[42]

- *Illegal lenders:* 165,000 households were estimated as being charged about £185 per £100 borrowed, resulting in APRs of several thousand per cent.[43] The Treasury study of Financial Inclusion (2007) reported that *"intimidation and violence to elicit payment are common'* (it is worth noting that this last picture is considered something of a myth by several experts, including some contacted for this study).

Extent and frequency of choice and ease of switching

The above services cater for the lower end of the income spectrum. What about the mainstream? Does the variability of the market mean that there is competition working to the benfit of consumers? The most recent study of switching has just been published by the Scottish Consumer Council and fortunately (for present purposes) contains comparative data for England & Wales (E&W). SCC's general conclusion was relatively optimistic regarding the broad population of consumers:

> *The headline message is a good one. In all markets (studied) the majority of consumers say they are happy to stick with their current suppliers, and people generally find it easy to obtain information on what companies have to offer. When people do switch they are doing so, to a fairly high extent, in those markets where it makes most sense to switch: where savings to be made are high (mortgages); where prices are changing markedly both up and down (gas and electricity); where it is very easy to do so (home insurance).*[44]

For FS, the proportions of consumers (service by service) found to have switched over a five year period were as follows:

- *Home insurance:* E&W: 29%; Scotland: 29%;

- *Savings account:* E&W: 7%; Scotland: 5%;

- *Current account:* E&W: 7%; Scotland: 6%;

- *Mortgage:* E&W: 31 %; Scotland: 27%.

Over three quarters found it very easy to change insurers in E&W and Scotland, between half and two thirds for mortgages, and around half for banks (over half in E&W).

There are differences in behaviour across different groups, but these are not massive. Those less likely to switch are older or disabled consumers and those on lower incomes and/or without internet access. On average, 33 per cent of consumers were found to have changed FS providers, of which 27 per cent C2DEs changed compared with 39 per cent ABC1s. However, these social differences are less significant than other factors. For example, those with online access changed in 41 per cent of cases, compared with 19 per cent for those without (a differential that will go some way to accounting for the social gradient observed). Here are the returns for financial services by social group and by sector in Scotland:

- *Home insurance:* ABC1: 29%; C2DE: 26 %;
- *Savings account:* ABC1: 6%; C2DE: 4%;
- *Current account:* ABC1: 8%; C2DE: 5%;
- *Mortgage: ABC1:* 27%; C2DE: 26%.

So while these differences are consistent in that they show a higher propensity to shift among the ABC1 group, the differences are not massive and could mask other factors. It is suggested here that the two groups would need to be disaggregated for stronger social differences to emerge. Indeed, for example, while 11 per cent of Scots do not have a bank account, this rises to 18 per cent of those on low incomes. This suggests that social differences are most pronounced among the very bottom deciles, rather than across the major aggregate groupings. Above that level the SCC findings are relatively sanguine from the competition viewpoint.

Home Credit market

Market structure: range and dominance of suppliers

As we saw at the start of this section, a rather less optimistic conclusion is likely to be found among the poor, judging from the cost of services on offer. Following a 'super-complaint' by NCC, a reference was made by the OFT to the Competition Commission (CC) in December 2004 regarding the workings of the Home Credit market. A 'super- complaint' (defined by section 11 of the 2002 Enterprise Act) is a complaint to the Office of Fair Trading (OFT) that features of a market harm the interests of consumers. According to the Competition Commission, Home Credit (HC) lenders lent about £1.3 billion to 2.3 million customers in 2005 and collected £1.8 billion in repayments.[45] Since 1994, the level of loans rose and then fell again and by 2005 was at the 1999 level. The CC found that the mean value of a HC loan was around £300 and 70 per cent of loans were below £500, with 90 per cent under £1,000. Most loans were repaid in a year or less, with a mean duration of 43 weeks.[46]

Six large lenders (five quoted companies) account for 90 per cent of the market (the sixth, Mutual Clothing & Supply Ltd, is a family firm, largely restricted to the East Midlands, whose cash loans were found by the CC to be cheaper than those of its competitors). Provident Financial is the largest Home Credit lender and accounts for 60 per cent of the market.[47] It explicitly targets unemployed borrowers in its mailshots, saying *'Tenants and unemployed welcome'.*[48]

Customers are more likely than average to be female, under 35, with young families, from socio-economic groups D & E, on low incomes and social housing renters. This profile has proved to be pretty stable.[49] Most HC borrowers were found by the CC to have at least one other credit option, although for some HC was the only source.[50]

Door to door canvassing of credit is illegal. So legally compliant HC is by definition bundled with the sale of goods or vouchers for goods. Nevertheless, in practice it may come close to the sale of credit, in particular through promotion of new loans on completion of, or incorporating, a previous one.
It is vital for an understanding of the HC market to appreciate its highly personal nature. For by far the most prevalent form of marketing of home credit is word of mouth, which is the most common source of new customers. The vast majority of home credit is provided by companies engaging agents who visit homes to collect repayments, and who sometimes assess creditworthiness and make loans. Two hundred sole traders carry out all of these functions. They, with partnerships, represent three quarters of HC lenders, although only a small proportion of the market in cash terms.[51]

Most corporate providers have self-employed part-time agents, mainly women, generally locally recruited and often former customers. The CC were told in evidence that over 40 per cent of agents had been with their respective companies for five years or more. They are paid on commission, which usually amounts to about 7-10 per cent of cash collected. Payment by commission is considered by the Consumer Credit Association (the relevant trade body) to be a brake on irresponsible lending.[52]

The personal nature of the service is reflected in the fact that court action to enforce payment is rare, the weekly visit being both a major advantage in terms of convenience and the most common guarantor of payment, as pointed out many years ago by the studies carried out by Elaine Kempson *et al*. This is significant because most loans incur at least one missed payment. In that event, HC companies do not generally penalise through extra charges, instead they extend the loan. This strategy can bring customer loyalty but can also bring commercial risks, and the larger companies incur annual bad debt charges of between 5 and 13 per cent of average receivables.[53]

Industry costs

It is a long held complaint of the HC trade body, the CCA, that APR is a poor measure of price and the CC agreed with that view, preferring to use the total charge for credit (TCC) especially for loans of less than a year.[54]

Nevertheless, the CC found in effect that the HC sector doth protest too much. APRs generally exceeded 100 per cent and that six month loans (approximately) often exceeded 300 per cent. TCC varied from around £30 per £100 for the shortest loans to over £100 per £100 for the longest. In contrast, Capital One's Classic Credit card (designed for sub-prime market) had an APR of 34.9 per cent and Post Office loans 7.9-12.5 per cent.[55]
The CC found that even while recognising the methodological difficulties surrounding measures of price (discussed later), there was still an unexplained gap.

Prices in the UK were higher than for comparable services in Ireland, and particular emphasis was placed by the CC on the finding that early payment by consumers seemed very expensive. This is highly significant as nearly half the borrowers pay early. Most loan charges remained payable on early settlement and rebates (the minimum level of which is governed by statute) were calculated in a way that favoured the lender. So one major disadvantage of HC compared with high street lenders was in poor early settlement rebates. Furthermore, the CC considered that the minimum rebate as set out in the Consumer Credit (Early Settlement) Regulations 2004 fell below what they considered appropriate in terms of the costs of the service.[56]

But one countervailing advantage was the absence of penalty charges. In all, the CC concluded:

> *We found that the prices of home credit loans however measured, were high by comparison with the prices of other credit products (although given the differences in the product offerings, that does not necessarily imply that a home credit loan represents worse value for money).*

The service has high costs because of its peculiarly labour intensive nature, but prices may still be excessive in terms of covering those costs. The CC concluded that both Provident and S&U had, in the period from 1999 to 2005, *'been earning returns substantially and persistently in excess of the typical cost of capital for a large home credit lender'*[57] (unsurprisingly, Provident disagreed). Similar conclusions were reached for other companies, regarding cost of capital. There had been 'persistent and substantial' returns above the cost of capital over a substantial part of the market, including some smaller lenders.

In summary, financial estimates of pricing compared to a competitive market concluded that charges for an average loan (around £300) were £20 higher than would be expected in cost based prices, resulting in an excess charge of £7 per £100 loan issued.[58]

The Competition Commission concluded that there was little evidence of switching, but there was evidence that customers felt generally satisfied. Nevertheless: *'While home credit provides a service that meets a distinct customer need, it does so at a higher price than could be sustained in a competitive market.'*[59]

No other services were good substitutes or posed a competitive threat. Although there were few barriers to small scale entry to home credit, there were significant barriers to large scale entry or to expansion. These include adverse selection (new customers being a worse credit risk than existing ones), incumbent advantage, and the need for 'local density'. Therefore, although there were significant differences in price, there was little movement between suppliers, and customers remained relatively insensitive to price. Incumbents with existing clients had a big advantage in that agents did not share credit data with others through Credit Reference Agencies.[60]

Illegal lending

Completing the round-up of possible substitutes for conventional credit, is illegal lending the 'end of the line' recourse for the desperate or the isolated, those refused other sources.

Lending without licence is illegal in the UK and door-to-door canvassing of credit *per se* is illegal. The stereotype of an illegal lender is a violent and threatening man, but some illegal money lenders are local women who lend small amounts.[61] Although intimidation and violence in debt recovery is a feature of illegal lending, it may have been exaggerated and used to discredit legal door-to-door sellers of goods on credit. Where it is most prevalent is in areas shunned by other lenders, such as those with a high level of criminality. Illegal loans are typically made on a weekly or fortnightly basis. Pension or allowance books may be taken to guarantee payment, a practice which is illegal. One per cent of Home Credit users said they used illegal lenders currently, although it would be unsurprising if this were an underestimate given the fact that it is illegal and stigmatised.

Verdict: *The answer to the competition question seems to be that the market is segmented with a mainstream in which switching is feasible and practised to varying degrees freely by consumers. At the other end of the spectrum is the illegal sector, the end of the line for the desparate. Turning to the HC market, the evidence is that the market is not competitive, although a part of the explanation may lie in its intensely local and personal nature. The evidence also seems to suggest a huge paradox. The service is very expensive and yet consumers seem to value it and we do not get the picture of them turning to the lenders out of pure desperation.*

In these circumstances, the natural question to ask is why do consumers use the service? To their credit, the FITF decided simply to ask consumers and the results are discussed in the next section.

Q.3 What are the particular challenges facing the sector regarding low income consumers?

So far, the picture emerges of a mainstream credit market which contains its own strains where consumers become over-indebted but where the system functions, and a marginal market which operates almost in parallel and in a more personal face to face way. The stigmatisation of this parallel market as more or less criminal does not do justice to the lenders or the borrowers, as it has far more complex attributes which are explored below. It is clear that it is a major challenge to regulate a sub-sector which operates at door step level.

In an attempt to address the apparent paradox that consumers on low incomes pick out expensive services, the Financial Inclusion Task Force commissioned a series of four deliberative workshops in Newcastle, Glasgow, Leicester, South Wales and a focus group in Stoke in 2004 attended by consumers, 8 per cent of whom did not have any kind of bank account and 12 per cent of whom did not have an 'everyday' bank account. Half the participants had borrowed money from a non-mainstream source. The workshops reached the following findings: [62]

The key demand side barriers to taking out bank accounts were as follows:

- *Lack of awareness:* consumers did not know about basic bank accounts (see later) and that access to them was easier than for current accounts. There was low awareness of affordable credit sources such as credit unions.
- *Lack of perceived advantage:* consumers did not see good reason to open a bank account.
- *Socio-cultural factors:* there was a common preference for cash, a common perception that banks were 'not for poor people'.
- *Attraction of alternatives:* e.g. other people's accounts. Some used POCA (Post Office Card Account). Many borrowed from family and friends and doorstep moneylenders and used catalogue sales.
- *Control:* many preferred to keep track by cash as they had worries about standing orders and direct debits. Some felt stung by past experience with loans and overdrafts.
- *Confusion and complexity:* e.g. ID requirements; difficulties of comparison of terms and conditions.
- *Fear and mistrust of banks and banking:* feeling of stigma against people on low incomes; fear of charges and penalties; even suspicion of trickery.
- *Perceived and experienced supply side barriers;* fear as to whether they will 'qualify' for loan; a poor credit history was felt to be humiliating.

There were also perceived benefits to bank accounts:

- Better security.
- Protection from irresponsible spending: 'money out of reach'.
- More convenient, e.g. ATMs.
- Direct payments of wages and benefits: (POCAs were available for benefits but not for wages).

- Access to direct debits; also recognition of discounts brought by them but also concern about the workings of direct debits.

- Access to specific products and services, e.g. those payable by credit cards or direct debits.

- Access to other bank services, e.g. mortgages.

The potential attractions of a basic bank account were recognised when explained: the buffer zone allowing a margin of error with small cash withdrawals (see below), the convenience of a debit card, and notably the *absence* of an overdraft.

Nevertheless, the research concluded[63] that:

> *The perceived barriers of mainstream banking and credit currently substantially outweigh the benefits. There are also some indications that financially excluded people currently accept paying over the odds and being excluded from information and services"…*later going on to say: *Encouragingly, the majority would want to open a bank account and access affordable credit if the barriers were addressed.* [64]

There emerged strongly from the discussions a strong preference for local and face-to-face contact. The advantages of less formal services emerged such as, in the case of Credit Unions (see below), the common bond, friendly staff, the local and convenient nature of the service and family membership. Further perceived advantages of CUs were low interest rates, built-in control, flexibility of repayment, and encouragement of saving.

In considering membership of financial institutions, the consumers in the workshops looked for ease of qualification including small initial deposits, ability to borrow small amounts, flexibility of repayment, consistent minimum standards, reduced ID requirements, buffer zone facility, aligning direct debits with incoming payments, regular statements, and early warnings of overdraft.

Currently, for many of the participants the conventional finance institutions were not providing these things, and the Home Credit market and other sub-prime providers had stepped in to meet that demand. The challenge then is for mainstream FS providers to emulate such positive features as are found by low income consumers in the HC market. Should this be done through new financial 'products'? Or are entirely new service providers needed?

New financial services (products)

Much has been made of the development of basic bank accounts referred to above. Although there is not a single model, these are broadly defined by the FSA[65] as comprising:

- Facilities for inward direct payments such as wages;

- Facilities for inward payment of cheques without charge;

- ATM cash card;

- Post Office withdrawal facilities;

- Direct debit facilities (some banks offer standing orders).

The main features that BBAs do not have are debit cards (in many cases),[66] cheque books and overdrafts. Some may have small ‘buffer zones’ to allow for the rigidities of cash denominations. (For example, an ATM may pay out £10 even if there is only £6 in the account.)[67] The FSA lists seventeen basic bank accounts as being currently available.[68]

According to the Financial Inclusion Task Force (FITF), basic bank account holders are far less likely to use direct debits or standing orders than current account customers (50 per cent compared with 82 per cent).[69] It is sometimes said that a basic bank account is a step on the escalator towards a full account. So, while about 7 per cent of unbanked consumers use credit cards, this rises to about 28 per cent for basic accountholders; 28 per cent of unbanked consumers have life insurance compared with about 63 per cent of basic bank account holders.

But the escalator effect should not be exaggerated. While just over 40 per cent of unbanked consumers have savings accounts, the figure rises to a little over 50 per cent for basic bank account holders - not a massive increase. British Banking Association (BBA) figures suggest that about 10 per cent of those who opened basic bank accounts since June 2003 have since upgraded to full service current accounts.[70] Again, this is a modest increase, especially bearing in mind the general increase in bank account holding over that period.
Niall Alexander for the National Housing Federation (NHF) makes the following judgement that high street banks are not rising to the challenge implicit in our question 3:

> *Banks argue to the contrary but many people believe that the basic bank account customer presents an unattractive option for banks, as there is very little evidence of migration from a basic bank account to other accounts or bank products, and poor cross-selling potential. Some banks prevent low volume cash transactions from the basic bank account in banking halls, some insist on appointments being made to open the account, most will accept only postal applications, some increase the length of time it takes to clear a cheque. These are not the actions of a bank keen to secure an individual’s custom.*[71]

Research reported by the NHF reports a ‘general disappointment’ with the workings of High Street Banks’ basic bank account offerings.[72] These centred around three main aspects:

- High charges for unpaid direct debits;
- The lack of a buffer zone to allow customers to overdraw relatively small amounts to meet the pressures of day-to-day living on low incomes;
- No electronic facility allowing customers to use their bank card at shops and other outlets.

Indeed, the National Housing Federation suggests that some of their tenants may end up in a worse situation as a result of opening an account. Research by Millward Brown for the British Bankers Association in 2005 showed that, of the half of all active basic bank account customers that had set up a direct debit facility, one third had experience of a bounced direct debit, often more than once.[73] The FSA lists typical charges for unpaid direct debits as ranging from zero to £38.[74] *(For explanation of zero charge see footnote.)*

The NHF calculates that a £38 charge for the typical housing association tenant whose weekly income is £216 gross represents 17.5 per cent of their weekly income. For comparison purposes this equates - in terms of impact - to a typical owner occupier’s weekly wage of £592 being charged £103.60 for an unpaid direct debit. Nevertheless, between April 2003 and December 2006, 2,259,000 basic bank accounts (accessible via the Post Office network) were opened, of which the BBA estimates 51 per cent (1,152,000 accounts) were opened by customers who were previously unbanked.

Post Office Card Account

The Post Office Card Account, or POCA, is an account with a simple cash in/cash out card; it is considered relatively difficult to open and carries fewer functions than a basic bank account, and yet over four million people opened one over the above period, clearly valuing the Post Office as a reliable delivery channel. Yet, despite new POCAs seeming to outnumber new basic bank accounts, the POCA is being phased out by 2010 and, at present, there are no signs of an alternative product other than a basic bank account.

New financial servce providers

Credit Unions

Turning from new products to new providers, the Credit Union movement was relatively slow to become established in the UK other than among particular populations, such as people from the Caribbean and Ireland, where Credit unions have a long history of being associated with the churches. CUs are mutually owned financial organisations which offer saving and loans to their shareholder members. They are registered under the Industrial & Provident Societies Act 1965 and regulated by the FSA and require a 'common bond' for purposes of registration. There are other common bonds than churches, such as employment; for example the London Taxi drivers and the Metropolitan Police have two large credit unions. The norm has been for members to access loans as multiples of shares amassed. There are moves to shift more towards 'capacity based lending' based on ability to repay; in other words, closer to traditional bank lending.[76]

Membership of CUs is growing, from 256,000 members at the end of 1998 to 492,000 in June 2005. Conversely, the number of unions declined from 630 to 567 and size increased, in part due to mergers. Credit normally depends on savings, with usually three months membership being required, although the Unions are becoming more open to those with no record of saving. CUs can lend for up to 5 years for unsecured loans, and up to 10 years for secured loans. The amount borrowable over and above savings in the CU has increased to between £7,500 and £15,000 depending on the status of the CU.[77]

Unlike the commercial banking sector, the rate of charge is subject to a cap. This has been the focus of government consultation in which the obvious contrast with commercial banks was remarkably under-discussed. One reason for the different treatment was historically the exemption of the credit unions from the provisions of the Consumer Credit Act 1974, an exemption which was renewed in 2006.[78]

Following the Chancellor's pre-budget report of 2005, the maximum rate of interest charged to consumers was raised from 1 to 2 per cent per month: this is the equivalent of an increase in APR from 12.7 per cent to 26.8 per cent. The previous limit was found to be too restrictive and inhibiting to the scope for loans to low income consumers. The Association of British Credit Unions Ltd (ABCUL), the trade body for most credit unions, argued that raising the cap would allow them to make loans to people without savings, thus making inroads into the HC market. For example, it was calculated that a £400 loan at 2 per cent per month would still cost £180 less in repayments than a HC loan at 170 per cent APR over 53 weeks.[79] A survey by ABCUL found that 50 per cent of loans were for less than £500 and, significantly for this discussion, 30 per cent of CU members used to have HC loans. This suggests that CUs are capable of making inroads into the commercial HC market and, in that sense, relaxing the interest rate cap was a logical step. Certainly they are not seen as a threat to the high street banks as is clear from the following two quotations:

> *It is not commercially viable for us to offer high volumes of very low value loans to customers. ..we think credit unions are well placed to do that and we are helping to support them.* (Gary Hoffman, Group Vice-chairman Barclays, who participated with ABCUL and the Office of the Deputy Prime Minister in a pilot project to change lending practices, moving in the direction of capacity based lending)

Provision of the short term, very low value micro-credit typically required by these customers is simply not deliverable (by banks) *in a cost effective manner…*(credit unions and CDFIs) *have the potential to make a significant impact in the market for small sum credit.* (HSBC written memorandum to FITF)

Credit Union membership has the following characteristics:

- 48 per cent owner occupier;
- 32 per cent of members have a household income under £200 per week;
- 62 per cent in full or part time employment;
- 14 per cent lone parents;
- 77 per cent of credit union members save weekly, fortnightly or monthly; and
- Average savings held are £261.

While this is not an affluent client profile neither is it the most disadvantaged. The credit union movement is being encouraged to reach out to poorer households, hence the change in interest rate cap, and has been the recipient of the government's Growth Fund capital for lending on to such consumers.

The Credit Unions' status does raise some issues which are currently under consideration by the FSA to whom they report. They do not pay interest to their members but dividends instead - a source of some confusion, as some Unions have been found to have advertised these returns as if they were interest.[81] While it might be argued that what matters to the consumer is the return regardless of dividend or interest, an obvious difference resides in the fact that the dividend cannot be declared until final year profits are known. The government is proposing to legislate to allow interest to be paid to saver members rather than dividends, and for membership to be extended to groups as well as individuals, and for 'radical change' to the definition of 'common bond'.[82]

Community Development Financial Institutions

CDFIs are not-for-profit organisations that provide lending and investment facilities in disadvantaged communities. The recipients are mainly small businesses, but there has been a recent rise in personal loans. Rates charged are between 15 and 30 per cent but are risk-based with higher charges to 'riskier' clients. In 2004, total lending came to only £150m of which three quarters comprised loans to small enterprises, including social enterprises.[83] The CDFI sector is not limited by common bond or boundaries, but nevertheless there is only a handful of personal lending CDFIs in the UK. CDFIs need partners to accept savings or deposits, and so partner with credit unions to deliver savings services. They see fewer personal clients than credit unions, but those they do see are more likely to fit the profile of the financially excluded.

Geographical considerations

The third sector credit working group of the FITF commissioned Experian (a credit reference agency) to undertake a survey in 2007.[84] They surveyed demand and supply of credit unions and community development finance institutions (CDFIs) in order to arrive at a map of the mismatch between supply and demand. The demand was based on the selection of five out of 82 lifestyle types most likely to indicate demand for affordable credit, plus low income and credit commitment data. Wards were then classified in terms of demand and local authorities classified in terms of the preponderance of high demand wards. For supply, all CUs and CDFIs were mapped and classified, and demand and supply then matched geographically. Demand and supply were then compared ward by ward to arrive at mismatch calculations: a high mismatch score reflecting high potential demand but low supply from such affordable credit providers.[85]

'Red alert' areas were then identified as those with 40 per cent or more of their wards among the most mismatched 1,000 wards nationwide: i.e. with high demand and little provision of third sector credit. 'Amber' areas were those with 20-40 per cent wards with high demand and little provision.

On the demand side, the highest levels were found in Blaenau Gwent, Merthyr Tydfil, Manchester, Stoke, Lincoln and several areas in North East England, Merseyside and the West Midlands. On the supply side, 550 organisations, not including workplace, religious or ethnic-based unions, were identified. The seventeen organisations in the top quintile (i.e. currently serving the financially excluded population, and capable of doing more) were quite widespread, including London, Bristol, Leeds, Sheffield, Hull and North West England outside of Manchester and Merseyside.[86]

Moving to compare supply and demand, the results were that of 408 Local authorities in Great Britain, 25 were classified as 'red alert' and 56 amber. The red areas included Stoke (top of the list), Corby (second), Lincoln, Manchester, and several locations in NE England and industrial Scotland. London, despite some very significant deprivation, is conspicuously absent from both the red and amber lists, which tend to be characterised by industrial decline.

Verdict: *So, is the sector rising to the challenge of serving low income consumers? Broadly, it is moving forward but slower than it might in terms of both types of services offered and service insitutions. Basic bank accounts are making modest inroads, credit unions still have a long way to go in terms of geographical coverage. The gradual relaxation of restrictions on their operations may improve matters. Failure to expand new services and new agencies, or even existing agencies and services such as Post Office accounts, will leave the market open to high cost home credit.*

Q.4 To what extent are assistance measures succeeding in addressing the problems which have been identified?

There are substitute (i.e. non-commercial) sources of finance for the poor from the state. As a preliminary comment, in referring to the social security system, it is worth noting that some mechanisms to promote banking have come about as a by-product of other support systems. Among the factors leading to the decline in numbers of unbanked households has been the payment modernisation programme for the receipt of social security payments. It is therefore of concern to note that some of these mechanisms are under threat, not least the services of the Post Office network.

Social Fund

The system of loans payable through the social security system from the Social Fund (SF) was introduced following the 1988 Social Security Act amid great controversy, replacing as it did many outright grants made to recipients of Income Support. This move from grants to loans coloured the way in which it was viewed at the time, for, on the face of it, a system of interest-free loans aimed at benefit recipients might be deemed to be 'progressive' in both fiscal and social terms. The criticism was that the loan repayments forced families below the minimum income that was meant to be guaranteed by the social security system.

The SF provides *budgeting* loans, which are available to those on IS, income based job-seekers allowance, or pension credit, for 26 weeks. The average loan in 2004/5 was £405, the range from £100 to £1,500. Any savings in excess of £1,000 (£2,000 for pensioners) reduce the loan payable pound for pound. Loans are interest free, but repayments are deducted from source (i.e. the benefit payment) to the extent of 5-12 per cent of disposable benefit (i.e. after housing costs have been met). Outstanding previous SF debt leads to disqualification from new loans and the loans are not available to those with less than 26 weeks on benefit. The gross loans budget was £560 million in 2004/5, and the net cost was £20 million, indicating a high rate of recovery, a crude calculation coming to about 96.5%. In 2004/5, an estimated 1.2 million budgeting loans were awarded, half to one parent families. It was reported to the CC that just under half of Income Support recipients had applied for a loan in the last twelve months, or were currently paying off a loan, mostly for the purchase of household goods. It is worth noting that there is some overlap with HC loans. For example, Provident (a major HC company) reported to the CC that 15 per cent of their customers had a SF loan in 2004.[87]

The Social Fund brings much needed help to many. It would clearly be unthinkable to abolish it. The controversy it has attracted relates to what it replaced. More generally, it is fair to say that the state has a limited role in the direct provision of financial services. It has, however, been extremely active in bringing together stakeholders into the development of a strategy for financial inclusion and it is to that that we turn.

Financial Inclusion Task Force

The Financial Inclusion Task Force (FITF) is both a rolling enquiry and a proponent of specific actions, having been set up in the wake of Policy Action Team 14, which dealt with financial exclusion in the Treasury report *Promoting Financial Inclusion* (2004).

The terms of reference of FITF are:

- Access to banking.
- Access to affordable credit.
- Access to free face-to-face money advice.

Regarding access to banking, the Terms of Reference are:

- To report to HM Treasury and the banking industry on progress towards the shared goal of halving the number of adults in households without a bank account and of having made significant progress in that direction within two years.
- To monitor provision of banking services to the financially excluded, including access, and report to the Banks and HM Treasury on findings.

The goal of the TF is to halve the number of households with no access to banking of any kind; this was set out in the Treasury's pre-budget report of December 2004, the terms agreed between the five biggest banks, the British Banking Association (BBA) and with the Treasury. The TF also advises government on the use of the Financial Inclusion Fund (see below).

In its evidence submission to the Commons Treasury Select Committee Enquiry on Financial inclusion, FITF summed up much of what has been discussed above:[88]

> *The Taskforce recognises that for people on low incomes, credit can often be necessary for day to day financial management. It would like to see a range of accessible credit products supplied in a competitive market at fair and transparent rates, where consumers have appropriate information and capability to make informed borrowing decisions. The taskforce recognises that even when these conditions are met, providing low value loans to low income groups may result in higher costs, and therefore higher prices for some. It is investigating additional measures whether by government or by providers of credit products, that may reduce these costs.*

The FITF annual report on progress towards the shared goal for banking (2007)[89] is quite clear on the continuing consequences of failing to take such steps:

> *Households that operate solely on a cash budget are unable to make savings via direct debits on utility bills, are more vulnerable to loss or theft, and they are far more likely to use the alternative credit market – and pay interest many times that of the standard personal loan, often contributing to spiralling debt.*

The FITF has been active in promoting the development of new service providers, such as Credit Unions and Community Development Financial Institutions through the Third Sector Credit Working Group chaired by Claire Whyley of NCC.

The Financial Inclusion Fund of £120 million was established for the period 2005-8. As indicated earlier, it prioritised access to banking, affordable credit and free money advice and funded the Financial Inclusion Taskforce, which acted as adviser.[90]

Under the Financial Inclusion Fund:

- T£47.5 million has been spent on 400 advisers with a further 150 due by 2008. 18,000 clients have been advised.
- TThe Legal Services Commission has invested £6 million on money advice outreach, providing advice to 8,000 clients (Treasury 2007).
- The government has invested £40million in the third sector through the Growth Fund since July 2006. The Growth Fund (GF) has supported 46,500 loans totalling £20.4million. (The target is 75,000 loans per annum.) Eighty per cent of the loans have been to low income clients in 'areas of exclusion'. Two thirds of third sector lenders are hitting targets for lending and repayment/arrears levels.
- The average value of the GF loans was within the £300-600 range as planned.
- Bank partnerships have been established with the third sector.
- More than half of the 600 planned new ATMs are up and running.

This has taken place in the context of other improvements being made irrespective of the Growth Fund, with a degree of government support or enabling provisions, such as:

- 17 million ISAs have been taken out since 1999 under 450 providers.
- In 2005 the Child Trust Fund was established, with children automatically enrolled at birth. Now there are 2.5 million with 120 providers.
- Basic bank accounts are now available from 17 providers. The government has encouraged the development of basic bank accounts in cooperation with Post Offices.
- Subsidies have been made available to the Post Office Card Account until 2008. 16,000 benefit payments are paid direct to PO Card Account (this, however, still pales into insignificance compared with the millions still being paid in cash by order book or girocheque).
- By 2003, 87 per cent of DWP claimants had suitable bank accounts for benefit payments.

Verdict: *Tackling financial exclusion has been a key policy driver for the UK government. Initially developed in the Policy Action Team (PAT) reports established after the Labour victory in 1997, subsequently there was a raft of initiatives including the savings gateway, community finance learning initiatives, the establishment of the Child Trust Fund, the universal bank backed by £181 million of money supplied by the five major high street banks, the establishment of 'phoenix fund' money to support CDFI initiatives, and the increasing awareness of community banking and other initiatives.*

The FITF and the treasury have clearly moved things forward since PAT 14 recommended the creation of basic savings bank accounts in Promoting Financial Inclusion published in 2004. However, there is still a long way to go. The FITF Working Group estimates further demand for £1.2 billion in the form of three million loans from the third sector. NCC is calling for a range of measures varying from the reintroduction of PO saving stamps to calling on the government to top up Child Trust Fund at age 14. More generally, there is clearly a desire to harness non-state providers to promoting public policy. Yet in some respects the responses of the third sector disappoint when examined in detail.

To discuss whether further improvement can be achieved, we revisit below the rather old-fashioned arena of regulation. To this end we take the last two framing questions together.

Q.5 What alternative policies might be pursued to assist low income consumers?

Q.6. Have regulatory arrangements helped or hindered?

Banking services are increasingly spoken of in the EU as Services of General Interest and have thus entered the debate on universal service. The UK, France, Sweden and Ireland among others have tried by legal means to broaden access.[91] In the UK, this has usually been through enabling intervention of the type discussed above with incentives to provide partnership arrangements with some public subsidy. In contrast to France, anyone seeking to open an account, but rejected by a bank, can contact the *Banque de France* which will provide a named bank, often the PO Bank, which will be obliged to open a bank account for that person. In other countries, postal banks are given the task of providing basic banking services.

This is not to say that the UK does not regulate; on the contrary, there has been a considerable amount of regulatory flux over the years. For example, under the Financial Services and Markets Act 2000, banking supervision moved from the Bank of England to the FSA. Closer to the consumer, the regulatory structure in recent years has been divided into prudential supervision and regulation (Financial Services Authority); retail behaviour (Office of Fair Trading nationally, Trading Standards service locally); credit licensing (OFT); dispute resolution (Financial Ombudsman Service). In the light of recent events, which have exposed weaknesses in the division of responsibility for banking between the Treasury, the Bank of England and the FSA, further bouts of re-engineering cannot be ruled out.

The FSA was established in 2001 as, in theory, a single regulator with four statutory objectives:

- Maintenance of market confidence in financial system;
- Promotion of public awareness and understanding of FS;
- Consumer protection;
- Reduction of financial crime.

The Financial Services Consumer Panel was established to monitor the FSA, and the Financial Ombudsman Service, having pulled together the previously disparate Ombudsmen for banks, building societies etc, was brought under the same roof. Finally, the Financial Services Compensation Scheme was set up to deal with events when a company goes out of business or is unlikely to be able to honour its obligations.

What is notable about the FSA is the absence of any particular responsibility for low income consumers, a lack which has been confirmed in discussions pertaining to this study. On the other hand, the FSA has far-reaching, rule-making powers which are only vaguely set out in statute and which, if exercised vigorously, could be beneficial to people on low incomes. The current trend is towards 'principles-based regulation' as opposed to the strictly defined 'rules-based regulation' which was previously prevalent in British public administration. The context of such reforms has been the EU Unfair Commercial Practices Directive, which evolved from an originally proposed duty to trade fairly to an obligation not to trade unfairly. The resulting changes to consumer protection regulations have seen many of the long-standing statutes, such as those related to Trade Descriptions and Misleading Advertising, swept up into new measures.

Treating Customers Fairly

An example of how principles-based regulation could be used to considerable effect is the recent *Treating Customers Fairly* initiative (TCF as it has come to be called). In practical terms, this involves such matters as presenting customers with Key Fact Illustrations and initial disclosure documents to aid the transparency of transactions and should include post-sales checks to ensure that all regulations have been complied with.[92] According to Hector Sants, CEO of the FSA: 'TCF...*underpins the delivery of our statutory consumer protection objective and is of key importance in these times of market turbulence when consumers need protection the most.'*[93]

Such are the rule-making powers of the FSA that, although TCF is not in itself statutory, the TCF guidance has the same effect as statute and compliance with TCF runs alongside compliance with regulations.[94] TCF is reaching a crucial stage at the end of 2008 when it is expected that firms will have undertaken a raft of activities to set up mechanisms for compliance with regulations, including those governing unfair contract terms, for example.

However, as yet the portents are not good. Only 18 per cent of firms had met the interim deadline in March 2008 for setting up systems of management information to measure outcomes for customers of TCF compliance (one third of Credit Unions seemed to be on their way to compliance[95]). The FSA calculates that 80 per cent should be ready to meet the full operational deadline of December, by which time it expects that firms will have: *'instilled a culture within the firm whereby they understand what the fair treatment of customers means; where they expect their staff to achieve this at all times.'*[96]

Among the unfair contract terms dealt with are such matters as nil refunds on single premium insurance policies and unauthorised bank charges. The FSA is clear that the presence of unfair contract terms in standard contracts will nullify compliance with the December deadline for TCF.[97] It is deeply worrying that half of the contracts reviewed by the FSA contained at least one unfair term, even in such recently developed products as the Child Trust Funds where, for example, unilateral variations in terms were encountered, a practice deemed to be unfair.[98] So, despite the far reaching potential of FSA principles-based regulation, and in this case expressed agreement by industry leaders, it takes time for reforms to penetrate the industry back offices.

The financial scandals of recent years have led to calls for the industry to clean up its act or for the regulatory bodies to force them to do so. Traditionally, regulatory initiatives have aimed at helping the consumer through better information on the one hand, and regulating the behaviour of service providers on the other. In both areas there has been a role for statute and for self-regulation. During the 1980s and 1990s the emphasis was on information, but the pendulum seems to be swinging back towards regulation, especially in the light of recent market turbulence.

Information to Consumers

Rigid definitions surrounding FS have proved to be mathematically complex and controversial, even at inter-governmental level where France and the UK have, for example, adopted differing definitions of interest rates which make comparisons very difficult. *Which?* found 11 different methods of presenting rates of charge in 2002.[99] Under those circumstances it is hardly surprising that regulation has proved to be so difficult. APR has been severely criticised as a method of presenting rates of charge, as indicated earlier in the discussion of Home Credit. HC suffers by the adoption of this formula in comparison with high street banks. Notably, APRs for high street lenders do not include late payment penalties. Indeed, the high street banks are somewhat flattered by several elements, such as penalties for unauthorised overdrafts being excluded from incorporation into APR. They, therefore, have an interest in the present APR formula and indeed the general denigration of the HC sector.

The Competition Commission recommended:[100]

- Requirements on lenders to publish loan price details in comparative form.
- Better information to customers, e.g. periodic statements (one per quarter or one per loan depending on length) which should include total cost of credit for loans, and early settlement rebates, a particularly sensitive issue in this market.

The Scottish Consumer Council also argued for better information on charging and better banking codes with better publicity. But they went further than simply wanting to give consumers 'early warning' of redemption charges. They argued for the need to resolve the substance of early redemption issues to enable greater ease of switching.

> *The FSA should regulate to eliminate barriers to switching mortgage providers brought about by early redemption charges. This should be applied to new as well as existing customers. It is unacceptable that redemption charges can be applied differentially.* [101]

Likewise, the Competition Commission recommended that all HC lenders should be obliged to give early settlement rebates as generous as that based on actuarial formulae in the Consumer Credit Early Settlement regulations 2004. They recommended that the lender should not be able to defer settlement more than 13 days or use actual payments rather than contractual payments as basis for calculation[102].

This debate indicates how there is a limit to how far information provisions can serve consumers, and this was found in the debate over the *caveat emptor* (buyer beware) principle.

Under the Personal Investment Authority regime (established in the late 1980s), firms were required to disclose information to clients as a contract with a Key Features Document (KFD). KFDs helped comparability at time of purchase and, by 2001, it was considered that the cost of products had reduced under the new disclosure regime, but KFDs still did not perform as intended. Most consumers did not read KFDs or only skimmed them, a common problem across the FS sector, characterised as it is by a great complexity of offers.

In theory, improved disclosure procedures allowed the continued application of the *caveat emptor* principle. NCC and the Consumers Association called for its non-application for private consumers, and for consumer protection principles to be applied differently between business and personal consumers. NCC argued: *'We would like caveat emptor to go in relation to retail consumers. If it does not, then it should be qualified.'* In the event, a new clause was inserted into the Financial Services and Markets Bill which obliged FSA to take into account the need for advice and accurate information. But the clause was a compromise; it also takes into account the general principle for consumers to take responsibility. The *caveat emptor* principle lives on.

However, the rather casual view, that once terms of agreements had been set out it was simply a matter for buyer and seller to strike a bargain, seems to be receding. The new Consumer Credit Act represents a more balanced approach of regulating both information to be understood by the consumer and behaviour of the service provider.

Licensing and registration of consumer credit

The new Consumer Credit Act 2006, which is still in the process of taking effect, sweeps up many of the preceding statutes. The Act was the culmination of a three-year review of consumer credit law and reforms the much criticised Consumer Credit Act 1974. The Act responds to the criticisms by consumer organisations of the old legislation in several respects:[103]

- It replaces the pre-existing 'extortionate credit' test (notoriously difficult to apply) with the unfair relationship test.
- It introduces an Alternative Dispute Resolution scheme (provided by the Financial Ombudsman Service).
- It strengthens the licensing regime enabling the OFT to keep rogues out of the market.
- It ensures clear information after an agreement is signed (from 1 October 2008).
- It introduces a more proportionate approach to the enforceability of defective agreements.

It remains an offence to canvass debtor-creditor agreements off trade premises, (effectively selling credit solely). But there are major caveats to bear in mind:

- Doorstep selling is not considered to be canvassing if the visit takes place in response to a written signed request. So successive follow-on loans can be suggested.
- An agreement to purchase (on credit) a voucher enabling goods to be purchased at specified stores is not a debtor-creditor agreement and is therefore allowed.
- One can canvass the sale of goods on credit.

The new legislation contains provisions to protect consumers at both the individual and collective levels. Perhaps the most innovative element is the Unfair Relationship Test which may prove to be particularly appropriate to the Home Credit market, and indeed that market is singled out for special mention by the OFT, which has oversight. The OFT will identify higher risk businesses and apply a higher level of scrutiny, and will require a Credit Risk Profile for *'high risk credit activities with potential for serious cosumer detriment'* and, in particular, for *'secured sub-prime lending and lending in the home'.* OFT and local authority Trading Standards services will have powers for on-site inspections, and *'irresponsible lending'* is now relevant to the 'fitness test' and could be considered to be *'deceitful or oppressive or unfair or improper'* and thus a potential reason for loss of licence.[104]

Since April 2007, the remit of the Financial Ombudsman Service (FOS) has been extended to cover consumer credit and the Unfair Relationships Test was introduced for new agreements. In April 2008, the OFT's new strengthened licensing regime was introduced; the Consumer Credit Appeals Tribunal (for appeals against OFT licensing decisions) was established, and the Unfair Relationships Test was extended to all existing credit agreements.

From 1 October 2008, lenders will be required to provide borrowers with much more information about their accounts, such as an annual statement and regular notices when consumers fall into arrears or incur a default sum. Exemptions are removed so that all credit agreements and all information service providers will need a consumer credit licence, as these services will be regulated by the OFT.

Unfair Relationship Test

The unfair relationships test provides consumers with a broad right to challenge unfair credit relationships in court, a useful power even if many individual consumers may be reluctant to apply to use it. The court has the power, if it finds that a relationship between a debtor or creditor is unfair, to remedy the unfairness by reopening the agreement or even setting it aside. The court will be able to require a lender to repay in whole or in part, may set aside the obligations of the borrower, and may direct the return of property provided as surety (such as by pawn). The unfairness will be determined by consideration of the terms of the agreement, the way in which the lender has enforced it, or 'by any other thing done (or not done) by or on behalf of the lender either before or after the making of the agreement or any related agreement'.[105]

From 6 April 2008 the OFT will assess a company's ability to run its business in a fit manner in the future as well as assessing past conduct and monitoring the conduct of a licence holder on an ongoing basis. The OFT will target businesses that work in areas where there is a high risk of consumer detriment, such as the home credit market, subjecting these businesses to more in-depth scrutiny.

Much interest can be expected in the workings of the Unfair Relationship test. In its guidance[106] the OFT does not seek to define what is an unfair relationship, leaving that to the courts to determine individual cases. Unfairness is seen as covering: *'situations where businesses infringe their legal obligations and as a result harm the collective interests of consumers'*. Such collective interests can allow the OFT to act in an injunctive way.

All of these steps were welcomed by consumer organisations, which had for many years acted in a defensive way towards the old licensing regime which, conversely, the industry had criticsed severely as being rigid and 'hitting the wrong target'. In particular, the old licensing regime operated on the basis of the threat of license withdrawal which tended to be the nuclear weapon that was not used, especially if transgressors were major financial institutions.

So we are seeing a shift in the concept of regulation towards a less literal interpretation of rules and an appreciation that the spirit of the legislation has to be honoured as well as the letter. Indeed, the letter is becoming less precise as the Unfair Relationship Test may come to signify. Is there a danger that this less literal interpretation may suffer from the same ambiguity that has affected self-regulatory mechanisms in the past?

Self regulation

The history of self-regulatory codes in FS is mixed. On the one hand, the obligation to present basic material on credit terms to the consumer in the form of a 'summary box' (first adopted under US law) was initially adopted by British credit card providers on a voluntary basis and is now more or less incorporated into the new Consumer Credit Act.[107]

On the other hand, the Banking Code of Practice was first introduced during the late 1980s to howls of criticism from consumer organisations who stated that it did little more than indicate on the part of the banks their intention to do what they were obliged to do anyway by law. Gradually it was strengthened during the 1990s, as was its profile vis a vis consumers. The 2005 review of the Banking Code of Practice led to the requirement that subscribers to the code (i.e. the Banks) should assess if clients' needs were suited to a basic bank account and, if so, offer one. Indeed, the offer of a basic account should be made pretty well automatically if specifically requested by someone meeting qualifying conditions. This is a clear example of the UK introducing into British practice through self-regulation a practice similar to that laid out in legislation in France.
In its review of the code, the Banking Code Standards Board found the following to be barriers to basic bank accounts: lack of availability of literature; staff unawareness of product features; ID procedures; time for opening; and use of credit searches. As a result, in 2006 the Code requirements were amended to introduce the following features:[108]

- more information about Basic Bank Accounts
- ID procedures in branches rather than centralised.
- Ten-day time limit for opening an account once procedures are completed.

According to BCSB research, there seems to have been an improvement from 2005 to 2007. But the FITF still finds information on accounts to be far short of the optimum, and also reported confusion over credit checks. One pressure for improvement is the fact that the Banking Code is covered by the Treating Customers Fairly initiative. Thus, self-regulatory codes are reinforced by the evolution of 'principles based regulation' which does not have to spell everything out in statute.

Verdict: *The above analyses have indicated that regulation for mainstream consumers has failed to reach many of those most marginalised. The FSA carries no remit for low income consumers. The emphasis on caveat emptor allowed governments to evade serious issues, such as early settlement rebates. So the question has been not so much what alternative policies might be pursued, rather where are the policies to begin with? The answer has been more in the enabling initiatives, such as the FITF, than in the regulatory process, where there needs to be more explict concern for vulnerable consumers as exists in some of the utility legislation. But the present lack may be changing. The 2006 Consumer Credit Act and the statements by the OFT with their emphasis on issues pertaining to Home Credit are very welcome. As to whether regulation has helped or hindered, it is quite possible that the literal basis of regulation in the past was both onerous for service providers, while not achieving the objective of protecting consumers, the worst of all worlds. Given the slowness of self-regulation in achieving consumer protection, the new emphasis on the spirit of the legislation shown by the Unfair Relationship Test, for example, may be a positive evolution.*

Tentative conclusions: Parallels with and differences from energy

The big difference between discussions of FS, particularly of credit, and those in energy, are to be found in the heavy overlay of considerations of moral hazard (as with nutrition). For while there are well-grounded concerns about lack of access to credit, for much of the later years of the twentieth century, there were also widespread and countervailing concerns about the hazards of too easy access to credit and its associated risk of indebtedness. Indeed, the very definition of debt is not clear. In classic economic parlance it would mean any outstanding commitments, such as public debt or the outstanding unpaid portion of a mortgage. But popular parlance refers to debt in much narrower terms; debt is credit 'gone wrong' where commitments are in excess of a consumer's ability to honour repayments.

Under the first definition, the right to incur debt is normal for individuals, corporate bodies and states. But the latter form is to be shunned and, in consequence, proposals to limit 'debt gone wrong' have often lost sight of the potentially perverse effects of 'turning off the tap'. Suppressing legitimate access may be reflected in such undesirable outcomes as pushing poor consumers towards expensive forms of credit or rendering homes unsellable and blighting whole districts. Such panic measures are not called for in the mainstream sectors, as the evidence is strong that most families manage their credit commitments without any problems.

A similar ambivalence exists regarding the difference between credit and savings. Credit is often deemed morally hazardous, but banking, and thus saving, is quite the opposite. This too can have perverse effects: it appears to allow the high street banks to be painted in a rather flattering light compared with the Home Credit providers, for example. Whether or not one adopts the stark conventional view, it seems clear that the absence of banking facilities may lead people towards getting involved in the more expensive forms of credit, thus reinforcing the pattern of detriment from which they may already be suffering.

That leads to the cross-over with energy markets, namely the clear link between access to banking services and access to lower prices for energy. The huge differentials that exist in prices due simply to methods of payment reinforce the patterns of detriment which exist in both sectors. The poor would tend to pay more in both cases, even without the cross-over. But the interaction of the price gradients in both sectors seem to amplify each other. And that seems to be the lesson of consumer detriment – it spreads.

Brief points to note

- The Professional and Financial Services sector has the highest proportion of total detriment (as defined by the OFT) suffered by consumers. It has the worst level of net satisfaction of the six broad categories and the lowest level of consumers who feel they have been fairly treated.

- Within the 60 sub-sectors of the P&FS sector, personal banking has the joint second highest frequency of detriment.

- Insurance services have the highest average amount of detriment and P&FS the highest of the six broad sectors.

- Lack of access to conventional banking has serious knock-on effects on such consumption sectors as utilities and credit and may even affect employment.

- There were two million adults living in 1.3 million households without access to a bank account in 2005/6. This represented a 30 per cent reduction since 2002/3. This decline is particularly marked among households where the main source of support is female. But the decline is general to all major categories.

- Low income families are more than twice as likely to be unbanked than the average.

- Most consumers do not have difficulty with credit commitments despite the increased levels of borrowing over the 15 years to 2005.

- Nevertheless, one in ten households have been found to be showing signs of financial stress, and a further 2 per cent are over indebted; although in neither case was low income found to be the major cause in 2005. A further 6 per cent are struggling on low incomes (these estimates are likely to be conservative gven that they preceded recent rises in fuel and food prices and other costs). Some of the last two groups show extreme levels of commitments, sometimes in excess of half of their disposable incomes.

- There are many sources of exclusion from FS, including screening and product design. There is also an element of self-exclusion, but in some circumstances low income consumers' reticence about FS may be a rational response to the risks involved for them.

- In mainstream FS, most consumers remain with their service providers, and switching is usually in response to price fluctuations. There do not seem to be major differences in the propensity to switch across broad social groups.

- Early redemption of loans is widely flagged as being inhibited by lender policies.

- Despite the existence of alternative sources, such as the Social Fund and Credit Unions, the sources of commercial credit available to the poor are massively more expensive than mainstream credit sources.

- The Home Credit market is highly concentrated with one company controlling 60 per cent of the market.

- The service is highly personalised and discretionary and most agents are women, often locally recruited. Comparisons with 'mainstream' credit may not be entirely fair because of the methodology of APR calculations, which tend to flatter high street banks.

- Despite the advantages of HC services, the service appears to be significantly more expensive than appears justified in general economic terms. Once again, early settlement rules are a major problem for consumers.

- The reasons why poor consumers use the Home Credit market are to be found in the defects, as they see them, of the mainstream banking and credit sectors. A huge premium is attached to personal service and flexibility, such as the lack of penalty charges.

- Credit unions are growing in membership and reducing in number. There are significant locations in the UK with very little such third force provision, leaving poorer consumers with little choice but to use the high cost sector.

- Progress is being made towards 'serving the unserved' under the Financial Inclusion Task Force and successive Treasury initiatives; furthermore, new financial products are being rolled out with the support and encouragement of government and these are gradually eroding the size of the unserved population.

- The basic bank account is increasing in coverage, but the increase appears quite modest and appears to have been outpaced by the threatened Post Office card Account.

- The *caveat emptor* principle continues to be applied to the legislation, despite massive evidence that consumers do not understand the terms and conditions of service offered to them, and even less the mathematical principles of the credit sector.

- The Treating Customers Fairly Initiative, while valuable in terms of content, is running seriously behind schedule at a time when the FS market is particularly in need of good practice.

- The 2006 Consumer Credit Act and its proposed application contains welcome emphasis on issues of concern to poorer consumers.

- The Banking Code of Practice has improved after a disappointing start for consumers. It has taken twenty years to do so.

Annex: international comparison of banking coverage

How do UK figures on banking compare with other countries at similar levels of economic development? In an analysis of the share of households with access to a bank account or using analogous financial services, Stijn Claessens of the World Bank reports that, in 2005, the following percentages of households using formal financial institutions to save are as follows:

Denmark 99.1;

Netherlands 98.9;

Sweden 98;

Germany 96.5;

France 96.3;

Spain 91.6;

US 90.9 in 2001;

UK 87.7;

Portugal 81.6;

Austria 81.4;

Ireland 79.6;

Greece 78.9;

Italy 70.4.

NB. The dates are variable and so are not strictly comparable.

Source: *Universal Access to financial services: a review of the issues and public policy objectives;* Stijn Claessens World Bank, in *Liberalisation and universal access to basic services,* OECD/WB Paris 2005.

There are nine EU countries with 'banked' rates of over 90 per cent and it is interesting to note that the percentages do not necessarily follow income levels. For example, Austria and Ireland are among the richest countries in the EU, and Italy has a similar GDP per capita to the UK. (It is worth noting in passing that Claessens' survey suggests that institutional initiatives can make a difference; for example, Jamaica had a rate of almost 60 per cent as long ago as 1997, doubtless due to the successful developments of credit unions, on which great hopes are being pinned now in the UK.)

One aspect of the analysis which is perhaps neglected is that the British use of credit cards is by far the highest in Europe (until recently it exceeded all the other EU countries three times over), while its use of basic banking services tends to be lower than its neighbours.

Notes

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4 OFT op. cit. para 3.5.

5 OFT op. cit. Chart 3.5.

6 OFT op. cit. paras 4.5 & 4.6.

7 OFT op. cit. chart 4.5.

8 OFT op. cit. chart 4.7.

9 OFT op. cit. charts 6.10 & 6.11. (In fairness, an FSA-sponsored survey reported in 2008 that the percentage of consumers who felt that they were treated fairly had risen from 57 per cent in 2007 to 61 per cent in 2008 *(Consumer awareness of FSA and financial regulation, FSA 2008, Ch 3.)*

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29 Alexander op. cit. p.12.

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40 CC op. cit. para 4.16.

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52 CC op. cit. para 2.7-8.

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Energy

"Ironically, if energy markets were working as efficient markets should, the requirement for all consumers to continuously monitor prices, switching whenever necessary, would not exist. Companies would know that if their prices were above the best on offer, they would lose more of their market than they could afford to and would be forced to match the best prices on offer."

Stephen Thomas

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1. Introduction

For many decades in Britain, access to an affordable and reliable supply of electricity has been essential to provide lighting and, in some cases, meet heating and cooking needs. The reliability aspect has become increasingly important as advances in electronics and information technology make functions that rely on electricity ever more pervasive. An efficient space-heating system is also a necessity and, over the past 30 years, natural gas has taken a dominant share of this market with now more than 80 per cent of homes heated by natural gas, with no ready alternative.

The way in which electricity and gas are supplied in Britain was transformed 20 years ago when the companies were privatised and regional monopolies in electricity and a national monopoly in gas were replaced by competitive markets wherever possible.[1] This reform became the model for many countries and provides the basis for the European Union's (EU) Directives on electricity and gas (Thomas, 2006A). The Directives require Member States to implement similar reforms to those introduced in Britain excluding requiring privatisation. Requiring privatisation would exceed the powers of the EU and, for example, the EU can exert no pressure on Sweden to privatise its state-owned electric utility, Vattenfall.

The British reforms have generally been seen as successful and were accompanied by real price reductions up to 2002. However, for this period, fossil fuel markets were benign with world prices falling in real and sometimes absolute terms. How far, if at all, the price reductions that occurred up to 2002 were the result of the benefits brought by this new model and how far they were the result of other factors is a moot point (see Thomas, 2006B). However, it is clear that this benign background meant that important aspects of the model are only now being tested for the first time.

The challenge facing the competitive model is not just how well it can deal with unpredictable fossil fuel markets, but also how it can cope with a need for the major changes required to reduce emissions of greenhouse gases. It seems clear that the market alone will not produce the changes required, whether they are increased use of renewables, nuclear power or energy efficiency measures. It cannot be assumed that energy prices will see sustained falls much below their present high level – they could well go higher.[2] By the end of 2008, these high prices could mean that a fifth or more of British households would, under the government's definition of fuel poverty, be classed as fuel poor; in other words, they would need to spend more than 10 per cent of household income on energy to maintain a satisfactory heating regime.

This situation is exacerbated by the price differential that has emerged between the methods of payment used by most low-income households, prepayment meters or standard credit terms (bills paid quarterly in arrears), which are on average 20-25 per cent more expensive than the cheapest form of payment: Direct Debit on-line accounts. In certain areas of the country this differential can be as much as 40 per cent higher. This latter method of payment is often not feasible for low-income households, for example if they do not have access to an internet connection, or they do not even have a bank account which allows them Direct Debits. Those that do have the scope to use Direct Debits may be concerned that their finances are not stable enough to commit to a Direct Debit without risking high overdraft charges. The government's target to ensure no vulnerable households are fuel poor by 2010 cannot now be met and the target that no households at all are fuel poor by 2016 looks increasingly unlikely to be met.

The questions that arise, therefore, are: How well has transforming energy from a monopoly to a market served low-income groups? Are they worse off than they would have been under a regulated monopoly? Can changes be made to the system that will alleviate the problems without seriously compromising energy markets, and are there lessons to be learnt from how low-income households are protected for other major purchases of essential services?

2. Purchasing electricity and gas

2.1 Product characteristics

While electricity and gas are especially important purchases for low-income households, their characteristics make purchasing them a very different process to most other purchases. Arguably, it is more difficult for consumers to get the best deal available than it is for most other purchases they make.

2.1.1 Demand for energy is a 'derived demand'

Demand for energy is a 'derived demand'. In other words, consumers do not want a kWh of electricity or gas, they want the service that this energy will provide, for example heat, light, cooking etc. The amount of energy needed to meet the service required is determined not only by the service requirement but also by the efficiency of the appliances used and, for space heating, by the size and thermal qualities of their housing. Therefore, consumers can receive the same level of energy service, but with significantly lower energy consumption if their appliances, especially cookers, fridges and light bulbs, are energy efficient and the building is well insulated.

For low-income consumers, this is a particularly important issue and means that those that suffer from 'fuel poverty', in other words not being able to afford to buy enough energy to meet reasonable standards of comfort, are not necessarily the same as those that suffer from 'poverty' in general. The fuel poor may not have incomes that place them in the lowest income bracket but, if their housing is poor quality, their bills could be difficult to afford. We return to the issue of fuel poverty and its definition later.

2.1.2 Standard product

Gas and electricity supplied by the public network are entirely standard products. The quality and reliability of supply is entirely determined by the quality and reliability of the supply system, and consumers do not have the opportunity to choose between a higher or lower quality of gas or electricity, or between product variants, except for the little used 'green tariffs' and the now relatively little used off-peak (Economy 7, etc.) tariffs. Opting for a 'green tariff' should provide guarantees that the supplier has sourced an equivalent amount of energy from sources that are certified as 'renewable'. However, as argued below, given that all retailers must source a given percentage of their electricity from green sources and the market for green electricity is considerably less than this percentage, consumers buying green power from the large retailers will not cause any more green power to be generated than if they had opted for a normal tariff. The Department for Food and Rural Affairs (DEFRA) has become concerned about this issue and, in June 2008, asked Ofgem to strengthen guidelines on green tariffs. The Minister, Hilary Benn said:[3]

> *It is increasingly difficult to demonstrate that buying a renewable electricity tariff is offering additional carbon emissions reductions compared with what suppliers are required to source to meet the Renewables Obligation.*

A month later, Ofgem published proposals for a new accreditation scheme that would assure consumers that opting for green tariffs would bring additional environmental benefits.[4]

energywatch has also been critical of the amount of information the companies give out on the sources for their power and which markets that power is sold to.[5]

The standard nature of the product means that the only relevant criteria, apart from environmental issues, for choosing one of the six major suppliers are price and service quality. However, the main interface between supplier and consumer is the meter reading and billing process. This should be an entirely routine process where there is little scope for one supplier to offer significantly better service than another. Despite this, billing and meter-reading complaints constitute the largest area of complaint to energywatch. Efficiency of complaint handling could also be a criterion for choice, but given that meter-reading and billing should be such a simple process, it is hard to understand how a large enough number of complaints could arise for this to be an issue (faults in the network are not the responsibility of the retailer).

So, at least in theory, service quality should not be a determining issue. All large suppliers are required to offer the full range of payment methods, so price should be the only criterion on which consumers choose their supplier. Ofgem research backs this up by showing that 78 per cent of people who switch do so to save money.[6] Given that there is effectively only one product, pricing schemes should be very simple, based on the rate per unit of energy. The decision by Ofgem to allow 'fixed' and 'capped' rates does somewhat complicate choice for consumers, but the take-up of these has been low and consumers do not seem confident enough yet to 'gamble' on whether rates will rise or fall. Opting for a fixed rate at what could be the top of the market could lock consumers into very high prices.

There are a number of problems that can arise when consumers try to compare suppliers' offerings. For example, the consumer might not know the terms and conditions under which they are currently supplied, nor have an accurate picture of how much energy they use over a given time period. Consumers could also be confused by the ways in which different suppliers apply discounts and use different consumption bands for different pricing levels. Some price comparison sites seek to make offers more comprehensible, making it easier for those consumers with ready access to the internet to make informed decisions about what deal is best for them. Certain consumers, such as Economy 7 users, can find it difficult to make an accurate comparison even with the aid of internet sites.

2.1.3 Availability of substitutes

For many products, there are substitutes available that provide a comparable service. For example, if a particular food product becomes expensive, consumers can switch to a different food stuff that will perform much the same function. This will reduce demand for the product that has become expensive and will tend to force the market to reduce prices for that product. For most electricity and gas applications, there are no easy substitutes and, even where there are substitutes, these require significant investment in new equipment. For example, switching from gas cooking to electric cooking would require a minimum of a new cooker. This lack of ability to switch demand to substitutes removes one of the weapons consumers would otherwise have available to impose discipline on their suppliers. In the future, this might change if technologies become commercial which would allow consumers to produce their own power; for example, small scale wind turbines or micro combined heat and power where a conventional boiler is replaced by equipment that supplies hot water and power.

2.1.4 Frequency of choice and ease of switching

The more frequently consumers are able to choose their supplier, the less significance to overall budgets each purchase has. For example, if someone purchases their weekly food shopping from a shop that proves expensive they can, generally, buy elsewhere next week. By contrast, some high cost products, such as insurance, are generally bought annually and choosing an expensive supplier is a mistake that cannot generally be corrected for a year once the statutory cooling-off period has finished. Some products, such as certain financial services like bank accounts which are subject to an ongoing implicit contract, can, in theory, be switched readily at no charge. In practice, because the choice criteria are not straightforward, consumers change such services infrequently. Choosing an energy supplier is a decision that, in practice, is an infrequent one. Unless the consumer has chosen a fixed term contract (few have so far), consumers can, in theory, switch supplier every 28 days with no charge from either the previous or the new supplier. In fact, a switch of energy supplier can take up to 6 weeks or, in some cases, even longer, so being able in theory to switch every four weeks is of limited value.

As argued later, while switching energy supplier should be simple and cost-free, in practice switches can go wrong at considerable inconvenience to the consumer, and choosing a supplier may take a considerable amount of research that is realistically only possible for those able to use the internet. In addition, there can be significant problems in switching for consumers that use prepayment meters or who have accumulated debt with their existing supplier, or who have to use Dynamic Teleswitch Meters. Like other services purchased on an open-ended contract, consumers cannot generally know in advance what the relative price of their chosen supplier is compared to other suppliers. At best, the consumer can know that when the choice is made, their chosen supplier is offering the best terms, although by the time the switch has been completed, this information could easily be out of date.

2.1.5 Location

For some products, the effective market may be quite localised. For example, consumers in rural locations (and some urban locations) may have a very limited practical choice (if any) of supplier, for example, of food or petrol. The British energy market is regional in scope and there are relatively moderate price variations between the 14 regions. However, there is no evidence that consumers in isolated or disadvantaged communities are charged more than those in cities. Some rural consumers may not have the option of a natural gas supply and may be forced to use expensive bottled gas or fuel oil.

2.1.6 Do residential consumers compete with bulk purchasers?

For most household purchases, residential consumers do not compete directly with large consumers for the same product. Bulk purchasers have much greater buying power and should be able to force suppliers to reduce their margins to a minimum, although the Business and Enterprise Committee (Business & Enterprise Committee, 2008) found that this buying power did not seem as strong as might have been expected. Electricity demand is split reasonably equally between residential consumers, industrial consumers and commercial consumers (e.g. offices). The larger consumers have the skills and the incentive to negotiate hard for attractive prices using specialist staff to research the market. There have been suggestions that household consumers should find ways to combine their demands, for example via the local council, a trade union or a housing association, so that they are buying in bulk, but this has not happened to any extent yet. Unless it does, residential consumers will have no scope to negotiate and are generally not aware of whether they are purchasing their energy on the best terms available. Suppliers may take advantage of this 'inertia' to offer disproportionately low rates to industrial consumers, who they can be sure will switch if their terms are not competitive, and much higher rates to residential consumers who are much less likely to know whether the rate they are being charged is a competitive one.

2.1.7 Demand cannot easily be postponed & consumers cannot store energy

Consumers generally have little discretion over when they consume energy. They need energy when they are cold, when it is dark or when they are hungry. Consumers cannot therefore choose to postpone demand to a time when prices are lower or they have more money available. In other sectors, consumers can also reduce the impact of short-term high-prices by keeping stocks of goods that can be used if a product is unavailable or high-priced. For gas and electricity, storage is impossible for a householder. This issue will need careful attention if proposals to install smart meters and time-of-day pricing for households are implemented. These issues are discussed in more detail in Section 4.

2.2 The 2007 Supply License Review

Since 1996-99 (depending on the region) household consumers have been able to choose their retail suppliers of electricity and gas. Initially, companies were required to allow consumers to switch supplier with 28 days notice without penalty and were required to offer terms to any consumer requesting them under a variety of payment methods. In July 2007, Ofgem (Ofgem, 2007) completed a review of supply licenses that led to significant changes in the obligations placed on retail suppliers of gas and electricity.
The main changes, implemented in August 2007, were[7]:

- The so-called '28 day rule', whereby consumers could in theory change supplier every 28 days was abolished. This allows companies to offer long-term fixed rate or capped prices to those prepared to sign long-term contracts;

- Suppliers with fewer than 50,000 consumers are no longer required to offer a wide range of payment methods. Ofgem hopes this will make it easier for new companies to enter the retail market to break up the market power of the six major companies.

3. Legal requirements

The increasing reliance modern societies have on a reliable energy supply and the issues raised by the 'marketisation' of energy services have led to an increase in the responsibilities governments have had to assume to ensure that the consequences of any 'market failures' do not impinge too heavily on consumers. In particular, the European Union has introduced a number of significant requirements in parallel with its Directives requiring the opening of energy markets to competition (this legislation is discussed in detail in Annex 1).

3.1 EU legislation

Electricity and gas are network-supplied energy products categorised by the European Commission as Services of General Economic Interest (SGEI). Under EU policy, this means that the service should be made available to all consumers of a Member State with a specified quality and at an affordable price, including, for electricity, complete territorial coverage.

The EU Electricity (2003/54) and Gas (2003/55) Directives contain provisions on public service obligations and consumer protection. These require Member States to take measures to protect vulnerable consumers. For electricity, the Directive (paragraph 3) states that all consumers have 'the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices'.

Gas is not categorised as a 'Universal Service' and the requirements in the Directive on coverage of the network are not so extensive. The new draft Directives on electricity and gas do not reduce these obligations.

A Directive on energy end-use efficiency and energy services was passed in 2006 that placed some further obligations on government. It requires the installation of 'smart meters' (meters that measure and transmit consumption data on a half-hourly basis) provided cost tests are met. In October 2007, energywatch strongly supported the introduction of 'smart meters' for all consumers within 10 years.[8] The government's Energy Bill that was being debated in July 2008 gave powers to Parliament to mandate 'smart meters' within five years.

European legislation also requires that consumers be provided with very extensive cost and consumption information. For example, bills should include: current actual prices and actual consumption of energy;

comparisons of the final customer's current energy consumption with consumption for the same period in the previous year, preferably in graphic form; wherever possible and useful, comparisons with an average normalised or benchmarked user of energy in the same user category. The extent to which these requirements have been implemented in the UK is questionable.

3.2 National legislation

Member States are required to translate Directives into national law so all provisions of the EU's Directives should be embodied in UK law within the specified period, or else the Commission will take action against the UK government.

The main legislation relevant to the EU's Directives is the 'Utilities Act' of 2000. The Utilities Act required the setting up of a Gas and Electricity Consumer Council (energywatch) and details the duties this body has. It also changed the primary duty of the regulatory body for gas and electricity from promoting competition to protecting the interests of consumers. For gas, the primary duty of the Authority, still jointly held with the Secretary of State, is:[9]

> to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed.

And for electricity:

> to protect the interests of consumers in relation to electricity conveyed by distribution systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.

However, for both gas and electricity, there is a secondary duty:

> In performing that duty, the Secretary of State or the Authority shall have regard to the interests of—
> (a) individuals who are disabled or chronically sick;
> (b) individuals of pensionable age;
> (c) individuals with low incomes; and
> (d) individuals residing in rural areas;
> but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

In 2004, the Minister of State for Energy, e Commerce and Postal Services issued Guidance to the Ofgem board under the Utilities Act legislation. This Guidance was more explicit on social issues and the role Ofgem was expected to play in meeting the government's objectives. It stated:

- The Utilities Act 2000 gives the Authority the principal objective of protecting the interests of consumers, wherever appropriate by promoting competition. It also places duties on the Authority in respect of a number of groups within society, namely the disabled or chronically sick, pensioners, those on low incomes and those living in rural areas.

- The Government considers that the Authority has a wide responsibility in relation to social issues, including equal access for all consumers to competitive markets and the desirability of lower levels of disconnection and arrears. It also believes consumers' interests include the quality of service provided and the size of energy bills. The Authority has a duty under the Sustainable Energy Act 2003 to produce impact assessments. These should include cost/benefit analyses of the social as well as the environmental impacts of the decisions.

- Within the context of protecting and helping vulnerable consumers, the Government is committed to achieving its fuel poverty target that, as far as practicable, no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010.

- The Government expects the Authority, within its sphere of responsibility, to put in place measures which will help achieve these targets.

The government also passed the Warm Homes and Energy Conservation Act in 2000, which required it to set out a 'Fuel Poverty Strategy'. This was published in November 2001. On 9 April 2008, a UK charity, Help the Aged and an environmental group, Friends of the Earth, launched a legal challenge to the Government to ensure it is held to its legal obligation under Fuel Poverty Strategy to eradicate fuel poverty by 2016.[10]

The 1998 Competition Act, which came into force in March 2000, gave new powers to regulatory bodies in relation to anti-competitive practices; for example, it gave regulators the ability to impose fines of up to 10 per cent of company turnover for three years for breaching the prohibitions of the Act.

The Office of Fair Trading and Ofgem are responsible for enforcement of the Competition Act 1998. Concurrency arrangements cover the gas and electricity industries, which mean that Ofgem is the competition authority that will deal with most cases in these areas.[11] The Enterprise Act (2002) gives Ofgem market study duties and power of referral to the Competition Commission. Ofgem also has a role in merger and takeover cases in the energy sector.[12]

4 The Market structure

4.1 The companies

The electricity market has evolved substantially since energy consumers were given a choice of supplier. Prior to the opening up of the gas market for residential consumers, the national monopoly retail supplier was Centrica, a company spun off from the privatised company, British Gas PLC. Centrica trades as British Gas in the UK even though it now has no connection with its former parent company, BG plc (outside Britain it is allowed to trade as British Gas).

For electricity, prior to the opening of the market, there were 14 regional electricity retail companies with regional monopolies. Twelve of these companies were in England and Wales and at that time also operated the monopoly low-voltage distribution system.[13] But these companies had few interests in generation. In Scotland, there were two companies, Scottish Power and Scottish Hydro, which were fully integrated companies owning almost all the generation in their region, as well as owning and operating the transmission and distribution networks and retailing electricity to final consumers.

When the gas and electricity markets opened, Centrica began to offer electricity in a package with gas (a so-called dual fuel offer) and the regional electricity companies became national in scope and began to offer gas as well as electricity. There was a rapid process of consolidation of suppliers and, by 2003, the 14 electricity retailers were owned by only five companies. Three of these were foreign-owned by the French company, EDF and by two German companies, RWE and E.ON, which took over the two largest generation companies, Npower and Powergen respectively. The other two companies were based on the integrated Scottish companies, which had expanded into England and Wales. Subsequently, Scottish Power was taken over by a Spanish company, Iberdrola.

Table 1 Structure of the British gas and electricity market

Electricity and gas companies	Former national/regional companies
EDF Energy	London Seeboard SWEB
E.ON/Powergen	East Midlands Eastern Norweb
RWE/NPower	Midlands Yorkshire Northern
Iberdrola/Scottish Power	South of Scotland, Manweb
Scottish & Southern Energy	North of Scotland Hydro Electricity Southern SWALEC
Centrica	British Gas Scottish Gas

Source: *Author's research*

New entrants to the electricity and gas markets for residential consumers have had only limited success in gaining market share and the market is now composed of the five electricity companies and Centrica/British Gas (see Table 1). The only exceptions are the handful of small companies. Three of these companies offer only green tariffs while the others (one of which buys all its power from SSE) offer a range of tariffs. The market share of these small companies was less than 1 per cent in March 2007[14] and the retail market is dominated by the big six companies.

4.2 Regulation

Autonomous sectoral regulators for gas, the Office of Gas Regulation (Ofgas), and electricity, the Office of Electricity Regulation (Offer), were set up when the industries were privatised in 1987 and 1990 respectively. These were headed by a Director General who, jointly with the relevant government minister, was responsible for the decisions made.

The government's Utilities Act 2000 required the merger of Ofgas and Offer to form the Office of Gas and Electricity Markets (Ofgem) in 2001. The single person regulator was replaced by a board, the Gas and Electricity Market Authority, comprising a Chair, Chief Executive, three Directors and six non-executive members. Its net operating cost in 2007/08 was about £40m and it employed about 300 people. Its budget far exceeds that of any other energy regulatory body in Europe.

4.3 Barriers to entry

An important characteristic of any market, particularly a relatively concentrated one, is how large the 'barriers to entry' for new companies are. Low barriers to entry mean it would be easy for a new company to enter the market. From a competition point of view, this is desirable especially if the market is concentrated. If barriers to entry are low and the existing companies charge prices that are higher than necessary, a new entrant could come into the market and take market share from the existing companies. However, if barriers are high, existing suppliers may believe that they can maintain high margins because they and their competitors will know it is probably not in their interests to start a price war.

For energy, entry barriers are extremely high for a number of reasons:

- The electricity market is dominated by generator-retailer companies who have a strong incentive to buy from their own sources and not sell wholesale power to the open market as this would make it much easier for new retailers to enter the market;
- Information asymmetry in favour of the dominant players;
- Complexity of the market rules and the regulatory regime;
- Energy wholesale supplies are generally available only in large quantities, contracted long-term and new entrants would not be sure enough of their market share to be able to contract long-term for large quantities of energy;
- All experience since opening of the market suggests that household consumers are only comfortable buying from companies with a strong brand name, with a record of operation in the energy sector and one which they have dealt with before. Even supermarkets with a strong brand name such as Sainsbury and Tesco both abandoned moves in 1997 to enter the market before their attempt had even been launched.[15]

Bizzenergy, a small electricity supplier to businesses, told the Business & Enterprise Committee that the attitude of the big six towards it was ‘we do not want to deal with you because all you are going to do is compete against our supply business’[16].

4.4 Pricing mechanism and cost structure

Consumer bills for energy are made up of six main components - wholesale, retail, metering, transmission, distribution and environmental costs - each of which is set by a separate pricing mechanism. Table 2 shows a breakdown of gas and electricity bills by main costs. This Table was based on information at the beginning of January 2008 before the large price increases of 10-15 per cent that were imposed that month, which the companies blamed on higher wholesale prices. Updated figures would therefore show a higher percentage of the bill attributable to ‘energy, supply costs and margin’.

Table 2 Breakdown of household energy bills ex VAT by cost category (%)

	Gas	Electricity
Energy, supply costs & margin	72	69
Distribution	21	18
Transmission	2	4
Environmental	3	8
Meter provision	2	1

Source: *http://www.ofgem.gov.uk/Media/FactSheets/Documents1/energy%20prices%20jan08.pdf*

Notes

1. This table reflects gas and electricity prices as of January 2008 except for the environmental costs, which have been updated to reflect the additional charges consumers will have to pay.
2. VAT is added to these costs at a rate of 5 per cent.

The main component of the environmental costs is the Carbon Emissions Reduction Target (CERT) programme which was launched in April 2008. This was expected to add, on average, £38 to the energy bill of a consumer using gas and electricity. The Renewables Obligation, whereby electricity suppliers have to source an annually increasing amount of electricity from renewable sources (10 per cent by 2010), adds around £10 per year to electricity bills and this is expected to rise to £20 by 2015 when the target will be about 15 per cent.

However, this table is not very revealing because it does not split the main cost, ‘energy, supply cost and margin’, now probably more than 75 per cent of total cost, into its components. The largest element of energy, supply cost and margin is ‘energy’; in other words, the wholesale price of gas or electricity. This should be set in a competitive market. However, as little of the wholesale trade is conducted in the open and visible market, little is known about the actual cost retailers pay for their wholesale supplies. For gas, a significant proportion of supplies are contracted long-term for supplies from gas producers. For electricity, most power is generated in retailers’ own plants and internally transferred to the retail division. Most of the rest is contracted long-term, at prices known only to the two parties to the contract, from independent generating companies, of which much the largest is British Energy, the privatised nuclear generation company, with about 12 per cent of Britain’s generating capacity but about 18 per cent of generation.[17] However, in 2008, this company was for sale and, if the sale goes through, the most likely buyers would be one or more of the big six energy companies. This would leave only about a quarter of electricity generation not owned by the six integrated companies.

The retail element should also be set by a competitive market and it is hard to determine how large the retail element is. When electricity and gas were monopoly markets, it was about 5-10 per cent. Competition has introduced extra costs, such as advertising or the cost of switching consumers etc., and some estimates, for example by the regulator, Ofgem, have suggested retail might account for up to 35 per cent of the final bill.

The transmission element, the fee to use the monopoly high voltage national electricity network or the monopoly high pressure national gas network, is set by the regulator, Ofgem. It accounts for about 2-4 per cent of the bill. The distribution element, the fee to use the monopoly low voltage regional electricity network or the monopoly low pressure regional gas network, is also set by the regulator, Ofgem and accounts for about 20 per cent of the bill. In theory, metering is a competitive business, i.e. consumers should be able to choose their meter supplier and operator, but for residential consumers this is a choice that is of little or no value to them.[18]

Unlike some countries, retailers in Britain do not provide consumers with a break-down of their energy bills into these component parts. One interpretation of the transparency requirements of Paragraph 24 of the Electricity Directive is that such a break-down would be required (see Section 4). The Directive states: ‘Member States should ensure that household customers enjoy the right to be supplied with electricity of a specified quality at clearly comparable, transparent and reasonable prices.’

The marginal cost to a supplier of supplying additional energy is very high. Transmission and distribution services must be supplied by legally separate companies and are charged on a kWh transmitted basis. Generation also has a high marginal cost and only the retail element is largely independent of the quantity of energy supplied. For many other products, the marginal cost of additional consumption is low (i.e. fixed costs are a large proportion of the overall price). For example, with public transport the cost of carrying an additional passenger is very low and, in telecoms, the cost of an additional phone call is minimal. This means the cost to a supplier of offering a concession that allows a consumer to receive at low or zero cost a service they would not otherwise consume is very low. It may be possible, as the government has increasingly sought to do, to negotiate voluntary concession schemes with commercial companies who may believe that the value of the publicity they will gain more than pays any additional costs if the marginal cost is low.

For energy, supplying an additional unit of energy is comparable to the average cost. This means that there is not a natural inclination for commercial companies to offer voluntary schemes to support low-income consumers, because they would be very costly. The option of passing the costs on to other consumers would be risky if the costs were significant and the market was genuinely competitive, because companies would risk losing any competitive advantage they held in the market.

4.5 Market shares

The national electricity retail market for residential consumers appears to be reasonably competitive (see Table 3) with the six dominant companies all having market shares of the same order (Ofgem, 2007). However, the companies all retain a large market share for the electricity market of at least 40 per cent and up to 80 per cent in their former home territory, with the average being around 54 per cent. Market shares of all the suppliers are not given by region as this information is regarded as commercially confidential. Centrica has no home territory for electricity so it is likely that its customers are reasonably evenly distributed across the country. This means it is likely that all regions are largely ‘duopolies’ with Centrica and the former incumbent holding on average about 75 per cent of the market.

energywatch[19] estimated that the electricity market Herfindahl-Hirschmann Index (HHI)[20] for the regions ranged from 2,500 in the regions where there has been most switching from the former incumbent, to 6,500 in the regions where the former monopoly company has retained most of the market. Even in the most competitive regions, the market would still be categorised, according to the HHI, as 'highly concentrated'.

Table 3 Market shares of major suppliers in electricity (%)

	Centrica	Powergen/ E.ON	Scottish & Southern	Npower/ RWE	EDF	Scottish Power
G Britain	21	19	18	16	14	12
E Midlands		47				
Eastern		49				
Norweb		40				
Scot Hydro			80			
Southern			62			
SWALEC			70			
Midlands				44		
Northern				45		
Yorkshire				47		
London					57	
Seeboard					51	
SWEB					54	
South Scot						61
MANWEB						48

Source: *Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London.*

For gas, the picture is rather different (see Table 4), with Centrica, the former incumbent, still holding 46 per cent of the national market. As market shares are not given by supplier at a regional level, we can make a simple assumption to see the regional picture. About 40 per cent of gas consumers buy their energy on a 'dual fuel' basis.[21] If we assume that 40 per cent of electricity consumers that still buy their electricity from their incumbent also buy gas, this means that, on average, the electricity retailers have a market share of about 22 per cent in the gas market of their home territories. On average, nearly 70 per cent of the gas market in each former electricity territory is therefore probably held by the former electricity and gas incumbents. energywatch calculated that the domestic gas retail market has an HHI of around 2,800.[22]

While the market shares of some of the incumbents are falling slowly, the regional markets are, by any standards, highly concentrated. In any other sector, if two companies held at least 70 per cent of the market and, in some cases, about 90 per cent (the Scottish Hydro electricity market), these markets would probably be seen as priorities for investigations to determine whether policy action was needed to break up these dominant positions. For example, the Competition Commission's market share test[23] that would be likely to trigger an investigation would be met if a merger led to the creation of a company with a market share of only 25 per cent.

The guidelines were reviewed in 2003, when the Competition Commission issued guidance under the 2002 Enterprise Act. This guidance stated that the test for referral to the Competition Commission would be based on whether the merger or takeover resulted in: 'a substantial lessening of competition within any market or markets in the UK for goods or services'.[24] In April 2008, the Competition Commission and Office of Fair Trading launched a further review expected to be completed by the end of 2008, which would result in new guidance.

Table 4 Market shares of major suppliers in gas (%)

	Centrica	Powergen/E.ON	Scottish & Southern	Npower/RWE	EDF	Scottish Power
G Britain	46	13	13	12	7	9

Source: *Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London.*

5. Fuel poverty

5.1 What is fuel poverty?

5.1.1 The definition

The definition of fuel poverty adopted by government in the UK Fuel Poverty Strategy 2001 – that a household is in fuel poverty if, in order to maintain a satisfactory heating regime, it would be required to spend more than 10 per cent of its income on all household fuel use[25] - has been widely accepted. While 'fuel poverty' and 'poverty' in general clearly have strong linkages, in the past decade it has increasingly been recognised that it is possible for 'fuel poverty' to occur in households that would not be considered to be poor in the wider sense. The measures necessary to deal with poverty in general, e.g. income support, Housing Benefit etc, will not be sufficient to address fuel poverty. A significant proportion of those categorised as suffering from poverty are fuel poor. However, a minority of the fuel poor, at least in 2005 when the number of households that were fuel poor was less than 2 million, would not be categorised as suffering from poverty in the wider sense.

As rising energy prices push a much higher proportion of households into the category of being fuel poor, problems with the 10 per cent definition will become more apparent.[26] Even in 2005, when only 1.7 million households were fuel poor, 6 per cent of those in the third income decile (gross weekly earnings of £215-292) were categorised as 'fuel poor'. By the close of 2008 the number of households living in fuel poverty is likely to be three times the 2005 level. This will mean that some households categorised as fuel poor are likely to be found in the fifth (£384-496) and even sixth (£497-623) income deciles.

The fact that some households in the sixth income decile could, by the end of the year, be spending somewhere in the region of £3000 per year on energy is an appalling indictment of the state of the British housing stock. From an environmental point of view, it must be a priority to put in place policies to ensure their housing is improved so that energy bills and hence 'carbon footprints' are much more reasonable. However, from a social policy point of view, it would be hard to justify directing large amounts of public money to households with relatively large incomes.

While there is not a perfect alignment between poverty and fuel poverty, fuel poverty disproportionately afflicts those suffering from poverty in the general sense. There were households in 2005 in the lowest income decile (less than £142 gross per week) who were spending 20 per cent of their income on energy. Energy price rises since 2005 may mean that such a household would now be spending about a third of their income on energy, perhaps leaving less than £100 for all other purchases. Taking such a household out of fuel poverty must surely be a higher social priority than helping someone in the sixth income decile who is paying 10 per cent of their income on energy? However, policies that are led by simple statistical targets do not distinguish such cases. Policymakers should not lose sight of the fact that their priority is to make the greatest welfare gain possible with the resources available, not make the largest improvement to simple statistics.

The statistical details of the 10 per cent definition itself are not without their problems, in particular how income should be measured. In the 'full income' definition, income directly related to housing is included, i.e. Housing Benefit, Income Support for Mortgage Interest (ISMI), Mortgage Payment Protection Insurance (MPPI), Council Tax Benefit (CTB) and the payment of council tax. The 'basic income' definition excludes income related directly to housing.

For both definitions it is the income, net of income tax and national insurance, of the whole household that is taken into account: that is the income of the Household Reference Person (HRP) and any partner, plus any other adult member. The arguments about which definition is more appropriate are complex. In general, use of the 'full income' basis leads to lower estimates of the number of fuel poor but it also changes the incidence of fuel poverty amongst demographic groups. For example, twice as many single parents are shown to be in fuel poverty under the basic income definition compared to the number under the full income definition.

5.1.2 Factors behind fuel poverty

Boardman (2008) identifies three separate elements that contribute to fuel poverty:

- The cost of fuel (determined by energy prices);
- The amount of fuel needed to heat a property (determined by the energy efficiency of the property) and provide other energy services;
- The ability of the household to afford the necessary fuel (determined by household income).

Traditionally, it has always been the second factor that was seen as the key determinant of whether a household would be fuel poor or not. In terms of actions to help the fuel poor, there is wide agreement that measures to improve the housing stock are the most important because they hold the promise of permanently fuel poverty-proofing buildings at a one-off cost. They also have strong advantages in terms of sustainability. While some of the benefits of energy efficiency measures may be taken as extra comfort, there will still be worthwhile reductions in carbon emissions. The high price environment we are currently witnessing will raise the range and standard of measures that will be seen as sufficient to ensure fuel poverty-proofing. For example, Boardman speculated that the minimum desirable SAP should now be increased from 65 to 80. This issue is examined in detail in Section 6.1.

Measures to artificially reduce the price of fuel or to provide income support are open-ended and potentially expensive commitments, especially if energy prices and the number of households needing support remain high. However, the magnitude of energy price rises since 2005 means that arguments about the cost of energy actually paid by low-income households are becoming more significant. There is a need to ensure not just that costs are as low as possible but also that the prices charged by the companies are justifiable given the costs they incur. There are particular concerns over the widening differential between fuel tariffs for prepayment and standard credit consumers and those that pay by on-line Direct Debit. So, while there is a strong case to argue that energy efficiency measures are by far the most efficient solution to fuel poverty, the rapid rise in energy prices means that energy efficiency measures alone will not be sufficient to eradicate fuel poverty, at least in the short- to medium-term. The process of upgrading the housing stock is inevitably a relatively slow one and measures are needed to protect consumers in the interim until improvements can be implemented. energywatch has sought to focus on the impact that increasing prices are having in driving up levels of fuel poverty. Scorer (energywatch) stated:[27]

> The number of GB households in fuel poverty has almost doubled in the last 5 years. The cause, of course, is a near-doubling in the average household's energy bill over the same period. Incomes have not been slashed and the level of investment in energy efficiency and heating programmes is still higher now than in 2005/6.

However, Ofgem has sought to emphasise the need for action from government on energy efficiency and income measures to address fuel poverty, while seemingly underplaying the need for action on the cost of energy being paid by fuel poor households. At its Fuel Poverty Summit in April 2008, Ofgem stated:[28]

Fuel poverty is part of a wider problem of poverty and social exclusion caused by a combination of high energy prices, low incomes and poor housing conditions. Given such wider causes, there will inevitably be a limit to the role that the regulator and industry can play in tackling fuel poverty. The main focus must be on raising incomes and improving housing, which are the responsibilities of Government. Ofgem's remit and the focus of the Summit was on tariffs and assistance provided by suppliers.

It is open to question whether such a limited role meets the requirements imposed in the guidance given to Ofgem in 2004 under the Utilities Act, which stated (see Annex 1):[29]

The Government expects the Authority, within its sphere of responsibility, to put in place measures which will help achieve these targets [no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010].

The Energy Retail Association has also sought to underplay the impact of rising prices on fuel poverty levels, by emphasising instead the need for action on the dimensions of fuel poverty that are in the government's hands. In May 2008, it stated:[30]

However, the fact cannot be ignored that the root of fuel poverty is, at its most simplistic, poverty, and although many stakeholders and the industry have a legitimate role to play, it is ultimately Government who is responsible for developing, delivering and sustaining a financially inclusive, socially conscious society which provides help for those who require it the most.

5.2 Who are the fuel poor?

The government's 2005 Progress Report reported that, for England, the total 'fuel poor number had fallen from 5.1 million in 1996 of whom 4.0 million were classed as vulnerable, to 1.2 million in 2003, of whom 1.0 million were vulnerable.'

The Department for Business, Enterprise and Regulatory Reform publishes, along with its annual progress report (BERR, 2007b, see below), detailed data on the characteristics of the fuel poor in England (BERR, 2007a) on which its annual progress report is based. While the report is dated 2007, the data relate to 2005, before the major price increases began to have an impact. This report has an annex which provides 72 tables showing the characteristics of the fuel poor in England. These tables are generally shown on the two income bases: full income including benefits, and basic income. Both bases are important for a full understanding of the issues. Under the basic income basis, in 2005, nearly 1.8 million households were categorised as living in fuel poverty, of whom 1.4 million (80 per cent) were vulnerable households. For these purposes, 'vulnerable households' are those containing 'older householders, families with children and householders who are disabled or suffering from a long-term illness'.

5.2.1 Payment methods

Of particular concern to this study is payment method (see Tables 5 and 6). Clearly it is not the method of payment as such that determines whether households are fuel poor, rather it is the tariffs charged under these different payment methods. Given that PPM and Standard Credit (SC) tariffs are 20-25 per cent higher on average than the cheapest household tariffs, and given that the cheapest tariffs - online Direct Debit accounts - may not be feasible for many low income households, it is not surprising that many of the fuel poor pay by PPM or SC. Under the basic income definition, 19 per cent of PPM electricity consumers and 17 per cent of PPM gas consumers are fuel poor compared to the overall percentage of households that are fuel poor of 8 per cent. The proportion of SC consumers who are fuel poor is a little above the average. Only about 4 per cent of Direct Debit consumers are fuel poor and it is highly likely that the percentage of online Direct Debit households that are fuel poor would be much lower.

It should also not be overlooked that those without a gas connection are also particularly at risk of fuel poverty: under the basic income definition, 16 per cent of those without a gas connection are fuel poor. The dramatic increase in the numbers of households that are fuel poor means that updated figures will look very different, but households that were fuel poor in 2005 will be suffering much more than those that have fallen into that condition since.

Table 5 Fuel poor households (2005): payment method – full income basis

	No (th) who pay for electricity this way	No (th) / % electricity consumers using this payment method in fuel poverty	No (th) who pay for gas this way	No (th) / % gas consumers using this payment method in fuel poverty
Prepayment meter	2996	300 / 10.0	2164	166 / 7.7
Standard credit	6936	696 / 10.0	5943	478 / 8.0
Direct debit	11202	532 / 4.8	10276	434 / 4.2
No gas			2750	451 / 16.4
Total	21134	1529 / 7.2	21134	1529 / 7.2

Source: *http://www.berr.gov.uk/files/file42705.pdf*

Table 6 Fuel poor households 2005: payment method – basic income basis

	No (th) who pay for electricity this way	No (th) / % electricity consumers using this payment method in fuel poverty	No (th) who pay for gas this way	No (th) / % gas consumers using this payment method in fuel poverty
Prepayment meter	2996	569 / 19.0	2164	372 / 17.2
Standard credit	6936	739 / 10.7	5943	539 / 9.1
Direct debit	11202	467 / 4.2	10276	366 / 3.6
No gas			2750	498 / 18.1
Total	21134	1775 / 8.4	21134	1775 / 8.4

Source: *http://www.berr.gov.uk/files/file42705.pdf*

The issue of which definition to use makes a significant difference to the diagnosis of the extent to which PPMs contribute to the problem. In its Domestic Retail Market Report 2007 (Ofgem, 2007), Ofgem asserts that 80 per cent of PPM customers are not fuel poor. On the full income definition, 19.6 per cent of the fuel poor are electricity PPM users and 11 per cent of the fuel poor are gas PPM users (29 per cent do not have a gas connection). However, on the basic income definition, 32 per cent of the fuel poor are electricity PPM users and 21 per cent of the fuel poor are gas PPM users (28 per cent do not have a gas connection).

5.2.2 Method of heating

The presence or otherwise of central heating and the main type of fuel used for heating are strong determining factors (see Tables 7 and 8). Under the full income basis, those without central heating are four times as likely to be fuel poor as those with, but under the basic income basis, only 3.5 times as likely. Those not using gas for heating are much more likely in all cases to fall into the category of fuel poverty, whether or not they have central heating.

Table 7 Fuel poor households 2005: heating method & fuel – full income basis

	No of households (th)	No (th) / % of whom fuel poor
Central heating	19918	1288 / 6.5
Gas	17264	886 / 5.1
Oil	834	126 / 15.0
Solid	237	106 / 44.8
Electricity	1580	170 / 10.8
No central heating	912	236 / 25.9
Gas	638	118 / 18.6
Solid	70	37 / 52.6
Electricity	205	81 / 39.6

Source: *http://www.berr.gov.uk/files/file42705.pdf*

Table 8 Fuel poor households 2005: heating method & fuel – basic income basis

	No of households (th)	No (th) / % of whom fuel poor
Central heating	19918	7.6
Gas	17264	6.1
Oil	834	12.4
Solid	237	46.8
Electricity	1580	15.6
No central heating	912	26.6
Gas	638	20.2
Solid	70	45.7
Electricity	205	40.0

Source: *http://www.berr.gov.uk/files/file42705.pdf*

5.2.3 Tenure

Of the 1.5 million households in England categorised in 2005 as fuel poor under the full income basis, 1.3 million (85 per cent) live in private accommodation (rented or owner-occupier), while 215,000 live in social housing (see Table 9). However, on the basic income basis (see Table 10), nearly a third (0.6m) live in social housing. This shows the impact of Housing Benefit on income for those in social housing.

Table 9 Fuel poverty by tenure 2005: full income basis

	th households (%)		
	Social housing	**Private**	**All**
Vulnerable households	164 (10.7)	1031 (67)	1195 (78)
Non-vulnerable households	51 (3.3)	284 (19)	335 (22)
All	215 (14.0)	1314 (85.4)	1539

Source: *http://www.berr.gov.uk/files/file42705.pdf*

Table 10 Fuel poverty by tenure (2005): basic income basis

	th households (%)		
	Social housing	**Private**	**All**
Vulnerable households	468 (26.4)	937 (52.8)	1405 (79.2)
Non-vulnerable households	108 (6.1)	261 (14.7)	369 (20.8)
All	577 (32.5)	1198 (67.5)	1775

Source: *http://www.berr.gov.uk/files/file42705.pdf*

5.2.4 Income and the thermal properties of housing

Tables 11 and 12 show the very strong relationship between fuel poverty, income and the thermal quality of the property as measured by the government's Standard Assessment Procedure (SAP) rating, a scale running from 0-100. As a reference point, it was assumed that a SAP of 65 would be sufficient to ensure that a property would be 'fuel poverty proofed', although the large rises in energy prices may mean that a much higher target, for example 80, may be needed. These figures show that the standard of British housing is generally well below this reference point.

Table 11	Fuel poverty 2005: income & housing thermal properties – full income basis			
% expenditure on fuel	**No of households th / %**	**Average basic income (£/year)**	**Fuel costs (£/year)**	**SAP rating**
0-5	13853 (65.6)	31400	780	50.9
5-10	5752 (27.2)	13100	870	45.5
10-15	1112 (5.3)	8700	1020	35.6
15-20	269 (1.3)	7400	1240	28.2
>20	148 (0.7)	5700	1480	20.8
Total	21134	24800	830	48.1

Source: *http://www.berr.gov.uk/files/file42705.pdf*

Table 12	Fuel poverty 2005: income & housing thermal properties – basic income basis			
% expenditure on fuel	**No of households th / %**	**Average basic income (£/year)**	**Fuel costs (£/year)**	**SAP rating**
0-5	13828 / 65.4	32500	790	50.3
5-10	5531 / 26.2	12900	860	46.2
10-15	1241 / 5.9	8100	950	39.2
15-20	336 / 1.6	6500	1090	34.7
>20	198 / 0.9	5000	1290	24.6
Total	21134	25300	830	48.1

Source: *http://www.berr.gov.uk/files/file42705.pdf*

One of the most worrying aspects of this data is the 26-27 per cent of households in England that spent 5-10 per cent of their income on energy. These households could easily fall into fuel poverty if energy prices increase; in fact many households already have. This figure implies that, all things being equal, if, as seems likely, fuel prices were to nearly double in real terms from their 2005 level, a further 5.5-5.8 million households could fall into fuel poverty, which would mean around a third of households in England would be fuel poor. Whether such a large increase in the numbers of fuel poor would actually happen will depend not only on whether energy prices rise to that extent, but also on increases in income, supplier and government initiatives to assist low-income households with the high cost of energy and whether consumers take steps to improve energy efficiency and save energy, or switch to cheaper payment methods and/or suppliers.

Some sources refer to 'extreme fuel poverty' under which more than 20 per cent of income is spent on fuel and, in 2005, 0.7-0.9 per cent of households fell into this category. If energy prices were to double in comparison to the 2005 level, this figure could rise to 7.3-8.4 per cent.

5.2.5 Other factors

As with the factors above, the figures on fuel poverty vary considerably according to whether the full or basic income basis is used.

Of the fuel poor, just under half live in homes that are categorised as 'not decent' using the government's fitness criteria; about 80 per cent of these households fail on the 'thermal comfort' criterion and perhaps other criteria (again for both full and basic categories).

In terms of composition, households with members over 60 years age and single person households are most likely to be fuel poor. On a full income basis, 18 per cent (20 per cent on a basic income basis) of households made up of a single person over 60 are fuel poor, while 16-17 per cent of households where the youngest member is over 75 are fuel poor; and 17-19 per cent of single person households are fuel poor (compared to 7-8 per cent overall). Looked at in a different way, while in only about a quarter of households is the youngest person over 60, such households account for nearly half the fuel poor (on a full income basis).
Not surprisingly, the unemployed suffer disproportionately from fuel poverty – 24 per cent on a full income basis but 44 per cent on a basic income basis. The economically inactive – 14-16 per cent – are much more likely to be fuel poor than the employed.

However, the figures on income are more surprising and reinforce the assertion that, while fuel poverty and poverty are strongly linked, they are not the same. Less than half (48 per cent) of those whose income falls in the first decile of income are fuel poor on a full income basis and on the basic criterion, the figure only rises to 55 per cent. Nevertheless, about two thirds of the fuel poor have incomes in the lowest income decile. Six per cent of those in the third decile are fuel poor on either basis.

In terms of the rural/urban split, those living in rural communities (villages, hamlets or isolated buildings) are much more likely to be fuel poor than urban consumers – 13-15 per cent of this category of household are fuel poor, albeit they account for less than 20 per cent of the fuel poor on a full income basis (15 per cent on a basic income basis). There is likely to be some association in this case with the low availability of gas connections for rural consumers as well as the nature of the properties, which may be more difficult to treat, for example if they have solid walls and no potential for mains gas connection.

In terms of location, the areas with the highest rate of fuel poverty are the North East (11.5-14.5 per cent) and the North West (9.2-10.3 per cent), while the areas with the lowest rates are London (3.9-6.4 per cent) and the South East (4.9-5.0 per cent). The higher figures are for the basic income definition. The North West alone accounts for 18 per cent of the fuel poor on a full income basis (17 per cent on a basic income basis) even though only 14 per cent of households are in that region.

The relationship between council tax band and fuel poverty is perhaps not as strong as might be expected on a full income basis. While 10.3 per cent of those in band A, the lowest value houses, are fuel poor, 6.1 per cent in bands F, G and H, the highest value housing, suffer. Nevertheless, on a full income basis, a third of the fuel poor live in band A homes. However, on a basic income basis, 15.4 per cent of those in band A are fuel poor and 40 per cent of the fuel poor live in band A homes, while only 4.2 per cent in bands F, G and H suffer. This perhaps reflects 'under occupancy' of large premises, for example pensioners living alone or as a couple in a large family house.

5.2.6 Summary

These figures show fuel poverty is a complex and multi-facetted phenomenon that, while it is most likely to be present in low-income households, it does affect some households that might not otherwise be thought of as poor. Equally, policies that alleviate poverty in general, e.g. housing benefit and tax reforms, may have a limited impact on fuel poverty because they do not address the main causes, that is, poor housing quality, high energy costs and the use of payment methods that attract a premium. Identifying all the nuances of the factors behind these figures would require a much more comprehensive analysis than is presented here. However, the figures show that there are important linkages to the housing sector. While these figures do not show that the link between fuel poverty and method of payment is causal, i.e. they do not show that households are fuel poor *just because* they use prepayment meters or pay using standard credit terms, the fact that PPM and standard credit tariffs are significantly higher than Direct Debit tariffs does demonstrate that the problem is significantly exacerbated by this price differential between different methods of payment. The issue of payment method is examined in section 6.

5.3 Impact of fuel poverty

The most extreme manifestation of fuel poverty is excess winter deaths. Help the Aged estimate that 25,000 people over the age of 65 die every year as a result of cold-related illnesses. Research (Howieson, 2005) reported in 2004 claimed that:[31]

Poverty is the main cause of premature death among the elderly in Scotland and the chances of premature elderly death are highest in Glasgow. These deaths could be prevented if measures were to be taken to keep pensioners warm in their homes during the winter months.

'Excess winter mortality' as defined by the Office of National Statistics[32] is calculated as winter deaths (deaths occurring in December to March) minus the average of non-winter deaths (April to July of the current year and August to November of the previous year). However, the figures on 'excess winter mortality' are influenced by factors other than fuel poverty. A very cold winter will increase the number of deaths; for example, the number of excess deaths in the very cold winter of 1962/63 was 80 per cent higher than in the following year. Also, a particularly virulent seasonal flu virus will increase the number of deaths. In 1999-2000, when excess winter mortality was the highest since 1985 at 48,440, just fewer than 22,000 were killed by the disease. In 2004-2005, when excess winter mortality was 31,640, there were an estimated 1,268 deaths due to flu. The link between winter deaths and fuel poverty may therefore be obscured. Nevertheless, a 2003 study did find that death rates in the UK were significantly higher than in other affluent Northern European countries (Healy, 2003).[33]

However, the impact of fuel poverty runs much deeper than excess winter deaths. Barnardo's states:[34]

> For those living in fuel poverty, the consequences are misery, discomfort, ill health and debt. It often means choosing between essential household items or living in an adequately heated home. According to the Executive's Scottish Fuel Poverty Statement, living in a cold, damp environment can cause discomfort and ill health. For example, health problems such as influenza, heart disease, and strokes can be exacerbated, and cold homes can promote the number of dust mites and the growth of fungi, which are often liked to asthma and other similar conditions. Households that need to spend a large part of the family income on fuel often have to spend less on other parts of the family budget. This may lead to a poor diet or reduced participation in leisure activities, both of which can impact quality of life and health, especially for vulnerable people such as children. Children's education may also be adversely affected. Cold homes can increase the amount of time it takes to recover from an illness, which could result in longer absences from school. Overcrowding in heated areas of the house could be distracting for a child who is trying to do schoolwork.

There is relatively little systematic research on this broader impact of fuel poverty. A small project was undertaken in 2005-07 by Rudge (2007) at the London Metropolitan University Research.[35] The conclusions stated:

> The results confirm some of the findings by others, while adding to the increasing body of evidence pointing towards health effects of energy inefficient buildings on their inhabitants, over and above their contribution to carbon emissions. The study demonstrates that these effects can be measured in terms of morbidity, as well as mortality, illustrating that the impact of cold homes is even more far-reaching than a proportion of the 40,000 annual excess winter deaths.

5.4 Government policy on fuel poverty

In 2000 Parliament passed the Warm Homes and Energy Conservation Act. The Act required Government to prepare and publish a strategy:

> setting out the authority's policies for ensuring, by means including the taking of measures to ensure the efficient use of energy, that as far as reasonably practicable persons do not live in fuel poverty.

In November 2001, government published its 'Fuel Poverty Strategy' (BERR & DEFRA, 2001) as stipulated by the Act. It provided a more precise definition of fuel poverty as follows:

> a fuel poor household is one that cannot afford to keep adequately warm at reasonable cost. The most widely accepted definition of a fuel poor household is one which needs to spend more than 10% of its income on all fuel use and to heat its home to an adequate standard of warmth. This is generally defined as 210C in the living room and 180C in the other occupied rooms – the temperatures recommended by the World Health Organisation.

This Strategy set a target to end fuel poverty for 'vulnerable households' by 2010 and to end fuel poverty for all households by 2016 so far as reasonably practicable. The two responsible government departments for England are Business Enterprise and Regulatory Reform (BERR, previously Department of Trade & Industry) and Department for Environment, Food & Rural Affairs (DEFRA). For Scotland, Wales and Northern Ireland, the responsibilities are devolved to the Scottish Government, the Welsh Assembly and the Northern Ireland Department for Social Development. These bodies publish an annual report on progress with the Fuel Poverty Strategy (BERR, 2007b).

In 2001, when the Strategy was adopted, government figures estimated that, in England (responsibility for policy on fuel poverty is devolved), 1.7 million households fell into the category fuel poor of which 1.4 million were vulnerable households. Estimates for 2007 suggest the number for that year was 2.9 million, of which 2.3 million were vulnerable households.

In April 2008, National Energy Action (NEA) estimated that 4.5 million households were fuel poor in the UK and that, by the end of 2008, this number could have risen to 5.5 million.[36]

5.5 Warm Front

A major element of the government's Fuel Poverty Strategy for England is the Warm Front [37] programme (there are devolved equivalents), which was set up in 2000 and provides grants for insulation, draught proofing and heating improvements for householders on benefits who are either owner occupiers or who live in private rented accommodation. In its 2004 action plan, government stated: 'Our main tool for eradicating fuel poverty in England will remain the Warm Front programme.'[38] In its 2005 Progress Report, it estimated that:[39]

61 per cent of the reduction since 1996 can be attributed to improvements in incomes. 22 per cent of the reductions are attributable to energy prices, while 17 per cent of the reduction is attributable to energy efficiency improvements, a sign that initiatives like Warm Front are having a significant impact in taking people out of fuel poverty.

Table 13 shows the annual expenditure under this programme.

In 2007-08, its budget was £350m, although the Fuel Poverty Advisory Group reported that this would be reduced by 25 per cent in the period 2008-11. The government estimated that its package of measures on fuel poverty and home energy efficiency was worth £2.3bn.[40]

Boardman (Boardman, 2008) was not only critical of the reduction in funding for Warm Front, she was also critical of the effectiveness of Warm Front at targeting fuel poverty. Her work backed up a report for the 'Eaga Partnership' by Sefton (Sefton, 2004). Boardman reported that government figures showed that only 16 per cent of households eligible for Warm Front assistance were in fuel poverty and only 60 per cent of the fuel poor were eligible for Warm Front assistance. She also reported that grants paid did not make a large enough difference to the efficiency of buildings. The government rates buildings on the Standard Assessment Procedure (SAP) rating, a scale running from 0-100.

Table 13 Warm Front spend since the scheme's inception

Scheme year	Approximate total spend/budget (£ million)
2000-01	72
2001-02	197
2002-03	163
2003-04	164
2004-05	166
2005-06	192
2006-07	320
2007-08	350

Source: *http://www.publications.parliament.uk/pa/cm200708/cmhansrd/cm080401/text/80401w0002.htm#08040186000041*

Historically, it has been assumed that a household living in a building rated 65 or higher would not be fuel poor. Boardman stated (Boardman, 2008, p 27):

> In 2005 using SAP 2005, more than 98% of fuel poor households lived in a property with a SAP lower than 65 [table 33, BERR and DEFRA 2007]. The households in the most severe fuel poverty (those needing to spend >20% of their income), the property had an average SAP of 21. About a quarter of the fuel poor consistently live in the very worst homes, with a SAP < 20, and around half in a property with a SAP < 35.

She also argued that higher fuel prices meant that a much higher SAP than 65, perhaps 80, would be required for the assumption that a household meeting that level would not fall into fuel poverty by 2016. By comparison, Boardman found that Warm Front lifts a property on average only by 16 SAP points (from 40 to 56).

5.6 The Carbon Emissions Reduction Target

The Carbon Emissions Reduction Target (CERT) is a three year programme that replaced the Energy Efficiency Commitment (EEC) in April 2008. EEC had operated for six years, also in three-year programmes (EEC1 and EEC2). These schemes allowed energy retailers to add a small percentage to the bills of consumers to create a fund to pay for energy efficiency measures that are then delivered in accordance with targets set by Defra and monitored by Ofgem. The objective of CERT is to reduce emissions of carbon dioxide by improving energy efficiency in a cost-effective manner. Consumers' contributions to CERT are approximately double those under EEC and average a total of about £38 for a consumer of electricity and gas. CERT is not specifically aimed at combating fuel poverty, but 40 per cent of the emissions savings (it was 50 per cent under EEC) must be achieved in the 'Priority Group', i.e. those in receipt of specified (mainly income-related) benefits. The qualifying benefits are similar to those which grant access to the Warm Front Scheme, but eligibility extends to social housing tenants. However, Boardman reported that, as with Warm Front, only about 60 per cent of the fuel poor are eligible for CERT assistance and 14.4 per cent of the households who were eligible for EEC were fuel poor.

5.7 Winter fuel payments

The Winter Fuel Payments scheme was introduced in 1997 and is an annual payment made to all pensioners of between £200 and £300. The rates announced in the 2008 Budget were: £200 for households with someone over 60, £300 if over 80, plus an additional one-off payment of £100 to over-80s households and £50 to over-60s households in 2008-09.

Government invariably mentions Winter Fuel Payments when detailing its measures on fuel poverty. However, Winter Fuel Payment is judged by Boardman and the Fuel Poverty Advisory Group to be an inefficient way of dealing with fuel poverty because it is not targeted at the fuel poor. Boardman (Boardman, 2008, p 25) estimates that only '11.6% of the households in receipt of Winter Fuel Payments were in fuel poverty.'

The government's cold weather payments scheme still exists but the amounts of money paid out are small and the cold weather conditions needed to trigger payments are seldom encountered. The group of people that are eligible to receive this payment is also restricted.[41] The payment is:[42]

> £8.50 when the average temperature where you live is recorded as, or forecast to be, zero degrees Celsius or below, over seven consecutive days during the period from 1 November to 31 March.

5.8 Decent homes programme

The Decent Homes Programme (see also the chapter on housing) was launched in 2000 and is intended to raise the overall standard of social housing. The programme is operated by the Department of Communities and Local Government and has a target to ensure that 95 per cent of social housing is 'decent' by 2010. There are four criteria for 'decency':

- It meets the current statutory minimum standard for housing;
- It is in a reasonable state of repair;
- It has reasonably modern facilities and services;
- It provides a reasonable degree of thermal comfort.

So the programme is not specifically targeted at those in fuel poverty and thermal efficiency is only one aspect of its remit. It is not clear how much of the Decent Homes Budget can be attributed to energy efficiency measures and those suffering from fuel poverty. The Select Committee on Communities and Local Government

(2008) found:

> The programme is widely seen as worthwhile for what it has achieved but a missed opportunity because of what it never sought to achieve. The Sustainable Development Commission, the Fuel Poverty Advisory Group and National Energy Action all believe the programme underachieved because specific energy improvement standards were omitted.

It recommended:

> We recommend that the Government include specific energy performance improvement standards in any social housing improvement programme that follows Decent Homes in 2010. In particular, we recommend that any future programme contain a specific minimum, rather than average, Standard Assessment Procedure target for all social housing. We seek the Government's view on the Local Government Association's suggestion that that minimum SAP rating should be 65.

5.9 Fuel Poverty Advisory Group

The government also set up the Fuel Poverty Advisory Group (FPAG)[43] 'to report on the progress of delivery of the Government's Fuel Poverty Strategy and to propose and implement improvements to regional or local mechanisms for its delivery'. This body covers England and there are devolved bodies for the other regions. FPAG is an 'Advisory Non-Departmental Public Body' sponsored by Defra/BERR and acts as an authoritative source of evaluation of the government's Fuel Poverty Strategy. Its 2007 Annual Report (Fuel Poverty Advisory Group, 2008), published in March 2008, expressed concerns on a number of points, particularly the apparent abandonment of the 2010 fuel poverty target. It found that energy prices, from 2003 to March 2008, had increased by 50 per cent[44] leading to the highest level of fuel poverty for a decade (2.9 million households in England in 2007). It highlighted the increasing differential between payment methods and it was critical of the decision to cut the Warm Front budget and of the rebalancing of CERT to the detriment of low income groups.

It made six recommendations, which can be summarised as follows:

- The Warm Front budget for 2008-11 should be restored to its 2007/08 level over-riding the 25 per cent cut that has been imposed. Several ways of funding this were suggested;
- Progress on reducing the differentials between tariffs should be made, including standard credit terms as well as PPMs;
- Energy companies have been increasing their prices faster than their costs are increasing their margins. FPAG recommended that Ofgem protect the interests of consumers more 'tenaciously' especially low-income households;
- Government should improve benefit take-up;
- Government and the Public Service Agreement should give adequate priority to fuel poverty so that the 2016 target on fuel poverty eradication will be met;
- Information on households should, with appropriate safeguards, be shared – especially by the Department of Work and Pensions – with Local Authorities and energy companies, to help to reach those in need.

6. Payment methods

Tables 14 and 15 show the different payment methods by company. These show that the three main payment methods, Direct Debit, PPM and standard credit (quarterly) account for about 95 per cent of all accounts. There are some differences by company. British Gas has a higher than average proportion of PPM consumers and a lower than average number of Direct Debit consumers. EDF also has a high proportion of PPM consumers. Scottish Power and Scottish & Southern have a high proportion of Direct Debit consumers. Powergen has the lowest proportion of PPM consumers. How far these differences reflect company policies and how far they represent historic or regional differences (for example, culture and income) is not clear.

Table 14 Payment methods for electricity by company (%)

	Direct debit	PPM	Quarterly	Fuel direct	Budgeting payment schemes	Other
British Gas	43	19	33	0.1	2.8	2.2
EDF Energy	39	17	41	0.1	0.5	3.4
Npower	43	13	39	0.1	2.3	3.5
Powergen	47	9	39	0.1	3.4	2.2
Scottish&SE	50	12	33	0.1	1.0	4.1
Scottish Power	54	14	27	0.2	2.8	2.0
Industry	47	14	35	0.1	2.1	2.9

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007' Ofgem, London*

Notes

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

Table 15 Payment methods for gas by company (%)

	Direct debit	PPM	Quarterly	Fuel direct	Budgeting payment schemes	Other
British Gas	40	13	40	0.1	3.2	3.4
EDF Energy	52	15	31	0.1	0.6	2.0
Npower	54	12	27	0.3	3.9	3.5
Powergen	58	6	31	0.1	4.2	1.2
Scottish&SE	59	7	28	0.1	1.4	3.7
Scottish Power	67	7	22	0.1	2.3	0.8
Industry	50	11	33	0.1	2.9	2.7

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007' Ofgem, London*

Notes

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

Table 16 reproduced from section 5.2 shows that the risk of fuel poverty is strongly influenced by the method of payment. In 2005, the most recent year for which full data is available, more than half of all electricity consumers paid by Direct Debit, which is well-known to offer the cheapest rates, while 33 per cent and 14 per cent paid by standard credit and PPM respectively. For gas, the equivalent figures are 56 per cent paid by Direct Debit, 32 per cent by standard credit and 12 per cent by PPM. The installation rate of PPMs for payment of debt has risen sharply since 2005 (see Table 17). The installation rate for debt was approaching 1000 a day in 2007 (14 per cent higher than 2006) and reflects in part the fall in disconnection levels.
An increasing number of consumers operate their accounts online paying by Direct Debit and receive significant discounts for doing so. Ofgem (Ofgem, 2008) estimated that about 2.5 million consumers now have online accounts, presumably most of which would be 'dual fuel', Direct Debit accounts.

Table 16 Fuel poor households (2005): payment method – full income basis

	No (th) who pay for electricity this way	No (th) / % electricity consumers using this payment method in fuel poverty	No (th) who pay for gas this way	No (th) / % gas consumers using this payment method in fuel poverty
Prepayment meter	2996	300 / 10.0	2164	166 / 7.7
Standard credit	6936	696 / 10.0	5943	478 / 8.0
Direct debit	11202	532 / 4.8	10276	434 / 4.2
No gas			2750	451 / 16.4
Total	21134	1529 / 7.2	21134	1529 / 7.2

Source: *http://www.berr.gov.uk/files/file42705.pdf*

Table 17 Average daily rate of installation of PPMs for debt

	2002	2003	2004	2005	2006	2007	2008 Q 1
Electricity	430	422	298	323	452	549	616
Gas	353	299	367	400	463	494	521
Total	784	721	666	723	915	1042	1137

Source: *energywatch*
Note:
Figures for Q1 2008 are estimates based on trend analysis.

6.1 Prepayment meters

The high prices charged to prepayment meter consumers are widely acknowledged as one of the major problems facing gas and electricity consumers who use this payment method. On the high prices paid by PPM consumers, the government's Fuel Poverty Advisory Group stated in its 2007 Annual Report:[45]

> The position here is shocking and has been getting worse. Customers with prepayment meters and those paying by cash/cheque are subsidising those paying by Direct Debit and online.

6.1.1 Background

Britain is alone amongst developed countries in having a significant number of consumers that pay their energy bills via prepayment meters (PPMs). These meters are generally electronic meters charged using a 'smart card' rather than the older coin/token meter, although a significant number of the latter still exist (see below). Use of PPMs for electricity increased sharply in 1992 when the number of consumers using electricity PPMs nearly doubled to more than 2 million (Table 18), while the increase in use by gas consumers came somewhat later. Electricity numbers have stayed at about the same level from 1997 onwards, but for gas the numbers have continued to increase.

After the meters were introduced on a large scale in 1992, consumers that had problems paying their bills had little choice but to switch to a prepayment meter if they were ineligible for or unaware of Fuel Direct (see below) and wished to avoid disconnection. These were generally operated by a 'smart card' that contained the individual consumer's account details and money could be added to these cards at a local retail outlet, such as a petrol station or newsagent. The Regulator was persuaded that use of PPMs entailed extra costs compared to normal meters. However, he was able, as the market for small consumers was still then a monopoly and tariffs were regulated, to require the retail companies to limit the premium between prepayment meters and standard credit terms to no more than 5 per cent.

Table 18 Customers on prepayment meters 1991–2007 (million households)

	Gas	Electricity
1991	0.75	1.15
1992	0.75	2.10
1993	0.80	2.40
1994	0.85	2.70
1995	0.85	3.25
1996	0.95	3.50
1997	1.1	3.6
1998	1.4	3.7
1999	1.6	3.7
2000	1.8	3.5
2001	1.8	3.8
2002	2.0	3.7
2003	2.0	3.7
2004	2.1	3.6
2005	2.2	3.6
2006	2.3	3.5
2007	2.3	3.6

Source: *Boardman B & Fawcett T (2002) 'Liberalisation of electricity supply and fuel poverty: lessons from Great Britain for Northern Ireland', Environmental Change Institute, Oxford for 1992-1996; Ofgem (2007) 'Domestic suppliers: social obligations annual reporting for 2006' Ofgem, London. http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Documents1/Monitoring%20Company%20Performance,%20Annual%20Report%202006.pdf and Ofgem (2008a).*

PPMs served a number of purposes for the companies. If there were additional costs over and above the 5 per cent they were allowed to recover in higher tariffs, they simply passed these on to other consumers. The 'smart cards' allowed them to recover debts because a proportion of any energy purchases made by the consumer went to pay off their debt. From a strategic point of view, the political problems caused by disconnecting consumers that did not pay their bills were addressed to a considerable extent. The Bates case of 2003 (see Section 7), when an elderly couple were found dead (one due to hypothermia) in their flat two months after being cut off by British Gas gave an extra impetus for companies to install PPMs for consumers who would otherwise be cut off. With a PPM, the consumer disconnects themselves if they cannot afford their bill. Blame for any harm that results does not rest so squarely on the energy company as it would have done if the company had disconnected them. Jewell (Jewell, 2003) found:

> In 1991, 48,000 residential customers were disconnected for debt. By 1998 this had dropped to 400, as prepayment meters replaced disconnection. However, a report published by the Energy Association (a trade group) in 2001 found that 24% of prepayment meter users self-disconnect in a given year, 11% of users for more than 7 hours. With 3.8 million electricity prepayment meters in place, that translates to 912,000 customers being disconnected (410,000 for over 7 hours). The survey found that about 1% of consumers were chronically disconnected (over 20 times in a year). This translates to about 36,500 consumers. In sum, the use of prepayment meters has dramatically increased the number of short term disconnections.

However, from a public welfare point of view, the disadvantages were clear. Jewell found:

> Consumer advocates in the UK have pointed out, however, that use of prepayment meters does not block the health and safety hazards associated with disconnection, but rather hides the rate of disconnections because consumers who cannot pay their bills now 'self-disconnect'. Prepayment meters effectively bypass the procedural protections against disconnection.

PPMs are often valued by consumers because of the control they give them over their spending, helping them budget their limited resources. They eliminate the risk that a large, unmanageable bill will be incurred. Any energy used has already been paid, thus reducing the uncertainty consumers might have about whether or not they can afford to heat themselves properly on a cold day. Of course, if they find they cannot afford the energy, they must simply disconnect themselves and try to put up with the discomfort or adopt hazardous coping strategies.

6.1.2 Price differentials

As long as electricity was a monopoly service, the 5 per cent price differential could be maintained because retail companies could recover whatever costs they incur. However, when the residential energy market was opened up, the companies were free to charge whatever the market would bear. Under the monopoly price regime, prices were closely related to costs and were fully determined by the regulator. Under the market regime, cost is just one of the elements determining prices. Companies will have an incentive to set prices at a high level for the consumers that are least likely to switch because the risk of losing their account is low. Companies will also target consumers that they expect to be more profitable (for example, they consume a lot of energy) or easier to serve. Particularly in the first years after market opening, there was a trend for companies to try to become 'multi-utilities' that sold a range of household services from utilities such as telecoms and water to other purchases, such as financial services and car breakdown recovery. This made richer consumers that were more likely to consume a range of services, particularly attractive.

Table 19 Extra cost to supplier of supplying PPM consumers vs. Direct Debit (£/year)		
	Direct debit	**Standard credit**
Prepayment infrastructure provision	40	40
Meter provision and maintenance	30	30
Supply business costs	15	-10
Total	85	60

Source: *Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London.*
Notes
1. Supply business costs include working capital, call centres and billing.
2. It is not clear why the standard credit column does not add up.

Ofgem (Ofgem, 2007) estimates that the additional cost of supplying a PPM electricity or gas consumer compared to a Direct Debit consumer is £85 per year and £60 for a PPM consumer compared to a standard credit consumer (see Table 19). These figures do not take account of any benefits to the company, for example the reduction in exposure to bad debt. However, some of these costs are questionable, while other factors are not included. For example, Ofgem includes as an extra cost: 'token meters require visits to the premises to recalibrate the meter when prices change'. However, given that such meters have been obsolescent since smart card meters were introduced nearly 20 years ago, it is hard to see why companies should be allowed to recover the costs of such an archaic method of payment. However, the analysis neglects the advantage that PPM consumers never incur debt recovery costs and, in a situation where energy prices are rising fast and large numbers of consumers are struggling to be able to pay their energy bills, this would appear a major advantage. Whether the costs are reliable must also be in question. They were given by one supplier and were not open to independent scrutiny.

energywatch stated (energywatch, 2008):

> As Ofgem is aware, energywatch wrote to all suppliers seeking their individual views on the £85 estimate. Of the responses received only two suppliers expressed broad agreement with the £85 figure, with the others viewing it as, to varying degrees, an underestimate. This echoes Ofgem's own assertion that suppliers will "have different costs and different methods of allocating costs to separate customer groups" – a recognition that clearly demonstrates the limited usefulness of putting forward an estimated, fixed cost figure of the additional costs associated with PPM provision. The divergent approach of suppliers to PPM pricing demonstrates that the assumed costs are viewed subjectively, reflecting how each supplier chooses to assign these. PPM pricing does not reflect fixed costs that are accommodated in line with a generic, industry-wide approach. The commitment of certain suppliers to maintain equalisation with quarterly credit rates for electricity PPMs further suggests that the scope for flexibility on cost interpretation and assignment does exist.

Even if we assume these figures are accurate and compare this differential with prices charged, the actual price differentials do not seem justified. Ofgem (Ofgem, 2007) states that:

> the difference between the best offer on prepayment and the best offer on monthly Direct Debit and standard credit tariffs for a combined gas and electricity customer, since January 2004... has fluctuated within a range of around £50 to £120, with what appears to be a slight upward trend over time; the current difference is however consistent with the estimated difference in costs to serve of approximately £85.

energywatch takes a very different view (energywatch, 2008). It found:

> Prepayment meter consumers pay on average £215 and up to £452 more per year for their energy than consumers paying by online Direct Debit.

And:

> It is readily apparent that current differentials between payment methods almost always exceed the £85 identified by Ofgem. On average, PPM consumers are paying 13% more for their energy than a consumer on a monthly Direct Debit tariff and 25% more than a consumer who pays by Direct Debit through online tariffs. In cash terms this translates as, on average, a £214 premium over an online Direct Debit tariff and up to £124 more than a consumer using monthly Direct Debit. Extrapolating current differentials shows that PPM consumers are paying an excess of £332 million when compared to online Direct Debit users.

What is more surprising is that there is little difference between PPM and standard credit terms now. This may in part reflect that some companies are seeking to stimulate an increase in the number customers using the 'secure' payment methods of Direct Debit and PPM, as this would improve cash flow and reduce the risk that Standard Credit (SC) poses of customers falling into debt. On average, PPM consumers pay about 4 per cent more than standard credit consumers, but some suppliers charge PPM consumers less than this, despite the extra costs Ofgem believes exist. This may reflect the fact that PPM consumers do not raise any risk that their bills will not be paid and PPM consumers pay in advance. Some companies may also hope that by narrowing the differential between SC and PPM tariffs - typically achieved by raising SC and holding or only marginally increasing PPM prices - they will be able to deflect some of the criticism on price differentials.

Thomas (Thomas, 2008) found that for a household categorised in the standard definitions as a 'medium user' of electricity and gas in London in March 2008 (see Table 20):

- On-line Direct Debit dual-fuel is 27 per cent cheaper than paying by PPM with the incumbent utilities;
- There is little to be saved within PPM suppliers. Now that SSE has increased its prices, the available savings are negligible;[46]
- Standard Credit terms are now generally little if any cheaper than PPMs; for example, if Ms A remains with the same supplier and switches to SC, her bills would actually increase;
- Significant savings are available if Ms A switched to paying by Direct Debit. The savings would be only about 4 per cent if she remained with her existing suppliers, but if she switched to the cheapest, excluding SSE, she would save 8 per cent;
- However, the big pay-offs arise when on-line DD are considered. Switching to the cheapest supplier (excluding SSE) would save 17 per cent;
- Switching to the cheapest supplier with on-line DD and a dual fuel offer would increase savings to 27 per cent;
- Now that SSE has increased its prices from April, anyone following Ofgem's advice in January and February to switch is likely to have found that by the time the switch was complete, SSE was no longer the cheapest supplier and their effort was wasted.

Table 20	Cost of purchasing energy in the London region				
	PPM	Standard credit	Direct debit	On-line DD	On-line DD dual-fuel
EDF/B Gas					
Electricity	401	401	393	393*	n/a
Gas	617	656	588	565	n/a
Total	1018	1057	981	968	n/a
Dearest					
Electricity	440 (Npower)	429 (S Power)	402 (Npower)	320 (Npower)	
Gas	676 (E.ON)	656 (B Gas)	633 (Npower)	595 (Npower)	
Total	1116	1085	1035 (Npower)	915 (Npower)	876 (S Power)
Cheapest					
Electricity	353 (SSE)	350 (SSE)	329(SS&E)	285 (Npower)	
Gas	579 (SSE)	535 (SSE)	503 (SS&E)	462 (SSE)	
Total	932	885	832	747	744 (E.ON)
Cheapest ex SSE					
Electricity	393 (E.ON)	393 (E.ON)	357 (S Power)	285 (Npower)	
Gas	617 (B Gas)	642 (E.ON)	580 (S Power)	565 (B Gas)	
Total	1010	1035	937	850	744 (E.ON)

Source: *http://www.energywatch.org.uk/uploads/PriceComparison_london_21February2008.pdf*

Table 21	Average price differential between different payment methods (£/year)			
Annual cost	**GB average**	**Max annual bill**	**Min annual bill**	**PPM differential as % of average bill**
Online Direct Debit	886	909	845	23
Offline Direct Debit	965	972	956	13
Standard credit	1048	1100	1006	4
Prepayment meter	1089	1144	1037	-

Source: *energywatch*

Notes

1. Based on an average gas consumption of 20,500kWh and electricity consumption of 3,300kWh per annum. Prices include VAT.
2. Prices are average for Great Britain (England, Wales & Scotland) as of 4 July 2008.

In July 2008, the mean PPM bill for a gas and electricity consumer using the average amount of electricity and gas was 23 per cent higher than for the average on-line Direct Debit tariff, 13 per cent higher than the average off-line Direct Debit tariff and 4 per cent higher than the average standard credit terms (see Table 21).

6.1.3 Token meters

The most up-to-date figures from Ofgem[47] show that in June 2007 approximately 500,000 electricity prepayment meters (1 in 7) are still of the archaic 'token' type. These raise a number of issues examined by energywatch (energywatch, 2008), such as the problem of suppliers being slow to recalibrate the meters to reflect current prices. There are major problems with this type of meter, but the suppliers have now agreed to replace all of them with more modern PPMs by the end of 2009.[48]

6.2 Social tariffs

The government and Ofgem place most emphasis on switching (see Section 7) and, to a lesser extent, use of social tariffs as ways to alleviate fuel poverty. In its Domestic Retail Market Review (Ofgem, 2007), it states:

> Suppliers are also playing an important role in delivering help and support to customers who are vulnerable – both those who are financially vulnerable and those who are vulnerable due to age, health or circumstance. Through their actions in this area, suppliers enhance their corporate reputation and brand value by acting in a responsible manner and can make an immediate and significant impact on customers' comfort and finances.
>
> All suppliers currently offer some sort of social tariff and/or rebate to provide cheaper energy to qualifying customers. Qualification criteria vary across suppliers, but often include being eligible for certain means tested benefits. The extent of the rebate or discount offered varies widely between suppliers, from a national average of £15 to £160. Customer numbers on these tariffs or rebates also vary a great deal between suppliers. One supplier – British Gas - offers substantial savings to up to 750,000 customers deemed 'vulnerable' by government.

In fact the latter statement seems to have been premature and, in June 2008, when talking about its Essentials tariff Centrica, told the Business and Enterprise Select Committee:[49]

> We have 350,000 customers; we would like to have more customers; and we are hoping to target more with the help of the DWP to actually increase that to 750,000.

In the 2008 Budget, Alistair Darling announced:[50]

> And I believe further action is now needed to help vulnerable groups deal with rising energy prices. We want to see the 5 million customers on prepayment meters given a fairer deal and energy companies to increase their support to vulnerable customers. We will work with the companies to take further action on a voluntary and statutory basis - to underpin this as necessary we will legislate. Energy companies currently spend around £50 million a year on social tariffs. I want to see this rising to at least £150 million a year over the period ahead.

In July 2008, Ofgem published its guidance on the measures that could be included in this spend.[51]

In April 2008, the resulting deal was announced involving the six large companies pledging an additional £225m over the three year period to 2011. This figure is based on the companies spending £100m in 2008-09, £125m in 2009-10 and £150m in 2010-11 compared to the current spend of £50m per year. This was projected to remove up to 100,000 households from fuel poverty. In their press release announcing this, BERR states:[52]

> The impact of this additional funding on the UK fuel poverty numbers will depend on how it is directed. If it is purely used to offset bills and equally distributed amongst the poorest households, then it could

help to remove up to 100,000 of these from fuel poverty. Other scenarios may bring different benefits - for example, energy efficiency measures may benefit fewer but will be permanent. We will be working with energy companies to ensure those most in need benefit and it is likely that a range of measures will be implemented.

Details subsequently emerged on the elements of the programme. Wicks, the Energy Minister, in a Parliamentary reply to a question on what the companies' contribution would be, stated:[53]

> The individual allocations have been calculated by reference to each company's market share based on customer account numbers. Each supplier has agreed to pay a contribution per customer account. The contribution per customer account is then multiplied by the number of customer accounts 'owned' by a supplier to arrive at each supplier's contribution. A breakdown of suppliers' individual contributions cannot be made available as it contains commercially sensitive information and therefore remains confidential between the Department and the energy supplier.

On the impact of high prices, he stated:

> We are concerned about the impact of higher prices on vulnerable people including pensioners and we continue to encourage energy suppliers to adopt initiatives to mitigate their impact. In Budget 2008, the Government said they would like to see the amount energy suppliers spend on social programmes increase to at least £150 million a year over the period ahead. A new voluntary agreement has recently been signed individually with the six major energy suppliers to treble their investment on social programmes in the next three years, reaching collective investment of £150 million by 2010-11. This will take spend to £100 million in 2008-09, £125 million in 2009-10 and £150 million in 2010-11.
>
> In addition, winter fuel payments helped keep 11.7 million people warm in winter 2006-07 and Budget 2008 announced an additional one-off payment of £100 to over-80s households and £50 to over-60s households in 2008-09.
>
> Finally, in the recent Ofgem fuel poverty summit a number of new initiatives were announced to improve the way we identify and target those in fuel poverty, provide support to vulnerable customers to use the competitive market effectively and ensure that tariff differentials are fair and justified.

energywatch and NEA were scathing about the adequacy of these measures. Allan Asher, Chief Executive of energywatch, stated:[54]

> We welcome the help to 100,000 fuel poor homes, but 4.4 million homes will remain trapped in fuel poverty. A serious and comprehensive response is needed. This deal is neither - it barely scratches the surface. Consumer groups and charitable organisations working to eradicate fuel poverty have been ignored. There is now no chance of the Government meeting its 2010 poverty reduction goal.

While NEA said:[55]

> While we welcome any move that helps those struggling to pay their fuel bills this winter, £100 million looks pretty paltry when you consider the billions made in profits by the major energy suppliers this year. The Government should introduce a simple mandatory social tariff, which guarantees that the most vulnerable customers get the lowest energy price a supplier offers. The Government should stop tinkering around the edges and introduce a more co-ordinated strategy to help over 4 million households in Great Britain that are now in fuel poverty. All six major suppliers have put their prices up

> this year forcing more than half a million more households into fuel poverty. The Government estimates that the extra funding unveiled today directed towards social tariffs could take 100,000 households out of fuel poverty. But what about the rest suffering fuel poverty? In England alone there are roughly 3 million fuel poor households – including families with young children and the elderly who are unable to keep warm and healthy. The resources directed towards the problem just aren't adequate.

It is clear that the agreement between the companies and the government does nothing on fuel price differentials, although Ofgem does claim its market probe will cover this issue.

A study on social tariffs commissioned by energywatch and published in January 2008 found the following main points on socially oriented tariffs (Cornwall Energy, 2008). On electricity, the study found that five suppliers had social tariffs and these cost them no more than £7m per year. At that time nearly 150,000 electricity consumers benefited from these tariffs with a benefit of between £23-75 per account for four of the companies, with the costs to the suppliers when expressed as a proportion of their turnover being negligible. The E.ON scheme (Staywarm) was treated separately in the study because it was found to be such an opaque arrangement that like for like comparisons could not be made.

For gas, the picture is similar, with five companies committing about £19m, benefiting about 230,000 consumers by £45-75 per account, again at negligible cost to the companies. The combined gas and electricity schemes cost the companies about £26m benefiting about 365,000 consumers by about £110 per account. Since this report was published, some suppliers such as RWE/NPower have agreed to do more following the March 2008 agreement with government referred to above.

6.2.1 Fuel Direct

Fuel Direct was introduced in 1976 and was designed to protect those families and individuals who found particular difficulty in managing their household finances and in budgeting for their energy bills. National Energy Action (2006) states (note the figures have changed since then):
The current operation of the scheme is outlined in an agreement between the Department for Work and Pensions and energy supply companies licensed by the Office of Gas and Electricity Markets. The purpose of the Statement of Intent is to ensure:

- A domestic fuel supply is retained or restored
- Energy suppliers receive, at four-week intervals, payments towards the cost of ongoing fuel consumption and, where appropriate, debt recovery

Access to the Fuel Direct payment method is restricted to householders in receipt of Income Support, Income-based Jobseeker's Allowance or Pension Credit and whose debt to their energy supplier is at least £56.20. Deductions from benefit will consist of an estimated figure to cover ongoing consumption, determined by a 'Decision Maker' within the Department for Work and Pensions, and a standard fixed weekly charge to defray any outstanding debt – currently £2.85 (£5.70 where arrangements are in place for both gas and electricity). In 1996, the number of households receiving Fuel Direct was 188,000 but, by 2005, the number was only a quarter of this figure or equivalent to less than 2 per cent of the fuel poor. NEA concluded that the decline might be due to:

> falling numbers of households eligible for the scheme; the expansion of prepayment meters as a means to manage fuel debt; reluctance on the part of many energy suppliers to promote access to the scheme; and antipathy to Fuel Direct on the part of the Department for Work and Pensions because of the expensive and cumbersome nature of this particular payment method.

Although Fuel Direct benefits only a relatively small number of consumers, the payments made to suppliers are relatively large. For gas, the average weekly payment for each supplier in the year from 1 October 2006 ranged from about £8 to £24.[56]

To summarise, Fuel Direct is a safety net against disconnection for recipients of certain benefits who are in energy debt. It is not, directly, a tool to reduce fuel poverty, although with some modification the scheme has potential to assist in that respect by functioning as a lower cost payment method for low-income consumers.

7. Disconnections and debt

Because of their vital role in modern life, disconnection of vital utilities has for a long time been an important issue. For water, disconnection for non-payment is now illegal, as is payment and arrears collection through prepayment meters.

7.1 Disconnections

Table 22 shows the number of disconnections for electricity and gas, and the number of consumers using PPMs. For electricity, the link seems clear with the very sharp reduction in disconnections following the large-scale introduction of PPMs in 1992. It is not clear whether the large increase in gas disconnections in 1997 was linked to the opening up of the gas market to competition and a more commercial attitude by the retailers to the consumers. For electricity disconnections remain at a low level compared to 1992/93 but have begun to increase from 2004 onwards.

There have been six key events related to disconnections since 2002:

- 2002: Ofgem and energywatch, with other interested parties, produced guidelines aimed at reducing the number of disconnections;[57]

- 2003: 'The Bates case.' An elderly couple, George (89) and Gertrude (84) Bates were found dead in their house, George due to hypothermia, two months after they had been cut off by British Gas over a debt of £140. The furore that followed led to a debate about the extent of powers for companies to disconnect. British Gas imposed a moratorium on disconnections in 2003 although, in 2008, it was reported to be reviewing this policy;

- 2004: In the wake of the Bates case, the Energy Retail Association (the industry body that represents the six major energy suppliers), developed a 'safety net' which was intended to prevent disconnections of vulnerable consumers;[58]

- 2004: A Trade & Industry Select Committee inquiry recommended that if progress was not made in avoiding disconnections of vulnerable consumers, legislation should be enacted to remove gas and electricity suppliers' powers to disconnect;[59]

- 2005: A review (the Sohn review) commissioned by energywatch and Ofgem concluded that while 'substantial effort and progress had been made' there were 'significant variations in approach by suppliers'.[60]

- 2008: Ofgem, in conjunction with energywatch, produced a report reviewing the progress that had been made since the Sohn Review. This found that some suppliers had made better progress than others in dealing with the issues of debt and disconnection.[61]

The disconnection rate was rising sharply in 2007. For gas, the level of disconnections was about 50 per cent higher than in 2006, its highest level since 2003. For electricity, the rate was double that of 2006 and would bring the level of disconnections up to levels last seen in 1993. Given that there have been large price rises since then it seems likely that, if nothing is done, the disconnection rate could rise still further. Further, if British Gas, as it has indicated it might, reverses its policy of not disconnecting consumers (it has not disconnected anyone since 2003), the numbers could rise sharply.

In its annual report on domestic suppliers' social obligation, Ofgem found:[62]

> In 2007, a total number of 8,384 customers were disconnected. This is an increase of 64% on the number of disconnections carried out during 2006. The number of electricity disconnections doubled in 2007 (from 1,258 in 2006 to 2,657 in 2007) and in gas they increased by 48% (from 3,859 in 2006 to 5,727 in 2007).
>
> Consistent with previous years, British Gas did not disconnect anyone during 2007. All other suppliers disconnected more customers in 2007 than in 2006, with npower disconnecting significantly more gas customers than any other supplier.

Table 22 Disconnections of electricity and gas (no of PPM consumers)

	Gas	PPM consumers (m)	Electricity	PPM consumers (m)
1992	15,707	0.75	18,018	1.15
1993	16,068	0.80	3,700	2.10
1994	16,308	0.85	1,200	2.40
1995	14,511	0.85	838	2.70
1996	8,826	0.95	477	3.25
1997	29,771	1.1	466	3.5
1998	29,500	1.4	400	3.6
1999	22,177	1.6	373	3.7
2000	16,500	1.8	300	3.7
2001	26,088	1.8	375	3.8
2002	21,780	2.0	995	3.7
2003	15,973	2.0	1,361	3.7
2004	2,553	2.1	727	3.6
2005	2,309	2.2	604	3.6
2006	3,859	2.3	1,258	3.5
2007	5,727	2.3	2,657	3.6

Source: *For 1992-2003, Parliamentary Warm Homes Group (2004) 'Disconnection from Domestic Gas and Electricity Supply' http://www.nea.org.uk/downloads/Parliament/Disconnection_from_Domestic_Gas_and_Electricity_Supply.pdf. For 2003-06: http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Documents1/Monitoring%20Company%20Performance,%20Annual%20Report%202006.pdf. For 2007: Ofgem (2008b)*

7.2 Debt

Disconnections are only one manifestation of the larger problem of affordability of supplies, and some disconnections may well result from households who are able to pay their bills but are making a wilful decision not to pay. Tables 23 and 24 show the trends for 2005-2007 on levels of debt and they show how PPMs are being used to deal with debt. The price increases in 2005-06 seem to have marginally increased the number of consumers repaying debt and also the average debt level. Not surprisingly, the majority of consumers in debt use PPMs, especially for electricity. There seems to have been a small increase in the percentage of electricity PPM consumers in debt, but a fall in the number of gas PPM consumers in debt.

The number of PPMs being installed increased markedly from 2006 to 2007 and a larger proportion are being installed as a way to recover debt. A main function of PPMs as far as the companies are concerned is debt recovery. On average about 1,040 PPMs were installed to recover debt every single day of 2007.

The graph directly below shows the numbers of PPMs installed to recover debt using data from Tables 23 and 24.

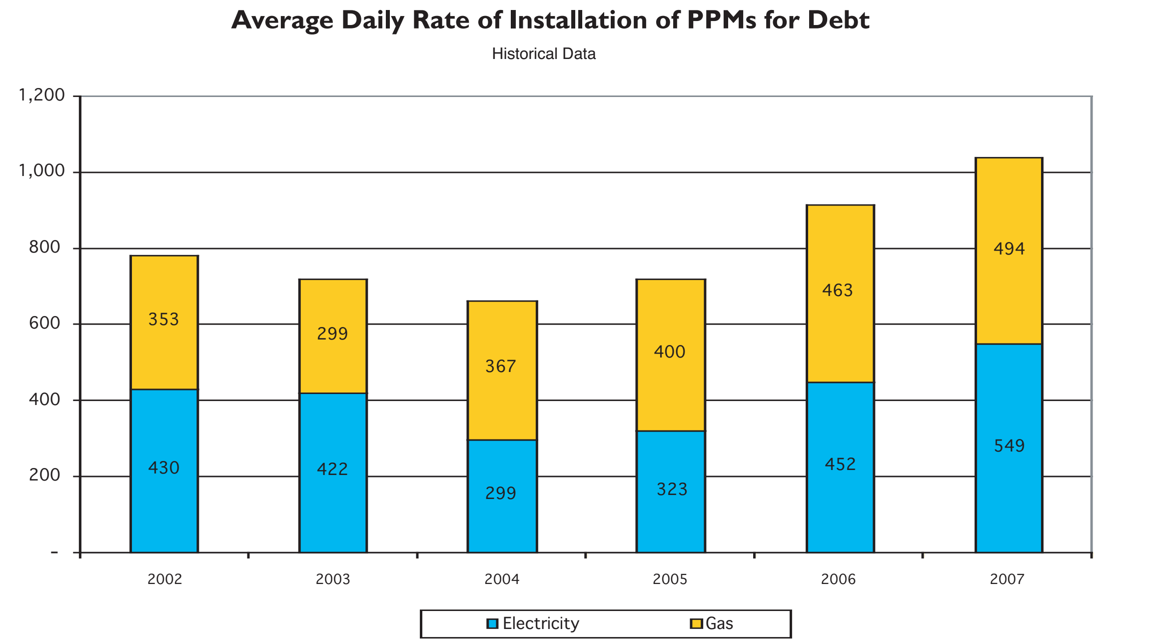
Table 23 Debt levels for electricity consumers

	No of consumers repaying debt (millions)	No of PPM consumers repaying debt (millions)	% of PPM consumers in debt	Average debt per consumer £	PPMs installed (of which to recover debt)
Q3 2005	0.8	0.5	14	170	57151 (29974)
Q4 2005	0.8	0.4	13	173	57422 (30864)
Q1 2006	0.8	0.5	13	182	59748 (37030)
Q2 2006	0.9	0.4	13	199	61792 (37636)
Q3 2006	0.8	0.5	13	194	72262 (43099)
Q4 2006	0.7	0.5	13	196	68848 (46915)
Q1 2007	0.8	0.5	15	209	95677 (47893)
Q2 2007	0.8	0.6	16	220	100897 (51175)
Q3 2007	0.7	0.6	17	223	75970 (52783)
Q4 2007	0.6	0.7	18	224	89618 (48382)

Source: *Ofgem (various) 'Monitoring company performance of domestic suppliers' Quarterly reports, Ofgem.*
http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx
NB: Ofgem have revised the numbers for Q3 2007 upwards following an update from E.ON.

Table 24	Debt levels for gas consumers				
	No of consumers repaying debt (millions)	No of PPM consumers repaying debt (millions)	% of PPM consumers in debt	Average debt per consumer £	PPMs installed (of which to recover debt)
Q3 2005	0.5	0.5	23	169	55710 (42396)
Q4 2005	0.5	0.5	23	180	54128 (35600)
Q1 2006	0.5	0.5	21	175	62513 (38950)
Q2 2006	0.7	0.5	20	179	59144 (45527)
Q3 2006	0.6	0.3	15	168	62257 (46653)
Q4 2006	0.5	0.3	14	177	55795 (37390)
Q1 2007	0.6	0.3	13	187	62136 (44126)
Q2 2007	0.7	0.3	15	189	65692 (49110)
Q3 2007	0.6	0.3	15	179	61174 (44982)
Q4 2007	0.4	0.4	16	204	63174 (41954)

Source: *Ofgem (various) 'Monitoring company performance of domestic suppliers' Quarterly reports, Ofgem. http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx*



Source: *Ofgem (various) 'Monitoring company performance of domestic suppliers' Quarterly reports, Ofgem. http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx* energywatch (energywatch, 2008) found (see Table 25 and 26):

> All companies recover a higher amount of debt per week from their PPM consumers than from their standard credit customers. This in part reflects the likelihood that a higher level of debt will have led to the installation of a PPM to collect arrears. Despite their obligation under licence condition 27.8 to take into account a consumer's ability to repay a debt, suppliers levy average weekly debt repayment rates of £6.47 per week for electricity, or 81% of the average annual bill for an electricity PPM; and £6.89 per week for gas or 53% of the average annual bill. These rates are more than double the maximum level permitted for weekly Fuel Direct payments. While energywatch accepts that not all consumers paying arrears through a PPM will be in receipt of qualifying benefits, it is clear from the demographics presented above that repayment levels at this level will prove punitive to low income households, especially as they come in addition to the premium that the PPM already attracts. The tendency of some suppliers to calibrate high weekly repayment rates appears to result from a desire to have the debt repaid in least amount of time possible, clearly this does not reflect a fair balance between the interests of the consumer and the interests of the supplier.

Table 25 Debt repayment for electricity

	Average weekly payment to debt £ (non-PPM)	Average no weeks to recover debt (non-PPM)	Average weekly payment to debt £ (PPM)	Average no weeks to recover debt (PPM)
British Gas	3.50	48	7.19	47
EDF Energy	3.67	53	7.28	83
Npower	6.75	41	5.40	64
Powergen	7.15	39	6.55	103
Scot & Southern	7.00	40	6.46	44
Scottish Power	2.03	52	6.03	69
Average	5.02	45	6.48	68

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007' Ofgem, London*

Notes

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

Table 26 Debt repayment for gas				
	Average weekly payment to debt £ (non-PPM)	Average no weeks to recover debt (non-PPM)	Average weekly payment to debt £ (PPM)	Average no weeks to recover debt (PPM)
British Gas	3.70	47	7.72	57
EDF Energy	4.17	53	7.42	82
Npower	6.04	39	4.14	108
Powergen	6.92	40	6.46	134
Scot & Southern	5.36	41	5.15	65
Scottish Power	2.09	52	8.38	21
Average	4.71	45	6.54	78

Source: *Ofgem (2008) 'Monitoring Company Performance of Domestic Suppliers Quarter 3 2007' Ofgem, London*

Notes

1. The data for small suppliers is excluded.
2. The data for Npower is an average for their three regions.

8. Switching

Ofgem and the government have consistently claimed large potential benefits for consumers prepared to switch. For example, one of the four main action themes that Ofgem identified as a result of its Energy Summit on Fuel Poverty concerned switching,[63] particularly easing practical problems with switching. The 2007 Annual Progress Report on the UK Fuel Poverty Strategy[64] stated that: 'Those in fuel poverty have much to gain by switching supplier' and 'If all customers were to switch to the best rate, this would take up to 200,000 households out of fuel poverty.' Of course, in the context of there being about 4.5m fuel poor in 2008, the figure of those that could be helped by switching is rather unimpressive. In addition, this does not address the problems that the fuel poor face in switching, especially out of a PPM.

However, as argued in Section 2, the problems with switching run far deeper than just the logistics of carrying out a switch and educating the public about the benefits of switching. The main problems include:

- Consumers do not know the price they will actually pay when they switch, they simply know the price at the time they research the deals. By the time the switch is complete, the prices offered by the competing companies are likely to have changed and the offer chosen will no longer be the best deal;

- The supply company structure is already highly concentrated and likely to see further concentration. The Herfindahl-Hirschmann Index, which measures market concentration, is well above the threshold level for 'highly concentrated markets'. With such a concentrated market, consumers can have little confidence that the companies are behaving competitively;

- By forcing household consumers to buy their energy from a competitive market, the government is placing them in direct competition with industrial energy consumers competing to buy a finite resource. This is a contest that household consumers cannot win and they will inevitably pay disproportionately more for their energy than industrial consumers who have a much stronger negotiating position and skills;

- The cost to the suppliers (both the company losing and the company gaining a consumer) of switching is high and this cost must be passed on to all consumers.[65] Whether these additional costs are justified by the savings consumers can make by switching is far from clear;

- Switching can be resource intensive. It requires free time, access to up-to-date pricing information and, ideally, internet access and a degree of IT literacy in order to ensure optimal outcomes. Without these the chances of being able to identify the best deal are minimal;

- The record of sales representatives of energy suppliers in helping consumers find the best deal is very poor and consumers relying on sales staff for impartial advice are unlikely to be well served. The companies have continually been found guilty of mis-selling (see below);

- The potential of 'smart meters', which the government and the regulator are now considering, would only be partially realised unless they included time-of-day pricing. If time-of-day pricing was introduced, there is a risk that consumers would not know, until the moment of consumption, how much they would pay for that energy. Depending on the tariff structure implemented, consumers could be left without a basis on which to compare prices and choosing one supplier over another.

These problems may be so fundamental that it becomes questionable whether any amount of fine-tuning of the switching process would result in a system that is more efficient in providing household consumers with a better energy service than they would receive under a well regulated monopoly system.

In January 2008, there were signs that the Energy Minister, Malcolm Wicks, was becoming disillusioned with the switching process. He told the Business & Enterprise Committee (Jan 21):[66] 'I do not buy the line that switching is universally the way in which our constituents always benefit from competition.' And 'I do recognise that the evidence suggests that when most people switch, they switch to a better deal.'

While the second statement is true, it does gloss over the fact that most consumers who switch do not move to the best deal; indeed, some switch to a worse deal (Waddams Price, 2004) and (Wilson & Waddams Price, 2007). He also identified some of the practical issues for low-income consumers switching:

> people who take for granted that everyone has access to a flat-screen computer, can go to the different sites and get the best deal, and has the wherewithal to then revisit and re-switch in x months' time.

In addition, Ofgem (Ofgem, 2008c), in their letter on PPM switching of 30 May 2008, have identified that most PPM customers who switch suppliers actually switch to the three most expensive suppliers:

> On the face of it, we would expect to see customers switching away from the relatively expensive suppliers and towards the less expensive suppliers, particularly as 78 per cent of customers say their main reason for switching supplier is to save money. However, information from suppliers about their PPM gains and losses does not show such a perfect relationship. In 2007 63 per cent of electricity and 56 per cent of gas PPM transfers went to the three most expensive suppliers.

However, for these purposes, the issue is whether switching can reduce the inequities that are now apparent. Low income consumers are seriously disadvantaged because of the high rates charged to PPM and Standard Credit consumers, the most likely methods of payment for low income households; switching is difficult for households that do not have free time, and easy access to and competence with the internet; switching is more difficult for consumers that use PPMs and/or have accumulated debt with their energy supplier. The Business & Enterprise Committee (2008) recommended:

> Ofgem should also investigate how all customers could benefit from competition, whether they switch or not, for example by preventing energy companies from over-charging their legacy customers.

8.1 Problems for PPM consumers and consumers with debt

In May 2008, as a follow-up to its Fuel Poverty Summit, Ofgem published an open letter on the issue of customers switching to more expensive suppliers. This acknowledged that, in the past, PPM and Standard Credit (SC) consumers were less likely to switch than Direct Debit consumers and that the premiums paid by both prepayment and standard credit customers over Direct Debit have, on average, significantly risen in recent years. In 2007, the switching rate for PPM consumers had risen to about the same rate as Direct Debit (DD) consumers (about 20 per cent per year) and to much more than SC consumers (about 12 per cent). However, in 2007, Ofgem found evidence that some of this switching was to more expensive suppliers. In 2007, 63 per cent of electricity and 56 per cent of gas PPM transfers went to the three most expensive suppliers.[67] Ofgem's analysis suggested that 70 per cent of PPM switchers did so on the basis of advice from doorstep or telephone sales personnel compared to less than half for those using other payment methods. This should hardly have been a surprise to Ofgem. It would be unrealistic to expect company sales staff to recommend an energy supplier other than the one they worked for unless they were under a specific duty to do so.

The problems of selecting the cheapest supplier are also well-established. In a detailed behavioural study, Waddams-Price (2004) found that, amongst a sample of about 400 consumers who switched supplier, 42 per cent of those switching ended up paying more, 14 per cent were paying the same, while only 44 per cent actually made savings. These percentages were calculated based on the time the choice was made, not when the switch was completed so the issue here was not price movements after the switch had been initiated. In later research, Wilson and Waddams-Price (2007) stated:

> that those consumers switching exclusively for price reasons appropriated between a quarter and a half of the maximum gains available. While such outcomes can be explained by high search costs, the observation that at least a fifth of the consumers actually *reduced* their surplus as a result of switching cannot.

In its response to the open letter, energywatch detailed some of the problems and complaints it had dealt with on behalf of PPM consumers. These included:[68]

- PPM users being sold products which are priced for Standard Credit or Direct Debit and explicitly exclude PPM users. Meaning the consumer switches thinking they are going to save money, but are actually defaulted to the much higher PPM tariff which they didn't sign up to.
- PPM users being sold fixed price products which appear to be good deals, only for the consumer to find out later that they also specifically exclude PPM users, meaning that consumers do not get the benefits they were promised.
- PPM users being given wrong, and in some cases we have seen, misleading pricing information as an incentive to transfer.
- PPM users switching supplier to a more expensive deal on the promise of a meter exchange and cheaper energy in the near future only to find out later that it is very difficult to get the PPM removed meaning, again, they are unable to access the cheaper energy that they signed up for.

Table 27 details suppliers' official policies for consumers wishing to switch from a PPM to a credit meter.[69]

The problems for low-income vulnerable consumers with PPMs were particularly clearly illustrated in a letter to the Guardian. The correspondent (who withheld his name) wrote:[70]

> As heart patients we have been instructed to stay warm in the winter as the cold thickens the blood. To this end I contacted my gas and electric supplier in a bid to have the prepayment meters taken out of my home as the tariff was too high and my income was so low. I was told it would cost £200. I told the supplier that the meters were in place from a former tenant and I had no credit issues with them. They told me it was not their problem. I went to the ombudsman and now I can have the meters taken out if I pay for the energy by Direct Debit, the rub being that I have to pay in advance, costing me 79% of my income in one month for this to happen. So it can't and they know it.

Table 27 Policies of big 6 suppliers on exchanging a PPM for a credit meter					
British Gas	**EDF Energy**	**Npower**	**E.ON**	**Scot Power**	**SSE**
Currently no charge for exchange if debt has been cleared and consumer passes a credit check. This is under review.	No charge for consumers who have used a PPM for more than 12 months or at change of tenancy or shortly after change of supply. Find PPM users like them and don't want to change.	No charge for changing PPM if customer has no debt, and satisfies certain credit checks or has a 12 month payment history with supplier. No charge to people who inherit a PPM and change to this supplier. No charge for 'vulnerable' consumers. Other consumers may be charged £70 for gas and £50 for electricity exchange.	Won't exchange PPM if it still has a debt. No charge for people who inherit a PPM provided they pass a credit check. Supplier may charge others up to £50. Will charge the full cost if have to reinstall a PPM.	No charge if no debt on the meter, but supplier may charge a security deposit for people with a poor payment history.	No charge provided a suitable payment arrangement which minimises chances of building up a debt is secured.

Source: *http://www.energywatch.org.uk/uploads/Response_to_Ofgem_Open_Letter_on_PPM_Switching_30_May_20081.pdf*

8.2 Mis-selling

The period following the opening of household energy markets was marked by frequent fines on companies for mis-selling practices. These mainly related to 'slamming' or switching a consumer without their informed consent. In recent years, the number of fines has fallen but, in April 2008, Ofgem opened an investigation into the marketing activities of RWE/Npower[71] following a formal referral by energywatch. This was triggered by an undercover investigation by the Sunday Times[72] which found that sales staff in South London were: 'making customers sign a form without revealing that it was a contract (slamming); exploiting people with poor English; pretending to be officials from the "electricity board"; and lying about standing charges.[73]'

energywatch had already raised with npower concerns about its agents' behaviour. It found that:[74]

> Over a 4-month period, contacts by disgruntled consumers over npower accounted for over a third of all miss-selling cases received by energywatch. The geographical spread of complaints suggests that npower's problems extend far beyond South London.

The companies seem to maintain an ambivalent attitude to direct selling methods. The Chief Executive of E.ON told the Business & Enterprise Committee of his personal dislike of direct selling but justified its continued use, saying it seemed to work in the UK market.[75]

In January 2008, the Energy Minister, Malcolm Wicks, told the Business & Enterprise Committee:[76]

> I am also aware, however, that some of our more vulnerable constituents can be subject to mis-selling, and I want to satisfy myself that the codes in place on that are rigorous enough.

The Business & Enterprise Committee took up and strengthened this warning in its report:[77]

> Any further significant breach of best practice by any supplier would inevitably lead to calls for this sales technique [direct selling] to be abandoned. The industry must consider itself on notice.

9. Suggested solutions

There is a wide, sometimes grudging, acceptance that the market is not working as efficiently as it should, particularly for low-income consumers. However, the range of solutions offered is wide and often contradictory. The Parliamentary Business & Enterprise Committee announced an Inquiry into energy markets in February 2008, following the spate of price increases.[78] The issues it decided to consider were:

- Whether the current market structure encourages effective competition in the retail markets for gas and electricity;
- Whether there is effective competition in the wholesale markets for gas and electricity;
- The implications of growing consolidation in the energy market;
- The relationship between the wholesale and retail markets for electricity and gas;
- The interaction between the UK and European energy markets;
- The effectiveness of regulatory oversight of the energy market; and
- Progress in reducing fuel poverty and the appropriate policy instruments for doing so.

Ofgem also hosted a Fuel Poverty Summit which took place on 23 April 2008, attended by government ministers, five of the six major energy company CEO's, charities, campaigners and others.

9.1 Ofgem

Ofgem has shown itself reluctant to acknowledge any failings in the current system. In January 2008, it repeatedly stated that it believed the markets were working well. For example, on 16 January, Ofgem issued a press release that said:[79]

> In their meeting today (Tuesday) with the Chancellor, Alistair Darling, Ofgem Chairman Sir John Mogg and Chief Executive Alistair Buchanan confirmed that Britain's competitive market in energy is working.

Yet only a month later, Ofgem announced an inquiry into markets in electricity and gas for households and small businesses. The initial announcement seemed to suggest that its inquiry would focus on international markets and maintained the line that no problems existed with the UK Market. Ofgem chief executive Alistair Buchanan said:[80]

> The decision to conduct the probe is in response to public concern about whether the market is working effectively. We are concerned about the increased volatility of wholesale prices and we want to investigate how European and other global energy market developments are affecting energy bills in Britain. We, of course, keep the market under constant surveillance but to date we have seen no clear evidence that the market is failing.

This chimes with the statement on the main 'markets' page on Ofgem's website that says:[81]

> Increasingly Britain is becoming part of Europe's gas and electricity market and the competitiveness of the GB market depends greatly on what strides forward European countries can make in opening up their own markets to competition.

However, a month later when it published its call for evidence for this inquiry, all references to European and international markets disappeared. The topics covered by the Inquiry stated to be:[82]

- The customer's perspective and experience of the market including access to information and barriers to switching suppliers;
- Suppliers' market shares, switching rates for different groups of customers (such as online, dual fuel, single fuel and pre-payment);
- The competitiveness of suppliers pricing the different market segments and customer movement between payment types as well as suppliers;
- The relationship between retail and wholesale energy prices; and
- The economics of new entry and the experience of companies trying to enter the energy market.

Whether this represents a withdrawal from the line that the only significant problems are caused by market failings in Europe is hard to tell. Its most recent Domestic Retail Market Report concluded (Ofgem, 2007):

> There has been a lot of political and media debate about how competitive the market for domestic gas and electricity is. Concerns include: the size and speed of suppliers' price cuts in response to falling wholesale prices, customer service levels and whether the market adequately protects vulnerable and fuel poor customers. Our analysis shows that all segments of the market remain highly competitive and not just for customers who pay by Direct Debit or online. The key findings are:

- Vigorous price competition between the big six suppliers for all customers - the spread between prices has shrunk and the most expensive suppliers have been forced to become more competitive to stem customers losses
- Suppliers are innovating to retain and win customers - there has been rapid growth in: fixed and capped price deals that shield customers from rising wholesale prices; cheaper online deals; and green tariffs. They now account for roughly 20% of the market
- Customer service is improving: suppliers are investing huge sums to improve their systems and 5 suppliers have cut the number of unresolved complaints
- Annual customer switching rates are at the highest in 4 years
- Customer switching in response to poor service or uncompetitive prices helps to keep the market competitive. We will continue to make sure that all customers - including the vulnerable and fuel poor - have access to good information to enable them to make the right choice for them and switching remains simple and hassle free.

Ofgem's message is spelt out here and in other documents. It is the responsibility of consumers to switch supplier regularly and this will ensure the smooth working of the market.

9.2 energywatch

energywatch takes a dramatically different stance on markets. In its submission to the Business and Enterprise Committee Inquiry into energy markets, it argued strongly that energy markets were dysfunctional. A substantial section looked at the need to ensure the market functions efficiently and effectively so that prices for all are set on the basis of genuinely competitive markets. However, it did not make specific recommendations on reforms to energy markets, leaving this to Ofgem, but committing itself to review any market reform recommendations by the Regulator.

It also focused on fuel poverty and made specific recommendations on PPMs (energywatch, 2008a). It concluded that:

> We believe there are reasonable grounds for suspecting that competition is not working effectively in the GB energy markets, most clearly evidenced in the electricity market. Our response focuses on fuel poverty and competition elements of the terms of reference. It outlines the features of the market we believe need to be investigated in a full and independent market investigation by the Competition Commission.

On fuel poverty, energywatch recommended that:

> To mitigate the impact of punitive prices on fuel poor households, Government must take the powers necessary to oblige suppliers to offer social tariffs in accordance with minimum standards. Standards should include a stipulation that a supplier's social tariff represents a rate lower than any other rate available to its other customers, regardless of the eligible customer's payment method.

To address the inequities faced by prepayment meter consumers:

- BERR to take steps to abolish prepayment premiums that are shown to be non-legitimate and inefficient.
- Ofgem to reinstate obligation on suppliers to provide annual statements to prepayment meter consumers and to specify that these provide pricing transparency, including: comparison of cost with other payment methods offered by supplier and breakdown of component costs that underpin the differential. The statement should also offer a comparison with competitors' prepayment meter terms.
- 'Health warning' on till receipts at charging points such as shops and post offices, which state that prepayment meter is most expensive payment method, unless supplier can demonstrate otherwise.
- A condition of doorstep acquisition of prepayment meter consumers should be that the acquiring supplier guarantees in the contract a better per unit deal at time of acquisition than their current supplier offers.
- Priority given to prepayment meter consumers in smart meter roll out.
- Provide greater access for prepayment meter consumers to switch through price comparison services.

energywatch provided detailed evidence to the Ofgem inquiry (energywatch, 2008b).

9.3 Energy poverty campaigners

Ofgem's Fuel Poverty Summit was preceded by a coalition of charities, consumer groups and trade unions coming together to express their concerns in relation to fuel poverty. The coalition included: Age Concern, Barnardo's, End Child Poverty, energywatch, Help the Aged, National Consumer Council, National Energy Action, National Housing Federation, RADAR, Save the Children UK, Spinal Injuries Association and Unison.

An agreed Summit Briefing was produced that made recommendations in four areas: social tariffs in accordance with minimum standards; energy efficiency schemes; income measures; and prepayment meters (see Appendix 1 for the full Summit Briefing).

On social tariffs, the coalition was critical of the government's decision to allow the companies yet another opportunity to make the voluntary approach work, despite the government's May 2007 White Paper (Department of Trade and Industry, 2007) appearing to have already issued the suppliers a last chance.[83]

On energy efficiency schemes, the coalition was critical of the cut in the Warm Front budget and of the lack of targeting of energy efficiency measures on the fuel poor. On income measures, the coalition recommended that the government extend the Winter Fuel Payment to recipients of the Cold Weather Payment, who would not qualify for the age related payment. On PPMs, the coalition challenged the government to: 'set out how it proposes to use statutory powers to abolish non-legitimate and inefficient PPM premiums.'

9.4 Fuel Poverty Advisory Group

The Fuel Poverty Advisory Group made six recommendations in its 2007 annual report. In summary, these were:

- The Warm Front budget for 2008-11 should be restored to its 2007/08 level, over-riding the 25 per cent cut that has been imposed. Several ways of funding this were suggested;

- Progress on reducing the differentials between tariffs should be made, including standard credit terms as well as PPMs;

- Energy companies have been increasing their prices faster than their costs are increasing their margins. FPAG recommended that Ofgem protect the interests of consumers more 'tenaciously', especially low-income households;

- Government should improve benefit take-up;

- Government and the Public Service Agreement should give adequate priority to fuel poverty so that at least the 2016 target on fuel poverty eradication will be met;

- Information on households should, with appropriate safeguards, be shared – especially by the Department of Work and Pensions – with Local Authorities and energy companies, to help to reach those in need.

9.5 The Business and Enterprise Committee

The Business & Enterprise Committee (2008) report was published in July 2008. It represented a very full investigation of the functioning of energy markets. However, it came to limited conclusions, arguing it was best to feed the evidence into the Ofgem Inquiry which was then expected to be published in September 2008. It did express reservations about the scope of the Ofgem Inquiry:

> We are concerned that Ofgem's terms of reference suggest it may pay relatively little attention to the wholesale markets, and, in particular, the wholesale gas market.

The Committee clearly believes that these markets are one of the main causes of the problems it identified:

> Our overall conclusion on the functioning of both the gas and electricity wholesale markets is that there are significant questions that need to be addressed in the interests of both retail and business consumers.

It was particularly concerned about fuel poverty. On social tariffs it stated:

> Energy suppliers' existing social assistance initiatives (which go well beyond specific tariffs) do not reach the vast majority of the fuel-poor. They also vary widely, confusing consumers and providing inconsistent coverage. Irrespective of its broader conclusions on the role of such tariffs, we believe the Government should define the criteria for both the prices charged by suppliers under the banner of social tariffs, and for identifying those customers that qualify for them.

It was critical of the cut in the Warm Front programme and recommended that it be increased and it also had little sympathy for direct selling methods. It recommended:[84]

> Any further significant breach of best practice by any supplier would inevitably lead to calls for this sales technique to be abandoned. The industry must consider itself on notice.

On tariff differentials it was especially critical of the differential that has emerged between the more expensive payment methods - PPM and Standard Credit tariffs - and the cheapest Direct Debit tariffs, warning of the need for re-regulation of tariffs if differentials did not reduce:[85]

> If, in a year's time, the 'Big 6' have still not narrowed the gap between the different payment types, Ofgem should consider re-introducing some form of price control, limiting the differentials that can be charged.

10. Findings

10.1 Buying energy

Energy purchases are some of the most difficult for households to carry out efficiently, in other words at lowest cost. In part, this is due to the intrinsic properties of energy, e.g. it is impossible to store, has no substitutes, demand cannot be postponed etc. However, the difficulty is also now due to the fact that consumers must compete in the market to buy their energy needs. Introducing competition holds out the promise that consumers will be able to reduce their energy purchase costs by shopping around and switching frequently between suppliers so that they are always with the cheapest supplier.

Achieving this ideal requires free time to research the prices and ensure any switches are carried out correctly; competence and confidence on the internet and an internet connection to do the searches necessary to identify the best deal and to operate the account; and access to financial services, especially a bank account that allows Direct Debits. In practice, even if all these conditions are met, consumers might not get the best deal on offer. For example, switching typically takes four to six weeks to complete, by which time the relative prices may well have changed and the process of switching should, in theory, be instigated again.

Whether consumers are actually better off than they would have been under a regulated monopoly is a moot point. The competitive market as currently constituted has brought with it significant extra costs which inevitably land on consumers. These include the cost of building and operating the systems that allow consumers to switch; advertising and promotion budgets; and sales staff costs. Whether the benefits of the GB model for placing retailers under competitive pressure outweigh these costs overall is far from conclusive.

Competition also raises important equity issues. In a competitive market, the supply companies offer their lowest prices to the consumers who can negotiate hardest and who they value most. This means that, in theory, industrial consumers will be offered lower prices (more than is justified by the lower cost of supply to them) than household consumers. It also means that they will offer lower prices to higher income households who are likely to consume more, will be paying by Direct Debit (possibly online) and who are unlikely to raise issues of debt.

Ironically, if energy markets were working as efficient markets should, the requirement for all consumers to continuously monitor prices, switching whenever necessary, would not exist. Companies would know that if their prices were above the best on offer, they would lose more of their market than they could afford to and would be forced to match the best prices on offer. Consumers would know they were paying the minimum because their supplier was obliged to match the best prices on offer.

10.2 The legal framework

The opening of markets has been accompanied by new legislation at both the national and EU level in an attempt to protect consumers against the risk that markets pose. Whether the letter of these laws, for example on Universal Service in electricity and pricing transparency, is being complied with is a matter for the courts, but it seems clear that the spirit of significant parts of EU law, which the UK is required to embody in national law, is not properly being met.

Under EU law, electricity is classified as a universal service requiring that all consumers have the right to be offered a supply at ‘reasonable, easily and clearly comparable and transparent prices’. The government believes it is meeting these requirements by promoting price comparison internet sites and because it requires all suppliers to offer supply terms to any consumer that asks for it. Given that not *all consumers* have access to the internet, the requirement that all consumers be offered ‘clearly comparable and transparent prices’ is not being met as fully as it might be.[86]

In practice, companies can essentially force consumers who are commercially unattractive to use PPMs. They can require an upfront deposit for those wanting credit terms. While the deposit has to be 'reasonable' it could still be unaffordable for a low income household leaving them with no alternative but a PPM. Whether effectively forcing consumers to use a payment method that is, on average, about 25 per cent more expensive than the cheapest tariffs is offering them 'reasonable prices' is highly doubtful. The information requirements for bills, for example on transparency, data consumption patterns and historical comparisons, certainly do not seem to be met by British suppliers.

From a national point of view, the government committed itself to eradicate fuel poverty amongst vulnerable households by 2010. This target is not going to be met and the government's own Fuel Poverty Advisory Group has said it believes the government had 'given up' on this target. In July 2008, a court case against the government brought by Age Concern and Friends of the Earth on the government's failure was still awaiting judgement.

10.3 The market structure

The market structure itself is so concentrated as to give rise to concern that the companies do not have sufficient incentive to compete vigorously. The market is dominated by just six vertically integrated competing companies in a structure which would, using the normal measures of market concentration, be regarded as 'highly concentrated'. Worse, the barriers to entry for new companies that could offer additional competition in both electricity generation and gas and electricity retail seem insurmountable. There is a strong likelihood that further mergers and takeovers will reduce the field of integrated companies to fewer than six, while the few remaining independent generators may also be absorbed by the 'big six'. The government and the regulator have done nothing to prevent this process of concentration. The regulator is required 'to put in place measures which will help achieve the fuel poverty targets [no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010]. However, as argued below, the way in which Ofgem discharges this responsibility is limited to monitoring and reporting on suppliers' social obligations and voluntary initiatives, research, and exhorting fuel poor consumers to switch to a cheaper deal. Rather than designing a market that works for consumers, it seems that Ofgem expects consumers to make the market work.

10.4 Fuel poverty

Fuel poverty is a complex and difficult to handle problem composed of three main elements: low income; high energy prices; and poor quality housing. It is the latter factor that distinguishes fuel poverty from poverty in general. Whilst measures to reduce inequality and to ensure that energy prices are not higher than they need be have a part to play, it is tackling the third element, the low quality of housing, which holds the promise of eradicating the problem. It also offers huge additional benefits in environmental terms, by significantly reducing energy demand and hence greenhouse gas emissions.
The thermal quality of British housing is poor. The government measures housing thermal quality with its 'SAP' scale (0-100). A rating of 65 has in the past been regarded as adequate. The average for all British housing is a little less than 50 but, for those that spend more than 20 per cent of their income on energy, the figure is around 20.

The government's analysis of fuel poverty in England is based on data for 2005 when only about 1.8 million consumers were fuel poor. The UK-wide figure was around 3 million at this time and, by mid-2008, the figure was probably 4.5 million and, by the end of 2008, the figure could be anywhere between 5.5 and 7 million depending on what price movements take place between July and the end of 2008.
In July 2008, British Gas raised its gas prices by 35 per cent and its electricity prices by 9 per cent. This might mean that a British Gas consumer in full-time work on the minimum wage would fall into the fuel poor category, even if they paid by Direct Debit and used no more than the average amount of energy.

This potential four-fold increase in fuel poverty means that the analysis of who is fuel poor is no longer valid. Nevertheless, those that were already fuel poor in 2005 will be suffering most from the price rises and efforts to target measures at the most needy should start with those households. It is, however, a priority to update the data so that it reflects the current reality of who is fuel poor.

The high fuel prices are likely to mean that the required level of thermal efficiency for housing will be higher than 65 and may, for example, now be as high as 80. This will mean that measures to improve housing will need to be far more extensive and expensive. Efforts to improve the housing stock will also have to be targeted at a much larger range of households. So budgets for energy efficiency measures will have to be increased, perhaps by an order of magnitude, if this challenge is to be met. It is therefore particularly disturbing that the budget for the government's flagship Warm Front programme was actually cut in 2008. Other measures, such as CERT and the Decent Homes Programme, should be targeted much more carefully to low income households so that they can have a much greater social welfare benefit.

The regulator is required 'to put in place measures which will help achieve these targets (that no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010). Ofgem seems to rely on encouraging consumers switching from expensive (PPM) to cheaper methods of paying (on-line Direct Debit) to fulfil its statutory obligations in this respect. It is clear that a PPM consumer who has never switched could probably save more than 30 per cent of their energy costs if they switched to the best deal. However, this begs the question why has the regulator allowed these differentials to grow to such an extent when the evidence is that the additional cost of supplying a PPM consumer is far less than this?

As shown in Section 8.1, the practical problems of escaping from PPMs to credit meters are large. This is especially so for consumers with a 'live' debt or a history of debt, who live in a property where a predecessor occupant has had a debt, who do not have an internet connection, or who do not have a bank account that allows them to pay by Direct Debits. As argued above, if the market was working well, consumers would not necessarily have to switch to ensure they are paying little or no more than the cheapest available tariff. The threat that consumers are willing to and can easily switch should be sufficient to maintain keen competition. The price they paid would reflect the costs they impose, not the premium companies think they can charge.

The government seems to be concentrating on private companies voluntarily introducing social tariffs and other initiatives in order to bolster its efforts to meet the targets it set itself. The social tariff schemes that exist so far can be limited in scope, with some offering only small reductions. To lift significant numbers of households out of fuel poverty would require large price reductions to be offered to several million households so that the fuel poor were actually paying less than the lowest commercial tariffs. It seems hopelessly unrealistic to expect profit-led private companies to voluntarily offer concessionary terms, which must be paid for out of profits or passed on to potentially price-sensitive consumers. Such a policy could not be justified to their shareholders. From a moral standpoint, it seems highly questionable that government abdicates responsibility for such an important element of social policy and leaves it to the vagaries of the market.

Annex 1 Legislation on governmental responsibilities for energy supply

A.1 EU legislation

Electricity and gas are network-supplied energy products categorised by the European Commission as Services of General Economic Interest (SGEI). Under the Charter of Fundamental Rights:

> the Union recognises and respects access to services of general economic interest as provided for in general law and practices, in accordance with the Treaty establishing the European Community, in order to promote the social and territorial cohesion of the Union.' Electricity is categorised by the European Commission as a 'Universal Service.

Under EU policy, this means that the service should be made available to all consumers of a Member State with a specified quality and at an affordable price, including complete territorial coverage.

In 2003, the Commission published a Green Paper on Services of General Interest, but this did not propose anything specific on energy. The main issue discussed in relation to energy was security of supply from an energy system (not a consumer) point of view.

This was followed in 2004 by a White Paper on Services of General Interest, which again had little specifically on energy. It was suggested that the White Paper would lead to an EU Directive. A Directive is European law that Member States are obliged to transfer into national law within a period (typically about a year) specified in the Directive. A draft services Directive was published in 2004, known generally as the Bolkestein Directive, after the then Internal Market Commissioner that proposed it. The main objective of the Directive was to create a free market in services by removing national barriers to companies. As such it would have little impact on UK energy consumers. After substantial opposition, a significantly revised Directive was approved by the European Parliament in December 2006 and must become national law by the end of 2009.

The EU Electricity Directive (2003/54) contains extensive provisions on public service obligations and consumer protection. Paragraph 24 of the preamble states:

> Member States should take the necessary measures to protect vulnerable customers in the context of the internal electricity market. Such measures can differ according to the particular circumstances in the Member States in question and may include specific measures relating to the payment of electricity bills, or more general measures taken in the social security system.

In the main text, Article 3 on 'public service obligations and consumer protection' gives more details. Paragraph 3 states:

> Member States shall ensure that all household customers…enjoy universal service, that is, the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices. To ensure the provision of universal service, Member States may appoint a supplier of last resort.

Paragraph 5 states:

> Member States shall take appropriate measures to protect final customers, and shall in particular ensure that there are adequate safeguards to protect vulnerable customers, including measures to help them avoid disconnection. In this context, Member States may take measures to protect final

customers in remote areas. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and dispute settlement mechanisms. Member States shall ensure that the eligible customer is in fact able to switch to a new supplier.

Paragraph 7 states:

> Member States shall implement appropriate measures to achieve the objectives of social and economic cohesion, environmental protection, which may include energy efficiency/demand-side management measures and means to combat climate change, and security of supply. Such measures may include, in particular, the provision of adequate economic incentives, using, where appropriate, all existing national and Community tools, for the maintenance and construction of the necessary network infrastructure, including interconnection capacity.

Gas is not categorised as a ‘Universal Service’ and the requirements in the Directive are not so extensive. Nevertheless, Article 3 on ‘public service obligations and consumer protection’ gives more details. Paragraph 3 states:

> Member States shall take appropriate measures to protect final customers and to ensure high levels of consumer protection, and shall, in particular, ensure that there are adequate safeguards to protect vulnerable customers, including appropriate measures to help them avoid disconnection. In this context, they may take appropriate measures to protect customers in remote areas who are connected to the gas system. Member States may appoint a supplier of last resort for customers connected to the gas network. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding general contractual terms and conditions, general information and dispute settlement mechanisms. Member States shall ensure that the eligible customer is effectively able to switch to a new supplier.

Paragraph 4 states:

> Member States shall implement appropriate measures to achieve the objectives of social and economic cohesion, environmental protection, which may include means to combat climate change, and security of supply. Such measures may include, in particular, the provision of adequate economic incentives, using, where appropriate, all existing national and Community tools, for the maintenance and construction of necessary network infrastructure, including interconnection capacity.

The new draft Directives on electricity and gas do not change these obligations.

A Directive on energy end-use efficiency and energy services was passed in 2006 that placed some further obligations on government. Paragraph 1 of Article 13 requires the installation of ‘smart meters’ (meters that measure and transmit consumption data on a half-hourly basis) provided cost tests are met:

> Member States shall ensure that, in so far as it is technically possible, financially reasonable and proportionate in relation to the potential energy savings, final customers for electricity, natural gas, district heating and/or cooling and domestic hot water are provided with competitively priced individual meters that accurately reflect the final customer's actual energy consumption and that provide information on actual time of use. When an existing meter is replaced, such competitively priced individual meters shall always be provided, unless this is technically impossible or not cost-effective in relation to the estimated potential savings in the long term. When a new connection is made in a new building or a building undergoes major renovations, as set out in Directive 2002/91/EC, such competitively priced individual meters shall always be provided.

Paragraph 3 of Article 13 requires companies to provide cost and consumption information:

> Member States shall ensure that, where appropriate, the following information is made available to final customers in clear and understandable terms by energy distributors, distribution system operators or retail energy sales companies in or with their bills, contracts, transactions, and/or receipts at distribution stations:
>
> (a) current actual prices and actual consumption of energy;
>
> (b) comparisons of the final customer's current energy consumption with consumption for the same period in the previous year, preferably in graphic form;
>
> (c) wherever possible and useful, comparisons with an average normalised or benchmarked user of energy in the same user category;
>
> (d) contact information for consumers' organisations, energy agencies or similar bodies, including website addresses, from which information may be obtained on available energy efficiency improvement measures, comparative end-user profiles and/or objective technical specifications for energy-using equipment.

It is not clear how this requirement can be met for prepayment meter consumers.

In Annex A, 'Measure on Consumer Protection', two provisions are of particular relevance. Clause (d) requires that consumers:

> are offered a wide choice of payment methods. Any difference in terms and conditions shall reflect the costs to the supplier of the different payment systems. General terms and conditions shall be fair and transparent. They shall be given in clear and comprehensible language. Customers shall be protected against unfair or misleading selling methods.

While clause (e) requires that consumers: 'shall not be charged for changing supplier'.

A.2 National legislation

Member States are required to translate Directives into national law so all provisions of the EU's Directives will be part of UK law.

The main legislation relevant to the EU's Directives is the 'Utilities Act' of 2000. This provided for the Secretary of State to give guidance to the Gas and Electricity Markets Authority ('the Authority') on the measures the Authority should take towards the attainment of the Government's social and environmental policies (see below).

The Utilities Act required the setting up of a Gas and Electricity Consumer Council (energywatch) and details the duties this body has. It also changed the primary duty of the regulatory body for gas and electricity. For gas (paragraph 9):

> The principal objective of the Secretary of State and the Gas and Electricity Markets Authority (in this Act referred to as 'the Authority') in carrying out their respective functions under this Part is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed.

And for electricity (paragraph 13):

> The principal objective of the Secretary of State and the Gas and Electricity Markets Authority (in this Act referred to as 'the Authority') in carrying out their respective functions under this Part is to protect the interests of consumers in relation to electricity conveyed by distribution systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.

In short, the principal duty of the regulator became the protection of the interests of consumers.

In 2004, the Minister of State for Energy, e Commerce and Postal Services issued guidance to the 'Authority' under this legislation. This guidance reiterated the four main goals of energy policy set out the government's 2003 Energy White Paper. These goals are:

- To put ourselves on a path to cut the UK's carbon dioxide emissions – the main contributor to global warming – by some 60 per cent by about 2050, as recommended by the RCEP, with real progress by 2020;
- To maintain the reliability of energy supplies;
- To promote competitive markets in the UK and beyond, helping to raise the rate of sustainable economic growth and to improve our productivity; and
- To ensure that every home is adequately and affordably heated.

The guidance to the Authority on social issues is:

- The Utilities Act 2000 gives the Authority the principal objective of protecting the interests of consumers, wherever appropriate by promoting competition. It also places duties on the Authority in respect of a number of groups within society, namely the disabled or chronically sick, pensioners, those on low incomes and those living in rural areas.
- The Government considers that the Authority has a wide responsibility in relation to social issues, including equal access for all consumers to competitive markets and the desirability of lower levels of disconnection and arrears. It also believes consumers' interests include the quality of service provided and the size of energy bills. The Authority has a duty under the Sustainable Energy Act 2003 to produce impact assessments. These should include cost/benefit analyses of the social as well as the environmental impacts of the decisions.
- Within the context of protecting and helping vulnerable consumers, the Government is committed to achieving its fuel poverty target that, as far as practicable, no household should be living in fuel poverty by 2016-18, and no vulnerable household should be in fuel poverty by 2010.
- The Government expects the Authority, within its sphere of responsibility, to put in place measures which will help achieve these targets.

The government also passed the Warm Homes and Energy Conservation Act in 2000, which required the government to set out a 'Fuel Poverty Strategy'. This was published in November 2001. On 9 April 2008, a UK charity, Help the Aged and an environmental group, Friends of the Earth, launched a legal challenge to the Government to ensure it is held to its legal obligation under Fuel Poverty Strategy to eradicate fuel poverty by 2016.[87]

Annex 2 Summit briefing agreed by the coalition

Background:

The escalating cost of domestic gas and electricity since 2003 has significantly undermined the government's Fuel Poverty Strategy and reversed the progress being made in tackling fuel poverty. High prices are outstripping income growth and outpacing the rate at which energy efficiency and heating improvements can be installed in fuel poor households.

Last year's annual progress report concedes that its 2010 target to eradicate fuel poverty in vulnerable households will not now be met. The government's own fuel poverty advisory body (FPAG) has gone as far as to say the government seems to have abandoned its fuel poverty targets.

Rather than strive to improve the situation, the government's response has been inadequate. It has:

- Relegated fuel poverty in its public service agreement, cut investment in its flagship energy efficiency programme Warm Front, and reduced the proportion of energy efficiency savings to low income households from EEC/CERT schemes, meaning these consumers now pay more but get less.

- Failed to use the Energy Bill to require energy companies to deliver real social tariffs based on agreed standards.

Ofgem's Fuel Poverty Summit must identify the steps necessary to make real progress in eradicating fuel poverty. Progress is reliant on the following policy actions:

1. Social tariffs in accordance with minimum standards

Despite the calls in the Budget for suppliers to increase their spending on social initiatives from £50 to £150 million, it was disappointing to see the government give suppliers yet another last chance to make the voluntary approach to social tariffs work. Some suppliers have made greater progress than others but, taken as a whole, the industry's response to the ultimatum laid down in the Energy White Paper has been shown to be inadequate.

A coherent and cohesive strategy is urgently needed to address the actual cost of gas and electricity paid by fuel poor consumers. Social tariffs represent the most effective way of delivering this. The government must now use the Energy Bill to ensure that all suppliers offer social tariffs in accordance with minimum standards, including the stipulation that suppliers' social tariffs should be the lowest tariff they offer.

Social tariffs offered in isolation will not eradicate fuel poverty. They must be offered as part of a holistic package which brings together affordable energy with all other available energy efficiency assistance and income maximisation initiatives.

2. Energy efficiency schemes

The government's decision to cut investment in it is flagship fuel poverty programme, Warm Front (England), by 25 per cent in real terms is inexplicable at a time when fuel poverty is increasing, when there is growing concern about the number of consumers being asked to pay a 'top up' fee for work costing in excess of the grant maxima, and in light of the waiting times that some qualifying consumers experience.

As the government's own Fuel Poverty Advisory Group have stated:

> The cut in Warm Front is, to put it mildly, difficult to understand - given the programme's success and given the still more pressing need, in the wake of the price increases, to improve the energy efficiency of homes and heating systems. The programme has been cut when fuel poverty is at its highest level for nearly a decade.

Government has sought to conceal Warm Front cuts behind increases in the spending on energy efficiency for low-income households that will accompany the introduction of the Carbon Emissions Reduction Target (CERT) obligation on energy suppliers. However, closer examination of CERT reveals a scheme more regressive than its predecessor.

Despite a 100 per cent increase in the levy low-income consumers pay to fund CERT, and despite the doubling in the energy saving target expected of suppliers, the share of the energy savings that suppliers derive from the provision of measures to low-income 'Priority Group' households has been cut from 50 per cent to 40 per cent, ignoring the recommendation on the FPAG. The ability of CERT to deliver the measures required to tackle fuel poverty in hard to treat homes is also limited. Despite the government now packaging the suppliers' obligation as a pillar of the fuel poverty strategy, there is no mechanism in place to assess or monitor the extent to which EEC/CERT has or will help to alleviate fuel poverty. CERT is only measured in terms of carbon savings and this is inappropriate given its stated social objectives.

Government must restore investment in Warm Front to at least 2007-2008 levels and, going forward, should seek to develop an energy efficiency programme that more effectively meets the needs of the fuel poor.

3. Income measures

While the 2008 Budget recognised the detrimental impact that high gas and electricity prices have on low-income pensioner households, it failed to recognise that high bills have devalued the Winter Fuel Payment. The payment would have covered 37 per cent of the average annual bill for a recipient in the 60-79 age group in 2003, but prices have eroded that to 24 per cent, even when this winter's one-off £50 supplement is included.

The struggle to stay warm for other groups acknowledged as vulnerable by the UK Fuel Poverty Strategy, namely disabled households, low-income families (including the 760,000 children living in fuel poverty) and those with long-term illnesses, continues to go unrecognised in the benefits system.

The government should extend the Winter Fuel Payment to those households aged below 60 who are already eligible for Cold Weather Payments. This is a readily identifiable group of vulnerable households (around 1.6 million), representing those on income support premiums because of long-term illness or disability, or because they have young or disabled children. The annual cost of this payment has been estimated by DWP at £320m. An extension of the payment would represent a significant step towards helping the government achieve its fuel poverty targets.

4. Prepayment meters

The competitive market has shown itself to be ill-equipped to recognise and serve the needs of low-income consumers. They are frequently expected to pay more for the gas and electricity they use, with prepayment meters (PPMs) presenting the most vivid example of discriminatory pricing policies.

When fuel poverty is measured on the 'basic income' definition, government data shows that around a third of the fuel poor are paying for their electricity through a PPM. People in this situation live on very tight budgets, carefully managing their energy use, and yet are left paying the market's premium prices. A consumer using both gas and electricity PPMs pays on average £215 more per annum than a consumer using the same units of energy, but paying by online Direct Debit. In the most extreme case a consumer could be paying as much as £452 more.

The 2008 Budget recognised that these differentials have increased even since the 2007 Energy White Paper, and that the issue must now be tackled. It is very discouraging to see Ofgem chair, Sir John Mogg, defend this practice by saying that retailers are entitled to charge a premium for these meters. The government must now set out how it proposes to use statutory powers to abolish non-legitimate and inefficient PPM premiums.

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Notes

1 This paper covers energy supply in England, Wales & Scotland. In Northern Ireland, the electricity system is a regulated monopoly for household consumers. The gas network is expanding but coverage is far more restricted than in England, Wales & Scotland.

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13 More precisely, distribution companies operate the Low and Medium Voltage distribution system and some of the High Voltage network including sections of the 132 kV Transmission network.

14 See Ofgem (2007) 'Domestic Retail Market Report' Ofgem, London, p 3. http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/DRMR%20March%202007doc%20v9%20-%20FINAL.pdf

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18 SSE argued to the Business & Enterprise Committee that metering should be reinstated as a regulated monopoly as part of the distribution business. http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf pp 487-88.

19 http://www.energywatch.org.uk/uploads/Ofgem_energy_supply_markets_investigation_30_April.pdf p 16.

20 The Herfindahl-Hirschmann Index measures market concentration and is calculated as the sum of the square of the market shares of the competitors. So, a market with only one company would have the highest possible HHI of 10,000 and a market with a large number of competitors each with a very low market share would have a HHI of close to zero. Conventionally, any market with a HHI of 1800 or more is categorised as 'highly concentrated'.

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40 http://www.defra.gov.uk/environment/climatechange/uk/household/fuelpoverty/pdf/fuelpov_actionplan.pdf

41 http://www.berr.gov.uk/files/file10717.pdf , p 27.

42 http://www.defra.gov.uk/news/2007/071206c.htm

43 It is payable to those on Pension Credit. It might be available to those who receive Income Support or income-based Jobseeker's Allowance and have a child under five or get one of the following: a pensioner premium, higher pensioner premium or enhanced pensioner premium; a disability premium or severe disability premium; a disabled child premium; Child Tax Credit that includes an individual element for a child or qualifying young person who is disabled or severely disabled.

44 http://www.direct.gov.uk/en/MoneyTaxAndBenefits/BenefitsTaxCreditsAndOtherSupport/Inretirement/DG_10018668

45 http://www.berr.gov.uk/energy/fuel-poverty/fpag/index.html

46 Note that SSE increased its prices again in August 2008 so that any expected savings from switching to SSE before March 2008 would be eroded and perhaps even lost.

47 http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Token%20PPMs%20%20April%20May%20June%2007%20Update.pdf

48 http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Token%20PPM%20and%20debt%20build%20up%20Feb%20Mar%20Update.pdf

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57 http://www.ofgem.gov.uk/Media/FactSheets/Documents1/1389-jan2403debtprev.pdf

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63 http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Fuel%20Poverty%20Summit%20Action%20Programme.pdf

64 http://www.berr.gov.uk/files/file42720.pdf

65 For example, in the first six months of 2008, marketing spending by the big six energy retailers increased by 25 per cent compared to the same period in the previous year to £58.5m. http://www.brandrepublic.com/Marketing/News/841660/Energy-brands-ramp-spend-amid-price-hikes/

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[81] http://www.ofgem.gov.uk/Markets/Pages/Markets.aspx

[82] http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx

[83] The White Paper stated: 'If no further action is undertaken by companies, we will consider whether to take the opportunity for legislation to enable the Secretary of State to require companies to have an adequate programme of support for their most vulnerable customers. In this context, we may consider the role of mandated minimum standards for social tariffs in the context of the review of the policy framework.'

[84] http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf p 35.

[85] http://www.parliament.the-stationery-office.co.uk/pa/cm200708/cmselect/cmberr/293/293i.pdf p 37.

[86] energywatch – a government sponsored body – provides printed price comparison factsheets on request, but prices change regularly and ensuring all consumers were kept up to date with prices would be a very costly and probably not very effective measure.

[87] http://www.foe.co.uk/resource/press_releases/government_sued_for_fuel_p_09042008.html and http://press.helptheaged.org.uk/_press/Releases/_items/_Fuel+poverty+initiative+will+only+scratch+the+surface,+says+Help+the+Aged.htm

Annex 3 Social tariffs for electricity and gas

Supplier	Social tariff name	Developments since Jan 2008[88]	Positives	Issues
British Gas	Essentials		Offered on significant scale – potentially up to 750k consumer accounts	Offers nothing to fuel poor customers paying by Direct Debit. More expensive than some of BG's open market tariffs. Least generous saving to recipients of all the social tariffs.
EDFE	Energy Assist		Lowest tariff offered by EDFE, 15% discount against existing tariff. Available regardless of payment method.	Yet to be seen how EDFE will further develop the tariff in light of the industry's agreement with government (see footnote 1).
EON	Staywarm			EON has advised Ofgem[89] that Staywarm is primarily a commercial product, that includes substantial support for 10,373 customers with significantly above average energy usage who are on benefits or with special needs. Restricted to over 60s and only those who are paying by Direct Debit and take both fuels from the supplier.
RWE Npower	Spreading Warmth	Commitment to invest '£53m in its social programmes, most of which will be spent on this new Spreading Warmth tariff' over the next three years. Npower is aiming 'to recruit up to 80,000 customers onto the tariff.'[90] Prior to announcement that figure was just 4,350. Recipients taking both fuels from Npower will now save £250, compared to £103 before.	More generous than previous social tariff offered by Npower and available regardless of payment method.	Fixed nature of offer (£125 per fuel) will mean its value is devalued by further price rises. Roughly in line with company's best open market offer (online Direct Debit), but does not represent its lowest cost tariff.
Scottish Power	Carefree Plus		A marked improvement on their position in January 2007 when, in responding to the energywatch consultation on social tariffs, they stated that 'ScottishPower's position has been to date, and continues to be opposed to the introduction of social tariffs.'[91]	Only available to over 60s and even then only on severely restrictive eligibility criteria.[92] Not available to customers paying by Direct Debit or Fuel Direct (deducts payments towards arrears and ongoing consumption straight from benefits - used by some of the poorest consumers). More expensive than some of SP's open market tariffs.
SSE[93]	EnergyPlusCare	Commitment in April to 'quadrupling the number of customers who benefit from "energyplus care", to 100,000 customer accounts, over the next year.'[94]	A commitment to ensure social tariff is lowest cost tariff offered by supplier (20% discount against existing tariff – see footnote 6) and available regardless of payment method. Increase in availability from 25k to 100k accounts.	

Conclusion

“Increases in global commodity prices, particularly food and energy, and the impact of the ‘credit crunch’ on financial services and housing costs have placed huge pressure on household budgets. Increasing energy prices will have a knock-on effect on transport prices, while water companies are generally asking for above inflation price increases for the five years from 2010. Only in communications is there an expectation that prices will increase by less than the rate of inflation. So the essential products and services covered here are expected to absorb a larger proportion of low-income households’ budgets for some time to come, causing real hardship.”

Stephen Thomas

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Conclusions

Over the past 20-25 years, the number of products and services that are regarded as essential has expanded, partly in response to cultural and technical changes, for example, mobile phones are increasingly seen as essential items. The expansion is also in response to the recognition that, in a modern society, government has a responsibility to ensure that all citizens have access to affordable products and services, not just for those needed for physical survival but also for those required for 'social inclusion'.[1]

At the same time, there has been a significant trend to privatise and marketise the ownership and provision of products and services that were, in a number of cases, previously supplied by publicly owned monopoly companies (telecoms and energy) or where markets were much less developed than they are now (financial services and public transport). The onus is now firmly on consumers to ensure they are getting value for money by exploiting the market. But this report shows that, for many of the essential purchases examined, this is not always a realistic prospect for all households, especially low-income households. In addition, the markets themselves are not always efficient or delivering the benefits expected of them because, for example, they are highly concentrated or price comparisons are difficult to make.

Increases in global commodity prices, particularly food and energy, and the impact of the 'credit crunch' on financial services and housing costs have placed huge pressure on household budgets. Increasing energy prices will have a knock-on effect on transport prices, while water companies are generally asking for above inflation price increases for the five years from 2010. Only in communications is there an expectation that prices will increase by less than the rate of inflation. So the essential products and services covered here are expected to absorb a larger proportion of low-income households' budgets for some time to come, causing real hardship.

For more than 30 years, the 'poor pay more' phenomenon has been recognised by consumer and welfare organisations, for example by the National Consumer Council (NCC) in the 1970s.[2] However, the combination of the 'Perfect Storm' of the 'credit crunch' and rapidly rising food and energy commodity prices, have had a punitive impact on low-income household budgets, and has highlighted that the problem of the 'poor pay more' remains at least as serious a problem as it was 30 years ago.

For various reasons, this sees low-income households having to pay more to receive the same (or sometimes an inferior) product or service than more affluent households. So, for example, households that do not own cars and have to shop frequently at small local stores have to pay more for their food than those that can profit from a weekly shop at a large supermarket. For energy, this issue is most clearly illustrated by the high relative price consumers using prepayment meters – an inferior form of service to other forms of billing – have to pay for their energy.

NCC returned to the theme of the 'poor pay more' in 2004,[3] seeking to stimulate a debate on the provision of essential services for low-income households. It again found that low-income households were 'paying more, getting less' and placed much of the blame on the increased role of competitive markets in supplying these services. It stated:[4]

> *Increasingly government has encouraged the private sector in the supply of essentials. This can be seen in the privatisation of national industries and the introduction of competition, mixed models of provision in public services and the withdrawal of public subsidies from public services. But competition is not serving the needs of the most disadvantaged. Public service rationing increasingly bars those with greatest need. Disadvantaged consumers are excluded either because they lack the skills to negotiate complex markets and systems, they are too costly to serve or they lack purchasing power. Market-based exclusion is therefore the problem to be tackled if the government is to be successful in eliminating poverty and social exclusion.*

The research presented here reinforces those conclusions and provides a more detailed analysis of where markets are failing low-income households. We have examined four key questions:

- To what extent have free, competitive markets been introduced in each sector?
- Have the theoretical benefits of markets actually been realised?
- Are these benefits limited to more affluent households who possess the skills and resources to exploit the potential of the market?
- To what extent has the market in each sector shown itself capable of (a) ensuring adequate provision for; and (b) serving the interests of low-income consumers?

Where the theoretical benefits of markets have not been realised, we asked:

- To what extent is this to the particular detriment of low-income consumers?
- Are the problems evident in the functioning of the energy market symptomatic of the problems that low-income households face in their procurement of essential services in other markets?
- What mechanisms and measures have been introduced to ensure adequate provisions to low-income consumers and how effective are these?
- Who has been responsible for implementing these protective mechanisms and measures?
- Are there lessons that can be learnt for the energy sector?

In seeking to answer these questions, the research has generated findings which can be grouped under five major headings:

- How effective are the markets in these sectors?
- The role of regulation
- How should assistance be targeted?
- The consequences of not consuming, or under-consuming; and
- Universal Service Obligations

The structure and operation of the market in the housing sector has little in common with any of the other sectors and, because parallels are difficult to find, the housing sector is discussed separately. While the nature and frequency of choice are very different to other sectors, housing does have important connections to energy, water and financial services. Housing strongly determines energy demand and water bills, while creditworthiness will determine if a mortgage is feasible and, if it is, what the cost will be.
We then look at the analysis of the other six essential services to see how far the energy sector can learn from the governance of the other sectors examined.

1. How effective are the markets in these sectors?

Of the seven sectors examined, only the food and drink sector comes remotely close to the neo-classical ideal of perfect competition, with its model of large numbers of market stalls all selling identical goods at prominently displayed prices. The home-buying and private rental parts of the housing sector, as well as the financial services sector, are both based on competitive principles, but they have little else in common with the theoretical ideal for market structure. Communications, energy and public transport are part monopoly (the infrastructure networks) and part competitive markets, although, like financial services, the infrequency of transactions, as well as other characteristics, means these markets are also far removed from the ideal. Of the sectors examined, only water remains a fully regulated monopoly.

The act of liberalisation will not by itself result in a market that can be considered truly competitive. Markets are only likely to be efficient if a number of rigorous conditions are met. There should be a large number of competing companies; new companies should be able to easily enter to enhance competition and, where companies run into difficulties, they should be allowed to fail, meaning that companies cannot rely on a bail-out if they prove uncompetitive. In a perfect market, supplier reputation and product differentiation should play no part in consumer choice.

1.1 Is there a competitive field of companies and are barriers to entry low?

Of the five sectors[5] other than housing (described separately) and water (still a regulated monopoly), a strong argument can be made that only for most financial services is there a large enough competitive field of companies. Foreign companies entering, and mutual companies demutualising and expanding their scope, have provided competition to the sometimes limited number of long-established companies. In some respects, regulatory requirements that force new companies to demonstrate their financial strength do make it more difficult for new companies to enter. However, in other respects these requirements give assurance that any company from which consumers buy financial services has met strong requirements from the regulator, which may make consumers more willing to switch to a new company. In reducing the significance that reputation plays in consumer choice, the barriers to entry are also reduced. But this review shows that in the case of services focussed on low income consumers, such as the Home Credit market, the relationship between consumer and provider is a very personal one, somewhat removed from the choice and competition model and hence, as the Competition Commission found, prone to monopolistic practices of a highly localised nature. ‘Free exit’ is notably absent in the banking sector, as was demonstrated by the rescue of Northern Rock in 2007 and the role of the financial authorities, including the Financial Services Authority, in organising emergency funds for Bradford & Bingley in July 2008.

Energy, the retail of food and drink and public transport are dominated by a handful of companies while, in the household landline telecoms market, the former monopoly incumbent, BT, is still dominant. In energy, there are six large companies that control the retail markets for electricity and gas, that are of comparable size in the UK market (four are subsidiaries of much larger foreign companies). The design of the wholesale markets for energy and the fact that, for electricity, the producers are the same companies as the retailers makes scale entry implausible other than by takeover of existing companies, most likely by one of the already established companies, a situation that erodes rather than stimulates competitive benefit. This vertical integration is in contrast to the food sector where the retail market is similarly concentrated but the retailers are not integrated back into food production. For the consumer, this means that the food retailers can place heavy pressure on their suppliers and some of the cost reductions may be passed on to consumers. For the electricity sector, the vertically integrated retail companies have little incentive to drive down wholesale prices because if these reductions are passed on to consumers, they will tend to reduce the profits of their generation divisions.[6]

For food, there are very large numbers of small stores, but the big four supermarket chains have such a high market share and such strong buying power, that it is difficult to imagine new entrants easily rivalling these four. While the takeover by Co-op of Somerfield - each with about 4 per cent of the market - does introduce a potential fifth player, it leaves the next largest company with less than 3 per cent of the market.[7] Nevertheless, the response to the economic problems of 2008 and the loss of market share experienced by high-priced stores, e.g. Marks & Spencer, at the same time as low-priced stores such as Lidl and Aldi have experienced increases in market share, does suggest that the balance of power in the market is not entirely fixed.

Public transport has also seen a remarkable process of concentration with a handful of UK-based companies now dominating rail franchises and bus markets. Clearly, the rail sector does not have free entry and exit. A vision of 'merchant' bus services was prominent when bus services were opened up in the 1980s, whereby small entrepreneurial companies identified attractive routes and competed for business against existing companies by offering better services or lower prices. In theory, passengers could literally choose at the bus stop which company to travel with. In practice, this sort of intense competition was short-lived, with new entrant companies either failing, or being swallowed up by the larger players. This policy was abandoned only ten years after it was introduced in order to allow a more planned approach that would allow policy aims, for example environmental and social objectives, to be more easily met.

For telecoms, the market dominance of BT is slowly being eroded. The emergence of broadband services as a large market has facilitated the entry of a significant number of new companies in offering 'bundles' of services including landline and mobiles. Whether BT's ownership of the landline network is an obstacle to competition is debateable. For mobile phones, there are five networks owned by the five major competing companies. This means that, despite the plethora of deals (which can be impenetrable to consumers) and the large number of brand names, competition is actually less intense than it appears to be. That said, there does appear to be some scope for new entry.

1.2 Alternatives to mainstream market provision

In some sectors, non-mainstream provision is making a useful, albeit generally limited, contribution to low-income households. For financial services, credit unions provide an important service to low-income households, while community transport provides valuable transport assistance at the local level. Farmers' markets can also be seen as an alternative to mainstream provision, although a primary driver in setting these up has been the desire of producers to increase margins by cutting out retailers.

Both the ethos and the ownership and governance structure of these alternative approaches to provision, whether they be charities, social enterprises, mutually owned or community interest companies, will mean that the motive to earn a profit may be balanced against other guiding objectives. Such initiatives seem most likely to be successful where distinctive products or services of particular value to low-income consumers can be offered that address the reluctance of providers in the mainstream market to cater to this group. For standard, essential products like energy and water and where scale economies in production are large, the prospects for non-mainstream provision seem less promising within the current market framework, at least until new technologies, such as community level or micro-generation (under which communities and/or households generate some or all of their heating and energy needs) become more viable.

1.3 Are the costs of switching borne by consumers?

For the public transport and food and drink sector, switching from one supplier to another (where possible with public transport) does not, by itself, create any additional costs other than the search costs that a switch might incur. The customer simply chooses a different supplier at the point of purchase. However, for the energy, telecoms and financial services sectors, there are significant costs associated with consumers switching supplier. These costs are inevitably passed on in some way to consumers and any benefits of competition must be off-set against these additional costs.

For energy, a switch involves re-registering the consumer's unique meter details with the new supplier. This would seem to be a simple process but, when competition in electricity was introduced in 1998 for household consumers, the cost of building and running the switching systems over an eight year period was close to £1bn, or about £5 per household per year.

The cost per switch should be relatively low if things go smoothly, but very high if not, as it involves large amounts of time by company staff trying to reconcile registration details. There is no recent authoritative estimate of the average switching cost but, in 1999, MacLaine estimated it to be about £50 per consumer.[8] If 20 per cent of consumers switch per year, this imposes an additional cost of £250 million for electricity alone. By law, companies are not allowed to charge an individual consumer for switching. This therefore institutionalises a cross subsidy from non-switchers to switchers, and even if companies were able to charge for a switch, the charge would deter consumers from switching, so they would be unlikely to make a charge. There is also no opportunity to recover these initial costs in higher charges in subsequent years as sometimes happens, for example, in the insurance sector – consumers are offered a low insurance premium in the first year, but the cost of this is recovered with higher premiums in subsequent years.

Intuitively, it might be expected that switching telecoms supplier would involve similar costs to switching energy supplier because they both basically require the transfer of a unique number between providers. While there is no information on the extent of these costs, the process does seem smoother than switching energy supplier.

For financial services, the checks and registration of details required for an insurance policy or a bank account are extensive. It is not clear what the scale of the costs is, or how the companies recover them, for example is this achieved by spreading them over all their consumers or by increased charges in subsequent years?

1.4 How easy is it to compare suppliers?

One of the major innovations in consumer purchasing has been the use of the internet to research and buy products and services. Price comparison sites allow consumers to compare a range of offers. Of the sectors we examine, price comparison sites are particularly important for financial services, communications and energy. Indeed, many people are now reliant on these sites to aid and inform their purchases. However, there are issues that need to be kept in mind. The sites must be independent and must offer impartial advice if they are to be credible and of real value to consumers. For the sites that offer energy price comparisons, energywatch reviewed its 'Confidence Code'[9] in April 2008 to which price comparison sites must adhere if they are to remain accredited by energywatch.

However, from a social equity point of view, the serious issue for low-income households is that many do not have ready access to computers and broadband connections, without which using price comparison sites is very difficult. As the Energy Minister, Malcolm Wicks, told the Business & Enterprise Committee:[10]

> *A final point - and I think this is the most important point - is that those who are more confident about switching as a key solution here are people who take for granted that everyone has access to a flat-screen computer, can go to the different sites and get the best deal, and has the wherewithal to then revisit and re-switch in x months' time. You know as well as I do that many of our constituents are nowhere near a computer and have so many issues on their mind that they are not readily able to make use of switching. Indeed, I was looking at survey evidence this morning and the evidence I am shown is, not surprisingly, that many of the most vulnerable, in the lower income groups, are the least likely to have switched. I do not want as an egalitarian switching to depend on the wherewithal and the access to technologies which our constituents do not have.*

The model of a competitive and efficient market relies on consumers making choices and switching where an economic advantage can be gained. However, experience in the energy market clearly shows that even with what should be a relatively straightforward choice, a significant proportion of consumers that switch do not achieve what they were setting out to do, which is to save money. For financial services, the consequences of making a bad choice, for example, on a pension plan, could be very long-lasting and financially serious. Consumers also have a range of criteria other than the simple price criterion when they make choices. This reduces the cost pressure on companies who can use, for example, customer loyalty and brand reputation to retain their customers, even when their prices are not competitive. The result is that the theoretical requirements for an 'efficient' market are not met. 'Switch-averse' consumers, who choose to stay with a product they have experience with and with a provider they trust, may be making a completely rational and sensible decision according to their own priorities, while appearing 'irrational' in terms of economic theory. Equally, choosing an expensive pay-as-you go mobile phone or a pre-payment energy meter may also be a rational choice for someone living on a very limited budget who needs to keep expenditure under tight control.

2. The role of regulation

In five of the seven sectors (energy, telecoms, water, rail and financial services), an independent regulator has been created in the past 20 years with responsibilities for overseeing markets. The Office of Fair Trading (OFT) and the Competition Commission have responsibilities across all sectors for monitoring markets (see Table 1). Most of these - Ofgem, OFT, Office of Rail Regulation (ORR), and the Food Standards Agency - are 'Non-Ministerial Government Departments' (NMGDs). Ofcom is a Public Corporation, while the Competition Commission is a Non-Department Public Body (NDPB).[11] The Financial Services Authority is a special case because it is a limited company, but it exercises statutory powers and is treated for many purposes as part of government.

For housing, the regulatory system is in transition. The Housing Corporation is being replaced by the Homes and Communities Agency and a regulatory body, provisionally called Oftenant, which will take over and expand the Housing Corporation's regulatory role, giving greater scope for tenants of social housing to require their landlords to give good service.

For these purposes, the distinction between the statuses of these bodies is of limited interest, but they have a number of features in common. They are not headed by government ministers, but were established by Act of Parliament and have statutory duties. They are accountable only to Parliament and the courts.

The role of the energy and financial services regulators has been brought into sharp focus by fast rising energy prices and failings at the Financial Services Authority in relation to the demise of Northern Rock. The GMB Union have even called for the abolition of Ofgem:[12]

> *GMB want to see Ofgem abolished and the government taking over the regulatory role itself and be answerable to parliament for this and we will continue to campaign for this.*

The main issues raised by the reliance on regulators are: political independence, and accountability and representativeness.

2.1 Political independence

The rationale behind these bodies is that they should be able to make politically independent decisions. This has an intuitively appealing logic: the bodies should make quasi-judicial judgements that should not be influenced by party political considerations. For example, this would seem to make it easier for them to make judgements for the good of consumers that might show the government in a bad light or highlight the failings of government policy. Government has made attempts to give greater independence to regulatory bodies in recent years, for example the Monetary Policy Committee is able to decide on the Bank of England base interest rate independently of government. The Competition Commission, whose remit had been limited to making recommendations to ministers, now has independent powers to enforce remedial actions on companies in many cases.

Whether this political independence is as real as it is portrayed to be is questionable. The decision-makers in these bodies are appointed by government ministers, with whom the bodies frequently share their statutory duties. For example, all the duties of the Gas and Electricity Markets Authority are jointly held with the Minister. The Minister is also able, albeit in restricted circumstances, to sack the regulators and override decisions using reserve powers in some instances.

Table 1 Regulatory bodies

Sector	Regulatory body	Primary duties	Areas of responsibility
Energy	Gas & electricity markets authority	To protect the interests of consumers through the promotion of competition, wherever appropriate.	Set prices for monopoly services, monitor quality, oversee markets.
Water	Water Services Regulatory Authority	To enable efficient companies to finance and carry out their duties while ensuring that consumers have access to water (and waste water services) at a fair price and with a high standard of service.	Set prices for monopoly services, monitor quality.
Telecoms	Ofcom	To further the interests of citizens in relation to communications matters; and to further the interests of consumers in relevant markets, where appropriate, by promoting competition.	A broad range of responsibilities in telecoms, broadcasting, setting and enforcing rules on fair competition between companies in these industries.
Financial services	Financial Services Authority	Maintaining confidence in the financial system; promoting public understanding of the financial system; securing the appropriate degree of protection for consumers; reduction of financial crime.	Wide range of activities, including monitoring the policies of banks to ensure their financial integrity.
Rail	Office of Rail Regulation	Setting framework under which the infrastructure provider works; the stewardship of the railway infrastructure; determining the efficient allocation of access to railway facilities.	To regulate Network Rail's stewardship of the national rail network; licensing the operators of railway assets, approval of agreements for access by operators to track, stations, etc, and enforcement of domestic competition law.
	Department for Transport		Government is in charge of setting the strategy for the railways including the level of public expenditure & key outputs to be delivered; the devolved governments in Scotland and Wales and regional and local funders would have an increased role in specifying and funding services.

Food & drink	Food Standards Agency	To protect the health of the public and the interests of consumers, in relation to food.	
Housing	Housing Corporation		Currently being replaced by two agencies, the Homes and Communities Agency and a regulatory body, provisionally called Oftenant, which will take over and expand the Housing Corporation's regulatory role, giving greater scope for tenants of social housing to require their landlords to give good service.
All (although powers and responsibilities are often delegated to sector regulators)	Office of Fair Trading	To make markets work well for consumers.	Gathering intelligence about markets and trader behaviour and responding to 'super-complaints' about markets (other than ones where the sector regulator responds) from designated consumer bodies (e.g. National Consumer Council). Where potential problems are identified, OFT undertakes market studies and recommends or takes further action where needed (e.g. referral to the Competition Commission).
	Competition Commission	Conducting in-depth inquiries into mergers, markets and the regulation of the major regulated industries.	Investigations in three areas: in mergers - when larger companies will gain more than 25% market share and where a merger appears likely to lead to a substantial lessening of competition in one or more markets in the UK; in markets - when it appears that competition may be being prevented, distorted or restricted in a particular market; in regulated sectors where aspects of the regulatory system may not be operating effectively or to address certain categories of dispute between regulators and regulated companies. Inquiries are undertaken in response to a reference made to it by another authority, usually the Office of Fair Trading. It has no power to conduct inquiries on its own initiative.

Source: *Various*

At times when issues relating to the above sectors are away from the headlines, governments are generally happy to be absolved from responsibility for making decisions that might prove unpopular. But when things go seriously wrong, as for example happened in 2001 with the rail industry, the government quickly moves in to take control. The first rail regulatory body, the Office of Passenger Rail Franchising, was abolished and partly replaced by the Strategic Rail Authority (NDPB) in 2001, which itself was abolished only three years later when its functions were taken over by the government through the Department for Transport. The Rail Regulator was replaced in 2004 by the Office of Rail Regulation (ORR) with much more restricted powers.

2.2 Accountability and representativeness

While the regulatory bodies are in law accountable to Parliament, the way in which this happens is far from clear. They are obliged to present annual reports featuring accounts signed off by the National Audit Office and Parliament, but there is no systematic process that then ensures Parliamentary interrogation of these. Given that these regulatory bodies account for the expenditure of a significant amount of public money, this seems a major omission. Select Committees scrutinise activities of these bodies on an ad hoc basis and have the power to examine them on specific issues as, for example, the Business & Enterprise Committee did in its Inquiry into energy markets in 2008.[13] The National Audit Office and the Public Accounts Committee can also carry out one-off investigations but also do not routinely assess 'value for money'.

The tacit assumption that there is a range of political decisions that are the responsibility of government to make (e.g. what is generally thought of as 'energy policy'), while there are others, which are essentially 'value-free' (e.g. what is generally known as economic regulation), that can be taken by apolitical bodies is also questionable.

For governments, it may be convenient to shelter behind regulatory bodies where politically contentious decisions are needed, for example decisions that lead to increased prices.

The same ambiguity about where political decision-making starts and economic regulation ends seems to exist within the housing market and decision-making on social issues related to housing are partly with national and local government, but also with unelected and weakly accountable regulatory bodies.

This weak accountability would seem to require that there was a particular onus on government to make these bodies at least in some sense representative of the public that they act for. But there seems to be a tacit assumption that decisions are technical ones and, for example, economic regulation needs to be carried out by those with business or governmental backgrounds.

3. How should assistance be targeted?

Of the seven sectors studied, water, energy, transport and housing have varying schemes, mostly funded by taxpayers, aimed at providing support to low-income consumers (see Table 2). Arguably and not by coincidence, these are the sectors where general indicators of poverty do not always provide a reliable indication of whether low-income households will have difficulty affording their needs. All things being equal, it is clear that money in these schemes should be targeted at those consumers facing the greatest difficulties to ensure that the maximum benefit is derived from the resources. However, the problems with accurately identifying the consumers facing greatest difficulty have meant that, in some cases, a very broad untargeted approach is used, for example bus passes and winter fuel allowances for those over a certain age.

Table 2	Current assistance mechanisms for low-income households			
	Government subsidy or support mechanism	Mandatory company assistance	Industry voluntary assistance	3rd sector/non-mainstream
Energy	Winter Fuel Payment, Cold Weather Payments Fuel Direct Warm Front in England and its devolved equivalents.	CERT	Limited social initiatives such as socially oriented tariffs and trust funds.	
Telecoms	-	BT Universal Service Obligation (and Kingston Communications in Hull and East Yorkshire area USO).	BT pre-pay scheme Pay& Call.	
Water	-	Vulnerable Groups scheme (WaterSure) 1999 ban on disconnections and pre-payment meters.	Charitable schemes set up by companies.	
Food & drink	Mother and baby vouchers. Sure Start education for mothers. School meals subsidies. Meals-on-wheels support.	None	Supermarket food banks for short-dated products.	Community gardens, box schemes, cafes, food banks. Soup kitchens.
Housing	Rent controls in social sector Housing benefit Income Support for Mortgage Interest Improvement grants and loans Council tax benefit.			Housing associations.
Public transport	Bus/train ticket concession. Rail subsidies for essential services.			Community transport.
Financial services	Post Office Card Account; Social Fund; Child Trust Fund; Growth Fund; Social Inclusion Fund.		Basic bank accounts.	Credit unions Commercial development financial institutions.

3.1 Pros and cons of the untargeted approach

Clearly, the winter fuel allowance and the bus passes for those over 60 do lead to a large amount of money being given to people who, by any standards, do not need this support. The government's Fuel Poverty Action Group (FPAG) in England, which monitors the effectiveness of government policies on fuel poverty, argues strongly that the money spent on Winter Fuel Allowances would achieve much greater benefits if targeted at those most in need, as those below pension age receive nothing no matter how dire their circumstances. FPAG also argues the money should be directed mostly towards capital expenditure on energy efficiency. This has the potential to permanently lift families out of fuel poverty, by reducing the amount of energy they need for a given energy service, whereas simply subsidising bills will be a recurrent item. Reducing energy demand would also tend to have environmental benefits. In its 2007 Annual Report, FPAG recommends:[14]

> *Warm Front annual expenditure should, in the 2008-11 period, be restored at least to its 2007-2008 level of £350m. This could easily be done if Government expenditure were better targeted, e.g. by discontinuing Winter Fuel Payments for higher rate tax payers, which would free up over £200m pa for Warm Front.*

However, such untargeted schemes are relatively straightforward to administer and their universal nature may be politically attractive. In addition, arguably, the consequences of someone who should receive support but who is not receiving it are much more serious than those of giving money to groups that do not need it. Put another way, 'errors of inclusion' are less serious than 'errors of exclusion'. But this argument effectively ignores the opportunity costs of the resources used.

Support mechanisms for low-income households for water are widely seen as very weak and few households are able to take advantage of even the low level of support offered.
The case for bus passes is also somewhat different as these may make a bus service defensible that would otherwise not be viable, resulting in benefits for all citizens in the area. Clearly for energy, there is no substantial issue of non-viability of existing services, although not all consumers have access to a mains gas service.

3.2 Problems with targeting

3.2.1 Groups with lowest incomes are sometimes not those in most need

For some of the sectors studied, e.g. food and drink, income would seem a good proxy for need because it is not distorted by other factors, such as the quality of housing. However, for energy and housing, and to a lesser extent water and public transport, this may not always be so. This means that targeting assistance at those most in need needs a specific determination of the individual's circumstances.

The way in which water is charged for many consumers, based on the size and value of the property and not volume of water usage, may also mean income is not a good proxy for need. But neither is volume consumed, as that will reflect such issues as family size, medical conditions and even employment. As with energy, the efficiency of equipment strongly influences demand and it is often possible to significantly reduce demand without altering the quality of service received. For example, an energy-efficient fridge can keep its contents as cold as an energy-inefficient fridge, but the energy consumption required to achieve this will be noticeably lower with the former than with the latter. For transport, the required expenditure to meet reasonable need will vary according to the geographic location of the household in relation to workplace, shops, schools and other services. It will also vary with the level of fares charged by the local transport provider, which can vary widely. Private transport is an alternative way to meet this need but, in some circumstances, might be the cheapest option.

These issues surrounding housing are taken up in more detail in section 5.

3.2.2 Low take-up of many benefits

If the social security system was well-designed, the amount of benefits paid out in Income Support should be a good indicator of how much support might be needed except, as noted above, for energy and, to a lesser extent, water for which the cost of the service is largely determined by the housing. However, the take-up rate for means tested benefits is often low, and it cannot always be assumed that the receipt of certain benefits is always a reliable indicator of need. Indeed, if a household does not take up a benefit to which it is entitled (for whatever reason), this could represent the difference between being able to afford adequate provision and not being able to.

4. Consequences of under-consuming or not consuming

While it is widely acknowledged that all the sectors studied represent essential purchases, for all except food, there is the possibility of surviving without having access to the product or service, albeit in a highly disadvantaged condition. Perhaps the extreme case would be homelessness, which would also be likely to entail not having access to a personal water supply and a personal energy supply. It would also almost inevitably be associated with not having access to a personal telecoms service and most financial services.

While homelessness is conspicuous and tends to give rise to public concern, other forms of not consuming, while less obvious, still have the potential to be seriously detrimental. For energy, there is the possibility of disconnection for non-payment of bills, albeit only after some safeguarding procedures have been completed. However, the circumstances of some pre-payment meter users may lead them to initiate their own disconnection and there is presently no safety net to prevent this, nor is there even any way to monitor the extent to which this behaviour is occurring.

For water, disconnection for non-payment of bills is illegal but companies still threaten consumers that have not paid their bills with disconnection.

For telecoms, landlines and mobiles, the procedures for disconnecting are in almost all cases not onerous and a consumer that is disconnected will find it expensive to re-connect. Financial services is a more diverse sector and not having a bank account is a very different position to be in to not having adequate insurance for housing or vehicles. Financial services consumers' reluctance to buy may be well founded and 'economically rational', given the high risk of a bad decision in a complex transaction involving large sums of money.

Under-consumption is a much more difficult issue to address. Determining where households are using less of a service than would be desirable for health and social inclusion reasons is often impossible. Households on limited budgets can economise on all of these services. They could:

- Eat cheap but non-nutritious foods;
- Not heating or lighting their dwelling to an adequate level;
- Live in non-decent housing;
- Lose contact with friends and relatives if they do not travel or use a telephone; and
- Risk serious financial losses if they do not insure their possessions adequately.

Only un-metered water users do not face self-imposed pressure to economise on use of these essential services when faced with budgetary pressures.

5. Universal Service Obligations

European Union attempts to liberalise services, such as energy and telecoms, have been accompanied by provisions to try to ensure that the desirable characteristics of a public service are not lost by transforming the service from a monopoly to a market. Of particular importance is the Universal Service Obligation (USO) imposed on Member States by the European Union on electricity, telecoms (landlines) and post. A USO requires that member states must ensure that such services 'are made available to all users in their territory, regardless of their geographical location, at a specified quality level and an affordable price'.

As shown in the telecoms chapter, these arrangements are clearly in place, although they remain somewhat problematic. For electricity, Ofgem believes that the obligation on retail suppliers to offer terms with a wide range of payment options to anyone that applies fulfils the UK's duties under USO requirements. In practice, the requirement to offer terms does not prevent a retail supplier effectively blocking an application by a consumer. Suppliers are able to ask consumers for a security deposit unless the consumer is paying through a prepayment meter (PPM). The only limitation on this is that the 'Security Deposit must not exceed a reasonable amount'. In practice, security deposits are not much used,[15] and deposit levels seem low. Consumers who believe that an unreasonable deposit is being asked for were able to appeal to Ofgem, but this provision was rarely used and, in the Supply License Review,[16] Ofgem removed the right of appeal. It also removed the duty on suppliers with fewer than 50,000 consumers to offer a range of payment methods.

However, the availability of PPMs means that retail companies have the ability to channel consumers that they might otherwise be reluctant to supply into this option. PPMs involve little or no commercial risk for the supplier who is guaranteed to be paid in advance for energy consumed. Whether the very large premium PPM consumers pay compared to the cheapest option (on-line accounts with direct debits) – on average they pay 25 per cent more – is compatible with the duty to ensure the service is 'affordable' is a moot point.

6. Housing

Whilst it is clear that house purchase and private rental is mostly carried out through some form of market, the structure and operation of this market has almost nothing in common with the markets for the other six sectors. It is also distinct from the other six sectors, in being the only one where the market is over-ridden so fully. This is partly through the provision of social housing and rent determinations and partly through the very extensive and complex housing benefits regime. Nevertheless, the connections between the housing sector and energy, water and financial services are strong and there are important lessons to learn.

6.1 General indicators of poverty are not reliable for housing and energy need

Housing decisions are 'lumpy'; in other words, they are taken infrequently and involve large sums of money, and they are much more lumpy than even energy, telecoms or financial services decisions. These services involve individual decisions which result in a commitment to paying sums in the order of hundreds of pounds for a year or more. This contrasts with 'switching' in the housing sector - i.e. moving house - which involves huge disruption and has major financial consequences. For a significant number of households, switching might not even be a feasible option, for example if the costs associated with buying and selling a property are prohibitive, or for those in social housing seeking different accommodation in an area with long waiting lists. By contrast with energy, telecoms and financial services, the cost of switching in the housing sector - removals, legal fees etc. - falls directly on the switcher rather than being distributed amongst all users, as in the other cases. The market search cost is also likely to be much higher.

However, despite these significant differences, there is perhaps a parallel with energy in the sense that indicators of poverty based on income are not always a reliable indicator either of 'fuel poverty' or of households that have most difficulty affording their housing; for example, a key worker living in London would find it much more difficult to afford adequate housing than they would if they lived in an area with lower housing costs. This is in contrast to food, communications and financial services where general indicators of poverty correlate reasonably well with the difficulty households will have in meeting need. For water and public transport, required expenditure may vary widely according to the situation of the household. While this issue does not relate directly to how well markets are serving low-income consumers, it is of central relevance when considering what measures might be appropriate to deal with market failures and how these can be best targeted.

In the case of energy, there is not always a clear overlap between poverty in general and ‘fuel poverty’, and someone with a relatively high income might suffer from fuel poverty if they live in a poorly insulated house. Equally, it is feasible that someone with a low income might have less difficulty paying energy bills if they live in an energy efficient home, although the magnitude of price rises in recent years will have made the level of energy efficiency required to achieve this situation much more challenging.

However, while required housing expenditure is relatively difficult to change and would generally require the household to move to lower cost accommodation, carrying out energy efficiency measures should cause relatively little disruption and could offer a long-term solution to the problem of fuel poverty by reducing energy need sufficiently to lift the household out of that condition.

6.2 Energy service companies

Many observers,[17] ranging from Ofgem[18] to the Greater London Authority[19] have advocated that we should move away from an energy retail market that sees gas and electricity suppliers compete to sell units of energy, towards a market in which Energy Service Companies (ESCos) compete to deliver a comprehensive energy service. The government defines an ESCo as:

> *A company that provides a customer with energy supply solutions (such as heating and lighting) rather than simply gas and electricity. An ESCo could provide a customer with a combination of energy-saving advice and equipment, renewable generation, planned maintenance, fuel and finance.* [20]

This would see suppliers move away from a business model based on selling units of gas and electricity, to one where the meeting the service need (the supply of energy as an outcome,[21] i.e. heat and power, rather than outputs, typically gas and electricity) of the consumer would be the primary driver. This would be achieved through a programme that included energy efficiency measures to improve the fabric of the dwelling, the installation of efficient appliances, and of which the supply of units of energy would be just one part. ESCOs would, in theory, exhibit a financial indifference towards how the service need was met, because provision of energy efficiency programmes would be as profitable to them as selling energy is today. The cost of energy efficiency improvements would be recovered from consumers over an extended period. Because the service need was being met, the consumer would be equally indifferent as to whether their energy bill paid for units of energy, or whether it paid for energy efficiency measures, provided the overall bill was no higher. If higher standards of comfort resulted or bills were actually reduced, consumers would receive a net benefit.

For a variety of reasons, there is little sign of this objective being met. One of the main problems is that a company would have no incentive to carry out energy efficiency measures unless it was sure of recovering its costs. This might be through locking the consumer’s energy supply in on a long-term contract, which defeats the purpose of retail competition; or through other, perhaps more damaging, ways of recouping the money such as debt recovery mechanisms.

Energy supply companies are currently required to deliver energy efficiency measures to consumers through the Carbon Emissions Reduction Target (CERT) obligation, and it is estimated that this costs a consumer with both a gas and electricity supply around £38 per annum.[22] CERT requires suppliers to achieve a specified level of carbon savings through a pre-approved range of measures/approaches. However, the level of investment, estimated at £2.8bn over three years, is determined by the target level of carbon savings, rather than by market needs. Although 40 per cent of carbon savings have to be achieved within the 'Priority Group', this element of the scheme is not specifically a fuel poverty programme; and the resultant level of investment (around £370m per annum) will not upgrade the housing stock sufficiently to make a large impression on the level of fuel poverty. If the energy service company model was to take off, the amount spent on energy efficiency would be determined by how much was economically justified. There must be a strong suspicion that this would have been far more than is paid for by the CERT scheme and its predecessors, especially with current energy prices. Such a model would also have produced substantial 'free' benefits for the housing sector.

Overall, an efficient ESCo market, provided it did not have the same in-built biases again low-income households that the current market has, is an intriguing and attractive way to deal with the problem of under-investment in energy efficiency measures. However, a large scale ESCo market is still a long way off and the role that nascent ESCOs can play in dealing with the current problems appears to be very limited.

6.3 Non-mainstream provision

The provision of social housing, increasingly the responsibility of housing associations rather than elected councils, does offer parallels with developments in the financial services and local public transport sectors where non-mainstream options - primarily credit unions and community transport - are being encouraged to fill the gaps left by the market and ensure provision to low-income groups.

7. Lessons for energy from other sectors

There are seven main areas where a comparison between energy and the other sectors examined provides interesting lessons for energy, particularly in how well markets serve low-income households:

1. The concentrated market structure;
2. The social issues raised by pre-payment meters and price differentials;
3. The role of the regulator;
4. The division of responsibilities between regulator and government;
5. Non-mainstream provision;
6. Dealing with sector poverty; and
7. Market solutions.

7.1 The concentrated market structure

It is open to question whether the fragmented market structure that market theory relies upon for efficient markets was feasible or even desirable for the energy industry. It is clear that the gas and electricity industries are now oligopolies composed of only a handful of companies. There is little likelihood of new entry and every chance that further mergers and takeovers will reduce the field of competing companies even more. The decision in 1998 to allow corporate integration of electricity generation and retail of gas and electricity (by electricity generators taking over retailers) made it almost inevitable that wholesale electricity markets would remain illiquid. It also made entry barriers for both generation and retail almost insurmountable.
The regulator and government has raised little or no objection to the mergers and takeovers that followed the 1998 decision, and any moves now to reduce the market power of the mainly foreign-owned companies would be hugely politically contentious.

It is difficult to draw comparisons with the other utility sectors. Water remains a regulated monopoly, while rail can never, for practical reasons, be a free market with easy entry and exit. The attempt to create a free market in buses was abandoned for a more planned approach after a decade of experience, which demonstrated that a free market would not deliver important social and environmental objectives for this sector. Whether a market is able to deliver the important social and environmental objectives that exist for energy, particularly reducing emissions of greenhouse gases, remains to be seen.

Telecoms remains concentrated with BT retaining a dominant market share in the household landline market, but it has been possible to gain new entry and the likelihood is that the telecoms landline market will become less concentrated. In part, this new entry has been possible due to the fortuitous introduction of broadband services, which allowed a new set of companies into the market who could bundle telecoms with broadband and television services. It is also due to the fact that a company offering telecoms services to final consumers does not have to undertake massive upfront expenditure or credit risk on the scale of, for example, building a new power station or signing a long-term contract for wholesale supply of gas.

7.2 The social issues raised by pre-payment meters and price differentials

Pre-payment meters for electricity and later gas were introduced on a large scale from 1992 onwards. Their introduction seems to have had more to do with political and corporate expediency – reducing the number of formal disconnections – than with any social welfare issues. The contrast with water is stark, where disconnections were quickly made illegal and pre-payment meters banned when it became clear that these measures were likely to cause serious hardship as well as having public health consequences. It is far from clear why government believed these measures were needed for water, but not for energy.
Pay-as-you-go mobile phones and, to a much lesser extent, pre-payment meters are popular with many of the consumers that use them because of the budgetary control they give. Consumers know they are not using any more energy or 'phone time than they can afford.

However, they raise two serious social welfare issues:

- They mask problems of affordability: instead of consumers who cannot afford their bills having disconnection enforced by their supplier, consumers initiate their 'self' disconnection. The disconnection rate would be a very useful indicator of the real affordability of energy supplies, were it not for the fact that it is currently near- impossible to estimate accurately the extent of self-disconnection;

- In a competitive market, they clearly identify consumers who have difficulty paying their bill. Competing companies may assume that these consumers are not as desirable as more affluent consumers, or they may believe that PPM users will be less price sensitive than other consumers because they are more likely to lack the skills and means to exploit the market, or they are blocked from switching because of debt. If the barriers to entry were not so high, it might be plausible that new niche companies would come in targeting PPM consumers in the way that there are companies that target pay-as-you go mobile phones and financial services companies that specialise in serving consumers with poor credit records.

It is interesting to contrast the government's and the energy regulator's defence of energy PPMs and disconnections with the government's attitude to water PPMs and disconnections. In water, disconnections and PPMs were quickly banned after they began to occur on a large scale. The large differentials between PPM and other methods of payment for energy have existed since the introduction of retail competition, but the regulator has showed little sign of concern until political pressures forced its hand in 2008, ten years after retail competition was introduced.

Before retail energy competition was introduced, the regulator required that the differential between PPM tariffs and standard credit tariffs should not exceed 5 per cent. At that time, direct debit use was much less common and on-line management of accounts was not available. These price controls proved effective in preventing PPM consumers paying disproportionately more for their energy. For water, the approach with metering cost is somewhat different but is still designed to ensure companies do not exploit a particular class of consumer. The water regulator requires that those whose consumption is metered should pay no more than the actual additional cost.

While the differential between PPM and other forms of payment has long existed, the biggest price differential is now between on-line direct debit and all other forms of payment. On average, on-line direct debit is about 20 per cent cheaper than either PPM or standard credit and is cheaper even than conventional direct debit. The reason for these differentials seems to stem from corporate priorities and, in part, reflects the inertia that is created by the difficulties that PPM and some standard credit customers face in switching to cheaper tariffs.

7.3 The role of the regulator

When the policy of privatising and introducing competition to public utilities, including telecoms, gas, water, electricity and rail, was introduced, the role of the regulator was ill-defined. Government rhetoric suggested that consumers could rely on markets and that the regulator would be no more than a ‘backstop’. This left consumers with little idea as to what they could expect from the regulator, or of where they stood in relation to the regulator. The architect of much of the regulatory regime and the electricity regulator for the first 10 years, Professor Stephen Littlechild, summed up the regulator’s role as ‘holding the fort until competition arrived’.[23] Reflecting this limited short term role, staffing levels were low. For example, Ofgem’s predecessor on the gas side, Ofgas, started work with a staff of 21 and the gas regulator suggested that this number would need to grow to only around 30 for regulation to be effective.

This vision quickly proved to be unrealistic on a number of grounds:

- Markets remained highly concentrated, generally oligopolies of no more than a handful of companies, meaning markets could not be left to operate without close regulatory supervision;

- The suggestion that markets would find ways to make even apparently permanent monopolies subject to competitive forces proved over-optimistic and regulators were required to continue setting monopoly prices using ever more elaborate, expensive and time-consuming methods;

- The companies have too frequently been found to be operating unfair practices. Regulators therefore need to monitor activities and check the information they are given by the companies. For example, electricity generators have continually been suspected of manipulating the wholesale market,[24] energy retailers have been guilty of mis-selling practices and water companies have misled the water regulator on leakage rates and bad debts, and have overestimated investment needs for the networks;

- The companies have not always maintained the sector networks to the standard required, most clearly for the rail network, but also the water network. With regards to the rail network, making up the deficit in maintenance has cost rail travellers dearly in terms of higher ticket prices and delay, leaving regulators with a major task in monitoring the condition of networks.[25]

Only three years after gas privatisation, electricity privatisation was accompanied with the creation of a regulatory body staffed by about 200 employees. Expectations that this level of staffing would only be needed in the early years while competition took hold also proved overly optimistic, with the staffing level and budget showing little sign of reducing even 20 years after the creation of an electricity regulatory body.

The telecoms utility sector has been the closest to the Littlechild model, with Ofcom now little involved in price-setting although, as the report on telecoms shows, Ofcom seems much more ready than Ofgem to act pro-actively on behalf of consumers where it suspects that the behaviour of companies is leading to consumer detriment. How far this reduction in the role of the regulator in telecoms can be attributed to good policy, and how far it can be attributed to very rapid technical progress, including the mass introduction of mobile phones and massive demand increases, is a moot point. Proposals to introduce competition to water do not seem realistic, except for perhaps the few very large users who already theoretically have some choice, and the regulator will inevitably continue to assume a central role in the industry.

In enacting the philosophy that regulation should be a temporary and diminishing presence, sector regulators have sought to minimise their interventions in a bid to leave competition unhindered. This has prompted questions over the extent to which regulators have become too passive and, as a result, have neglected their duty to protect the consumer interest. The government itself has contributed to the pressure on regulators to minimise their impact on industry through the Better Regulation Task Force (BRTF) set up in 1997 and replaced by the Better Regulation Commission (BRC) in 2005. The premise of these bodies has always been that regulation is unnecessarily intrusive on industry and should be cut back. For example, the BRTF's objective was 'to advise the Government on action to ensure that regulation and its enforcement are proportionate, accountable, consistent, transparent and targeted.'[26] While the BRC's remit is to to advise the Government on action to: 'reduce unnecessary regulatory and administrative burdens.'[27]

The contrast between the complacency of Ofgem when faced with rapidly rising prices in 2008 and OFT, who have been far more pro-active and whose threat is seen to be more credible than that of Ofgem, is particularly stark. OFT has threatened the banks that they would face stronger regulation and a full-blown investigation if they did not reduce their charges and make them more reflective of the costs they incurred in providing the service to consumers.[28] What was particularly telling was OFT's concern for low-income consumers. One of its key findings was:

> *First, there seems to be a substantial cross subsidisation from those consumers who incur insufficient funds charges to those who do not; and to a significant extent from 'vulnerable', low income and low saving consumers, to higher income, higher saving ones.*

Indeed, the Consumer Credit Act 2006 goes considerably further than its predecessors in the scope for enforcement by OFT, Trading Standards and the Courts. By contrast, in 2002, wholesale electricity prices collapsed but none of this price reduction was passed on to household consumers; in 2005, retail prices rose rapidly at a rate that did not seem to be justified by costs; in 2006, when wholesale prices fell, the reductions were not fully passed on to consumers; and in 2008, retail prices rose rapidly again. Ofgem only seemed to respond with the launch of its market probe after being forced to by pressure from consumer bodies and the government and after being pre-empted by the House of Commons Business & Enterprise Committee. Despite the large price differentials between payment methods appearing soon after retail competition was introduced a decade ago, Ofgem is yet to carry out any in-depth investigation examining whether such differentials are justified by additional costs.

7.4 Division of responsibilities between regulators and government

The role for independent regulators is to take decisions in consumers' interests that do not involve political judgement and are better taken by an 'independent' body not subject to political pressure. Government's role is to set the policy framework within which the regulatory body should work. Government makes the laws and the regulator makes quasi-judicial rulings, setting monopoly prices and laying down the rules of competition.
In practice, it is clear that regulators are not as independent as the theory would imply, and are not immune to political pressure. They are appointed by government and can be dismissed by government, and they share

their duties with the government minister, so it would be difficult for a regulator to pursue a policy that is not in agreement with or runs counter to the government. Of the sector regulators, the first regulatory body for rail came into most overt conflict with government and inevitably, and probably rightly, given that government is the elected representative of the public, it was government that prevailed.

The other side of the coin is the risk that for politically contentious issues where government is reluctant to get involved, government may try to place regulatory agencies in a policy-making role. Far from interfering, the government is abdicating its responsibility to make and enforce public policy. This is illustrated clearly with fuel poverty where it is now clear that, despite setting itself mandatory targets on reducing fuel poverty, government's efforts have been inadequate. It has had some success in raising incomes but its energy efficiency programmes, while useful, have proved far too limited. Government has relied on falls in energy prices to reduce the number of fuel poor despite it being clear that, in the medium term, prices were bound to rise, reflecting, for example, the need to reduce greenhouse gases and fossil fuel depletion. This has left Ofgem to take an important role in dealing with fuel poverty in an area where its scope for action is limited.

Of the other utility sectors, water remains a regulated monopoly, meaning the distortions that are apparent in energy markets do not arise. However, government acted decisively to ban disconnections and pre-payment meters for water. Communication and transport are not intrinsically linked with physical welfare in the way that water and energy are, so the issue is primarily one of social inclusion. Each household's need for communications and transport is unique to their own circumstances, meaning it is much less clear where consumers are not using these services as much as would be necessary for social inclusion

7.5 Non-mainstream provision

As argued above, the nature of energy – it is a standardised product - and its demand characteristics – it is an essential purchase - means that non-market provision will not easily flourish, because it is difficult to produce 'niche' products that exploit unfulfilled demand and which do not threaten the existing companies. In some countries, notably the USA, energy continues to be supplied by cooperatives, which originated in areas (mostly rural) that existing suppliers saw no economic incentive to serve.[29] These cooperatives remain protected monopolies and it is difficult to see how such organisations could now emerge in the EU. Whether creative thinking could produce new non-market ways of supplying energy is hard to determine. Woking Borough Council has set up Thameswey Energy Ltd, a not for profit joint venture, 'to invest in combined heat and power plant (energy stations), to sell heat and power in an environmentally friendly way, with a view to improving the environment within the Borough.'[30] This scheme is targeted at sheltered housing residents and has been successful in ensuring that the energy bills of all the residents represent no more than 6-7 per cent of the state pension.

In the medium- to long-term, non-mainstream provision could become more important if some of the promising technology options become commercial. Micro-generation options, such as wind power, solar panels, ground source heat pumps and micro-turbines (where the central heating boiler would be replaced by a gas turbine that would generate power as well as providing the hot water needed for space and water-heating) could allow consumers to reduce their dependence on the commercial energy market and potentially even profit from selling surplus power back to the grid. Local supply options, such as combined heat and power and district heating, could also reduce households' dependence on the national market.

7.6 Sector poverty

For some of the sectors, it is a difficult judgement whether there is specific sector poverty. Are the households that are finding it difficult to purchase enough of the necessities struggling because of their specific needs, or simply because their income is too low? If it is the latter, then the fundamental solution is increasing their income.

There are issues for low-income households in rural locations that cross a number of sectors. For example, rural households may find it more difficult to access financial services, they may have to pay more for food and drink because shops are either further away or not subject to the strong competitive pressure that are evident in towns and cities. They may also have particular problems with transport because public transport services are sparse and petrol prices are often higher than in towns and cities. For energy, the main issue for rural consumers is whether they have access to a gas supply. As government data shows, households that do not have a gas supply are much more likely to be fuel poor than those that do. However, it might not prove economically feasible to provide a gas connection to many of those in a rural location who do not already have one.

Apart from the issues outlined above for rural consumers, in telecoms, food and drink and financial services, sector poverty is not a major factor. Therefore, probably the best way to help low income consumers would be to increase their overall income. For transport, everyone's needs are different depending on a number of factors including where they live and how far they have to travel to work. Some concessions exist, notably for pensioners, students and the unemployed, but these do not address the problems of working age families. The issue of payment method differentials, which contributes significantly to fuel poverty, is discussed above. It is far more pronounced than for other purchases and reducing these differentials, so that the methods of payment used by low-income households were closer to other payment methods, would go a significant way to assisting low-income consumers and reducing fuel poverty.

'Housing poverty' does arguably exist, as the affordability of housing is influenced as much by the location, size and condition of the property as it is by disposable income. Government policy recognises this with the very extensive and complex Housing Benefit system that directly subsidises rental costs and is, in some instances, paid direct to the provider (landlord). Housing Benefit is unusual amongst support mechanisms for essential services in that it will subsidise up to 100 per cent of the recipient's 'eligible' rent.

'Water poverty' does exist to a certain extent, in part because of the arcane method of charging that exists. For metered households, there are demand side measures that can be taken to mitigate the risk of water poverty, for example efficient toilets, washing machines etc. to reduce demand whilst providing the same service. However, energy is very different from the other sectors in the extent to which there is the scope to take demand side measures which could allow households to get the same or better energy service as they get now but, at the same or, potentially, lower cost. Conservation is the perfect example of a win-win solution. In the longer term, microgeneration technologies may, in conjunction with energy efficiency measures, also play an important role in achieving this outcome.

In part, more efficient appliances, particularly fridges, washing machines, televisions and lighting, would help. But it is improvements to the fabric of housing that hold the most potential for reducing fuel poverty, and the interaction between the housing sector and the energy sector is particularly important. Measures to improve the housing stock would contribute to achieving a number of policy objectives, including improving health and welfare, reducing emissions of greenhouse gases as well as effectively permanently reducing fuel poverty. It is therefore all the more bewildering that the government chooses a time of rising energy prices to reduce spending on Warm Front, its flagship energy efficiency programme in England.

7.7 Market solutions

In the long-term, energy efficiency measures have the greatest scope for removing households from fuel poverty. However, if, as we argue, prices are higher than an efficient, competitive market should be delivering, especially for low-income households, and if nothing is done to tackle the market problems identified in this report, the cost of energy will remain at punitive levels. This will inevitably have a knock-on effect in driving up the costs of the energy efficiency measures needed to deal with fuel poverty, as the efficacy of mainstream measures is compromised, prompting a shift towards 'super' energy efficiency measures. This would mean that the costs of fuel poverty proofing the fabric of a building would inevitably be higher than would be the case if energy prices were set at their efficient level. In the short-medium term, tariff and income policies are required that will assist low-income consumers until such time energy efficiency programmes can identify and assist them. The need for a fit for purpose energy efficiency programme does not detract from the need to address the market problems identified here.

The immediate priority is to get through the next couple of winters without high energy prices leading to major social and health problems. The number of households now in fuel poverty is likely to top 5 million in the UK.[31] Targeted tariff assistance which adheres to appropriate minimum standards has the potential to play a positive role providing immediate and effective assistance to those most in need. However, if the companies can afford to put several hundred million pounds (the sort of sum needed to make a significant impact) of genuinely new money (i.e. not recovered from other consumers) into such schemes, that would pose further questions about the profit levels that the companies enjoy. If the companies were allowed, or required, to recover the money to fund social tariffs from other consumers, a permanent cross-subsidy would be needed for this purpose. This would have to remain in place until such time that energy efficiency interventions had lifted households out of fuel poverty permanently.

Some observers[32] have argued that a 'windfall tax' is justifiable on the grounds that the energy generation companies (who in nearly all cases are the same companies that also supply consumers) are making unearned profits. Such unearned profits should, it is argued, be clawed back to benefit those who have been hit hardest by high energy prices. These profits come from trading emissions certificates issued free of charge to existing generating stations under the European Union Emissions Trading System (EU ETS). However, given the environmental objectives underpinning the EU ETS, there is likely to be a strong countervailing argument that any such proceeds should be used to fund initiatives that reduce greenhouse gas emissions. Paying to subsidise consumption in the way that providing short-term assistance on energy bills requires, would be at odds with the objectives of the EU ETS.

If a windfall tax was imposed and the proceeds were directed to providing short-term assistance to pay the energy bills of those most in need, it could prevent some of the worst consequences of the high energy prices in the winter of 2008/09. However, it would do nothing to eliminate the structural failings that lie behind the current problems. It would not deal with the uncompetitive market structure that leads to suspicions whenever prices rise (or fail to fall) that the companies are exploiting their oligopolistic positions. If it was directed solely at paying energy bills it would also do nothing to address the poor condition of the British housing stock, especially that used by low-income households.

One simple measure that could make a useful difference would be to dramatically reduce the differentials between the payment methods. This might involve raising prices for direct debit consumers but, unless companies can provide significantly more convincing evidence that existing differentials are justified by cost differences, this would be a legitimate course of action. The regressive cross-subsidy that is apparent in these differentials cannot be justified.

In the longer term, the onus is on Ofgem to identify solutions to the serious market deficiencies identified here and, for example, by the Business & Enterprise Committee. If the outcome of its market probe and the solutions therein are not satisfactory, the Secretary of State has the power to refer the energy market to the Competition Commission, should he see fit to do so. It seems unlikely that cosmetic 'technical fixes' to the wholesale market can solve these. The problems seem to lie in the concentrated structure of the market and this can only be dealt with either by breaking up the companies, or applying much more rigorous regulation so that companies are not able to exploit their dominant positions.

Summary of conclusions

This report examines how well competitive markets are serving low-income households when they purchase essential products and services. It looks at seven sectors, including energy, and attempts to determine whether lessons for energy can be drawn from the way in which low-income households are dealt with in the other sectors. The role competitive markets play for these purchases ranges from negligible in the case of water, which remains a regulated monopoly, to a dominant role, as in the case of food & drink.

The level of specific public support to ensure low-income households are able to secure provision of these goods and services at a level adequate to ensure their physical and mental well-being also varies markedly. There is a very extensive and complex support regime provided for the housing sector, while for water, financial services and food and drink, specific support is very limited. The extent of third sector and industry sponsored initiatives also varies greatly across sectors.

We conclude that there are significant problems with the operation of the markets in all those sectors we look at that are, to a greater or less extent, operated as commercial markets. That said, the way in which the water sector operates (the only remaining regulated monopoly) seems to serve low-income consumers little better.

The nature of the products

Free markets work best under quite specific conditions and for the products and services examined here, these conditions remain a long way from being met. The prefect market can be portrayed as a large number of market stalls, all selling identical or near identical goods with prominently displayed prices. This allows the buyer to easily identify and opt for the cheapest deal, and forces sellers to match the lowest price on offer if they are to sell any goods. No real market meets this ideal and, of the sectors here, only food and drink could conceivably come close.

These problems make an efficient search process crucial if consumers are to get the best deal. Access to price comparison sites and to the internet in general is near essential for the search process. Low-income households might not enjoy access to an internet-ready computer, or might lack the confidence and/or competence required to carry out searches effectively. Household circumstances and commitments can also mean it is difficult to dedicate the time required to carry out such searches.

Corporate concentration

In all the competitive sectors, except housing and perhaps financial services, there is a high degree of corporate concentration, meaning that consumers only have a limited field of main suppliers to choose from. This is likely to mean that companies can charge higher prices than would be sustainable in a more competitive market. Whether this degree of concentration is inevitable is a moot point; for example, scale economies might give large suppliers such an overwhelming advantage that small companies cannot challenge this dominance, or even survive in some instances. However, any market with only a handful of main players is inevitably going to fall into competition authorities' category of 'concentrated' or 'highly concentrated'. This generally requires that the dominant companies be broken up to prevent them exploiting their dominant positions or, if this is not possible or not prudent, that measures be taken to mitigate the market power of these large companies.

The problem of a concentrated market restricts choice for all classes of consumer but, again, the need for an efficient search process so that advantage can be taken of the competitive forces that do exist is crucial. Those low-income consumers who are not in a position to take advantage of competitive forces in this way are left exposed to inflated prices.

Sector regulators

The monopoly and former monopoly sectors (water, energy, rail and telecoms) are now regulated by sector regulators. These have duties to set prices for any remaining monopolies and also to oversee the operation of their respective markets. In general, these regulators, who have a statutory duty to guard the interests of consumers, have sought to regulate with a 'light touch'. This has been encouraged by the government and, in particular, by its 'Better Regulation Taskforce', and also by regulators' general belief in the efficacy of markets, which reinforces a reluctance to hamper the action of markets.

In some instances, this light touch seems to have resulted in some regulators failing to take a pro-active attitude to imposing competition and only intervening when, for example, political and public pressure becomes overwhelming. This was well illustrated by the apparent reluctance of the energy regulator, Ofgem, to acknowledge that energy markets were not working well in early 2008. The energy regulator has also been particularly complacent in allowing a large, regressive price differential to grow between the forms of payment most often used by low-income households and those most accessible to more affluent households. Pre-payment meter and standard credit tariffs are on average about 25 per cent higher than on-line direct debit tariffs, despite there being no evidence that current differentials are justified by higher costs to serve.

Is a regulated monopoly preferable?

The remaining monopoly service, water, is scarcely any better at catering for the needs of low-income households than the competitive sectors. In theory, a monopoly can, more easily, be regulated to cater for the interests of low-income consumers. In the competitive sectors, any measures designed to help low-income households are inevitably portrayed as compromising the market and reducing its efficiency.
The British government, perhaps because of its political commitment to allow markets to work unhindered, seems reluctant to impose requirements and conditions on commercial companies. In energy, the government has demonstrated an increasing reliance on voluntary schemes, even though commercial companies are unlikely to voluntarily offer enough resources to allow such schemes to make a real difference to low-income consumers.

Lessons for energy

None of the other six sectors seem to offer straightforward lessons for energy, even though energy appears to be more systematically stacked against low-income consumers than the other sectors. There is scope in the future for greater third sector involvement along the lines of that seen in the housing, public transport and financial service sectors, but this first requires the energy market to evolve to the stage where numerous, potentially locally focused, ESCOs compete to deliver a comprehensive package of energy services. Such a development would both complement and be further stimulated by greater development of decentralised approaches to energy provision. However, if the status quo continues and the retail of units through a national network remains the norm, all but large scale enterprises are closed out, meaning that non-mainstream approaches can play only a peripheral role at best.

This bias that the energy market displays against low-income consumers partly reflects the emphasis this market places on the need for frequent, resource-intensive searches by consumers to ensure they are getting the best deal for energy. However, this bias is most readily apparent in the price differentials noted above. If low-income consumers were charged no more than the price of suppliers' lowest tariffs, a significant number of households would no longer fall into the category of fuel-poor.

Government and the regulator seem reluctant to take the measures necessary to either make markets work or, where markets cannot work, take the necessary steps to protect low-income consumers.

Neither the government nor the regulator have acted to prevent the remarkable level of corporate concentration and integration that has taken place in the past decade. And government seems to be complicit in allowing further concentration by tacitly encouraging the take-over of the only remaining major independent generation company by one of the 'big six' integrated energy companies.[33]

Despite professing concern on a number of occasions, neither government nor the regulator have shown the appetite required to either deal with the blatantly unfair price differentials that impact disproportionately on low-income households, or to impose mandatory minimum standards on 'social tariff' schemes that will ensure recipients can access tariff rates that are more favourable than suppliers' open market rates.

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Notes

1 There are various definitions of social inclusion/exclusion, but the UK government's Social Exclusion Unit, when it was set up in 1997, defined social exclusion as: 'A shorthand label for what can happen when people or areas suffer from a combination of linked problems such as unemployment, poor skills, low income, poor housing, high crime, bad health and family breakdown.'

2 National Consumer Council (1977) 'Why the poor pay more', National Consumer Council, London.

3 National Consumer Council (2004) 'Paying more, getting less' National Consumer Council, London. http://www.ncc.org.uk/nccpdf/poldocs/NCC068_poor_pay_more.pdf

4 http://www.ncc.org.uk/nccpdf/poldocs/NCC068_poor_pay_more.pdf,

5 Energy, communications, financial services, food and drink and public transport.

6 Note that in 2002, when the wholesale price apparently fell by 40 per cent, none of this price reduction was passed on to household consumers.

7 http://news.bbc.co.uk/go/pr/fr/-/1/hi/business/7508982.stm

8 MacLaine, D, 1999. The UK Electricity supply market. Financial Times Energy, London.

9 http://www.energywatch.org.uk/uploads/The_New_Confidence_Code_and_Code_Guidance_29_April_20081.PDF

10 http://www.publications.parliament.uk/pa/cm200708/cmselect/cmberr/293/293ii.pdf

11 energywatch is also an NDPB.

12 http://www.gmb.org.uk/Templates/Internal.asp?NodeID=97288

13 http://www.publications.parliament.uk/pa/cm200708/cmselect/cmberr/uc293-vi/uc29302.htm

14 http://www.berr.gov.uk/files/file45365.pdf,

15 Ofgem reported (http://www.ofgem.gov.uk/Markets/RetMkts/Compl/SLR/Documents1/16507-217_06.pdf) 'Between July and September 2005 1,218 security deposits were being held by suppliers in the electricity market. Of these 436 had been held for more than 12 months and the average value of the deposit was £112.47p. Between July and September 2005 4,662 security deposits were being held by suppliers in the gas market. Of these 1,701 had been held for more than 12 months and the average value of the deposit was £147.76p.'

16 http://www.ofgem.gov.uk/Markets/RetMkts/Compl/SLR/Documents1/SLR%20Final%20Proposals%20Decision%20Doc.pdf

17 http://www.eci.ox.ac.uk/research/energy/downloads/bmt-report4.pdf

18 See for example: http://www.ofgem.gov.uk/Sustainability/Environmnt/EnergyEff/Documents1/2073-escos2002.pdf

19 http://www.london.gov.uk/mayor/environment/energy/partnership-steering-group/docs/making-escos-work.pdf

20 Meeting the energy challenge: A White Paper on Energy, DTI, 2007, p99: http://www.berr.gov.uk/files/file39387.pdf

21 http://www.defra.gov.uk/environment/climatechange/uk/energy/energyservices/documents/workshop-070508-overview.pdf

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23 Beesley, M & Littlechild, S (1989) 'The regulation of privatized monopolies in the United Kingdom', Rand Journal of Economics, 20, 3, 454–72.

24 See, for example, http://business.timesonline.co.uk/tol/business/industry_sectors/utilities/article3708590.ece

25 In fact, it was estimated in 2007 that since privatisation, the cost of running the British rail network has increased three-fold. To pay for this, the government subsidy has quadrupled and income from passengers has more than doubled. http://www.timesonline.co.uk/tol/travel/article2056540.ece

26 http://www.corporateaccountability.org/regulation/brtf/main.htm

27 http://archive.cabinetoffice.gov.uk/brc/about_us.html

28 http://www.oft.gov.uk/shared_oft/reports/financial_products/OFT1005.pdf

29 See for example http://www.nreca.org/

30 http://www.woking.gov.uk/environment/climate/Greeninitiatives/sustainablewoking/thameswey.pdf

31 The National Housing Federation estimated in September 2008 that, by the end of 2009, nearly a quarter of UK households, 5.7 million, would be fuel poor.
http://www.housing.org.uk/default.aspx?tabid=254&mid=828&ctl=Details&ArticleID=1391

32 See for example: http://www.compassonline.org.uk/campaigns/campaign.asp?n=2773

33 See for example: http://business.timesonline.co.uk/tol/business/industry_sectors/utilities/article4760960.eceSee for example: http://business.timesonline.co.uk/tol/business/industry_sectors/utilities/article4760960.ece