University of BRISTOL
Personal Finance Research Centre

The Poverty Premium

When low-income households pay more for essential goods and services

Using pre-payment meters
£38

Not switched to best fuel tariff
£233

Paying to receive paper bills
£12

Using higher-cost credit
£55

Paying to access money
£9

Not paying by cheapest billing method
£33

Insuring specific items
£27

The average annual poverty premium per low-income household is
£490

Premiums related to where people live
£84

In the UK the poverty premium – the idea that the poor pay more for essential goods and services – is an important social policy concern for low-income families. Providing a timely update to earlier research, this study reflects markets and household behaviour as it exists today, and, for the first time, explores how *many* low-income households are actually affected by the poverty premium, and by how much.

KEY POINTS

We estimate that the average cost of the poverty premium is **£490** per household per year. This is lower than the previous estimate of around £1,300 per year (Save the Children, 2010). The difference is largely explained by the fact that we take into account the proportion of households that incur each of the eight components that make up our poverty premium.

Not all low-income households experience all components of the poverty premium. We identified seven distinct clusters of poverty premiums experienced by low-income households. Their different exposure ranged from experiencing an average of only three types of premiums, to an average of eight. Based on these patterns of exposure, the cost incurred by households ranged from an average of **£350** among the 'premium minimisers' to **£750** among the 'highly exposed'.

"Averages can mask significant variation in the lived experience of the poverty premium. One 'highly exposed' family for example is estimated to incur a premium of £1,680 per year, considerably more than the average premium of £750 for their cluster."

The largest share of the average premium incurred by low-income households related directly to low-income households who had not switched household fuel tariff. This was compounded by other, albeit much smaller, premiums associated with households' fuel payment methods. And, even a household that had switched to the best prepayment meter tariff could still expect to incur an estimated premium of £227 compared to the best deals available to those who pay by monthly direct debit.

It is important to remember that the poverty premium reflects the additional costs low-income households pay for goods and services compared to those on higher incomes. It does not take into account the extent to which low-income households avoid paying poverty premiums simply because they can't afford to and instead go without.

The findings of this research suggest that there is still scope for the poverty premium to be reduced, and there is a role for providers, government and regulators to help address it. Central to the solution may be striking a better balance between cost-reflective pricing and cross-subsidy (where cross-subsidy is possible) and roles for greater partnerships and involvement of trusted intermediaries. The clearest priorities for action relate to insurance, higher-cost credit, and fuel.

WHY IS THE POVERTY PREMIUM IMPORTANT?

The significance of the poverty premium is that it exacerbates poverty and adds to the difficulties low-income households face in making ends meet. In low-income households, even small amounts of extra income can make a difference. Therefore, tackling the poverty premium is a key component of poverty reduction.

UNDERSTANDING THE POVERTY PREMIUM

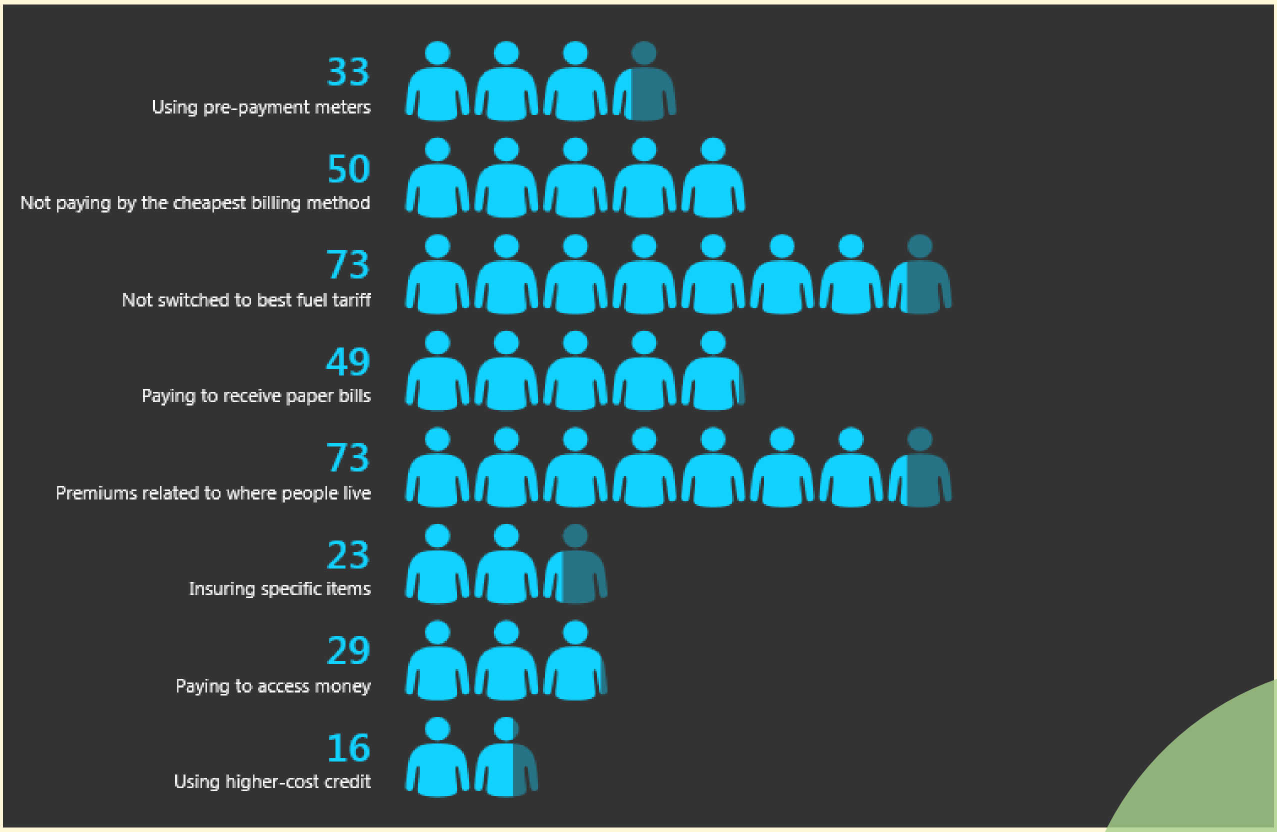
The poverty premium arises for a mixture of reasons:

1. **Demand-side** factors which relate broadly to the needs and preferences of low-income consumers.
2. **Supply-side** factors which reflect how markets shape the choices available to consumers and impose additional costs on them.
3. **Compounding** factors such as financial and digital exclusion and geography.

From this understanding, we identified 29 individual premiums across eight different components, these components reflect the extent to which they are more or less imposed on low-income households or driven by the complex choices households find themselves making.

The contribution of each component to the overall poverty premium derives from both its incidence and the size of the calculated cost of the premium. In other words, some components are problematic for low-income households because a large number of households incur a poverty premium (i.e. they are broad) such as premiums associated with where the household lives; insurance (particularly car insurance) and difficulties in accessing low-cost supermarkets. Other premiums are problematic because a small minority incur a very large premium (i.e. they are deep); for example, although it was unusual for households to have used high-cost credit those who did incurred the highest costs overall – up to £540 per year for some types of borrowing. And other premiums still, such as not being on the best fuel tariff, are problematic because large costs are incurred by large numbers of low-income households (i.e. they are both broad and deep).

PERCENTAGE OF LOW-INCOME HOUSEHOLDS INCURRING PREMIUM TYPES



IMPACT OF THE POVERTY PREMIUM

The average poverty premium of £490 per year is undoubtedly a significant sum to low-income households. It might represent a family holiday, enough clothes and shoes for the children, keeping the home warm in the coldest winter months, all things considered important for a reasonable quality of life and avoidance of social and material deprivation. Further analysis showed that the hardest hit by the poverty premium were single-adult households followed closely by lone parents. Although single adults incur the lowest poverty premium cost, their lower household income means that the financial impact of the premium to them is greatest, leaving them needing almost three weeks' additional income each year just to cover it.

WHAT NEXT FOR THE POVERTY PREMIUM AND POLICY?

Our study offers a nuanced and detailed picture of the poverty premium as experienced by different types of low-income households. It also provides a much-needed 'proof' that the poor are not an homogenous group. In particular, it highlights how important it is to distinguish those who regularly use higher-cost consumer credit from those who do not, as this makes a very big difference in the size of the premium incurred overall. The analysis provides a clear focus on the range of overall costs experienced in core areas of household expenditure and by different clusters of households.

In policy terms, a particular challenge facing the UK (and elsewhere) is increasing 'marketisation', and the current emphasis on switching as a solution to perceived market failures. This implies an increasing responsibility on households not to incur a premium, rather than on suppliers not to charge it and industry bodies and government to regulate it. It is likely that low-income households are the least equipped to avoid premiums. The supply and provision of goods and services does not adequately account for how people on low incomes often prefer to manage their money, or their sensitivity to the risks associated with upsetting close budgeting control and as such indicates a market failure.

ABOUT THE RESEARCH

Using previous research and new qualitative data we developed an overarching conceptual framework for the poverty premium, to understand why different premiums arise and the underlying conditions that make low-income households vulnerable to them. For each poverty premium that we identified, we calculated a nominal cost, and by measuring the proportion of low-income households exposed to each premium we estimated the average, experienced, cost of the poverty premium. Finally we conducted a segmentation analysis of low-income households based on their patterns of exposure to it, to offer a detailed and nuanced understanding of how the poverty premium is experienced by low-income households. In doing so, we identified seven different clusters of exposure to the poverty premium and for each, provided an estimate of the cost these households incur.

FURTHER INFORMATION

The full report, *Paying to be poor: uncovering the scale and nature of the poverty premium*, by Sara Davies, Andrea Finney and Yvette Hartfree from the University of Bristol's Personal Finance Research Centre, is available to download at

www.bristol.ac.uk/geography/research/pfrc

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