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.

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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 Department for Transport	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. 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.

References

J Bradshaw et al. (2008) 'A minimum income standard for Britain: What people think' Joseph Rowntree Foundation.

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

22 http://www.defra.gov.uk/environment/climatechange/uk/household/supplier/cert.htm

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