



**FAIR BY DESIGN**

Ending the extra costs of being poor



*Action for Warm Homes*

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# SOLVING THE COST OF LIVING CRISIS

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The case for a new social tariff  
in the energy market

# THE CASE FOR A NEW SOCIAL TARIFF IN THE ENERGY MARKET

**Low income energy customers face a double burden from the current energy crisis: the rising cost of bills and paying more for their energy due to the poverty premium.**

The government must introduce a new social tariff to lower the cost of bills for low income households.

A social tariff is a targeted discount energy deal for qualifying low income consumers. It is a safety net for eligible households who might be struggling to afford their bills. It is typically below the price of the cheapest available energy tariff and targeted at those living in fuel poverty or on a low income.

**LOW  
INCOME ENERGY  
CUSTOMERS FACE  
A DOUBLE BURDEN**



**THE RISING COST OF BILLS  
& PAYING MORE FOR  
THEIR ENERGY DUE TO THE  
POVERTY PREMIUM**



## The new social tariff in the energy market must:



- **Be additional to the Warm Home Discount and Default Tariff Price Cap.** These policies perform different functions which would not be included in a social tariff.
- **Be mandated across all suppliers** so that those who qualify for a social tariff do not lose out because their supplier has not gone as far as other suppliers.
- **Be targeted at those most in need:** low income and vulnerable households that use prepayment meters are currently disadvantaged by the market. They must be a priority group benefitting from the introduction of a social tariff.
- **Reduce costs for consumers:** at a minimum the new social tariff must help vulnerable consumers reduce their energy costs and be priced below the default tariff price cap.
- **Auto-enrol all eligible consumers:** this can be done using suppliers' existing customer data and/or via data sharing with the Department for Work and Pensions (DWP).

## In order to create a new social tariff we need:



- **Government** to consult on how best to implement a social tariff as soon as possible.
- **MPs** from all political parties to come together to show support for the introduction of a social tariff by raising it in debates in parliament.
- **Energy suppliers** to use their platforms to show support for the social tariff and share ways it can be implemented successfully.
- **Civil society organisations** to show their support for the social tariff by lobbying government and MPs, by using the arguments and explanations in this briefing report.

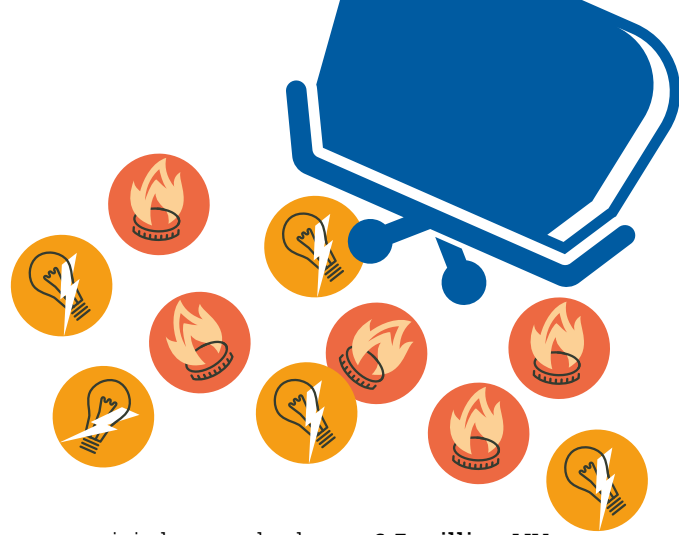
# THE EFFECTS OF THE ENERGY CRISIS ON LOW INCOME HOUSEHOLDS

While energy price rises affect everyone, the impacts are not felt the same by everybody. Low income consumers face a double burden of the rising cost of bills as well as paying more for their energy due to the poverty premium.

The cost of gas and electricity has skyrocketed, mostly due to rises in wholesale costs. Ofgem's price cap restricts how much a supplier can charge consumers for energy, but the price cap alone can only restrict price rises that are deemed unreasonable by the regulator. The cap will not protect against **unaffordable** price rises that the regulator considers reasonable such as any increases in the cost to suppliers buying gas.

Since April 2022, the price cap has **risen by 54% to nearly £2,000**. In October 2022 energy bills are predicted to rise to an average of **£2,800 a year**, a further increase of over 40%<sup>1</sup>.

Sharp rises in the cost of energy will increase the number of people who pay **over 10% of their income** on household energy costs, also known as fuel poverty.



The energy crisis has pushed **over 6.5 million** UK households into fuel poverty, **up from 4 million** in October 2021. If the predictions are correct, then a **further 5.5 million** people will be pushed into fuel poverty this year, **totalling 12m**<sup>2</sup>.

## THE POVERTY PREMIUM IN THE ENERGY MARKET

The poverty premium describes the extra costs people on low incomes pay for essential services such as energy, credit, insurance, transport, and food.

Sometimes the poverty premium reflects the extra costs to supply low income customers with a product: such as using a prepayment meter for paying for energy<sup>3</sup>. Sometimes it is because the ways of getting the cheapest deal are inaccessible for low income customers: such as requiring all consumers to compare online offers by suppliers to find the best available deal. It also manifests itself in the poor quality housing that many low income households live in, where they are unlikely able to afford to make modifications which would improve energy efficiency.

The poverty premium proves what we have known for a long time: it's very expensive to be poor. And while the Government has a plan to make low income homes more energy efficient, it's vital we find ways to remove the extra costs faced in the market for those on low incomes.

1 <https://www.theguardian.com/business/2022/may/24/energy-bills-likely-to-rise-by-800-in-october-says-ofgem-chief>

2 <https://www.bbc.co.uk/news/business-61562657>

3 Households using prepayment meters are typically on low incomes. These meters are often imposed on households or they are useful for households as a way of managing budgets. There are extra costs associated with being on a prepayment meter for the supplier that are then passed on to customers.

## NEEDING MORE THAN MARKET SWITCHING AND THE PRICE CAP

Despite the Competition and Markets Authority (CMA) stating<sup>4</sup> that people should not be required to spend significant lengths of time negotiating a good deal – or feel that they must be ‘on guard’ against being ripped off – there continues to be an expectation that active consumers must be willing and able to shop around to access the best deals<sup>5</sup>.

The social tariff is a long-term solution to the non-switching penalty. It guarantees a low cost option for households unable to actively engage in market comparisons or switching.

Research has shown that the price difference between the more expensive Standard Variable Tariff (which many low income households stay on) and the best online-only fixed tariff was £213 in 2019. The price difference between the best pre-payment meter tariff and the best online-only fixed tariff was £131<sup>6</sup>. **Even with the energy price cap<sup>7</sup> there are big price differences for low income households.** While there are few cheap fixed deals available on the market right now, it is expected they will return.



4 <https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint>

5 <https://fairbydesign.com/wp-content/uploads/2020/11/The-poverty-premium-A-Customer-Perspective-Report.pdf>

6 *ibid*

7 <https://www.moneysavingexpert.com/utilities/what-is-the-energy-price-cap/>

## SOCIAL TARIFFS IN THE 2000s

Social tariffs are not a new concept in the energy market. In the 2000s, it existed on a voluntary basis as an attempt by Government to protect the poorest consumers from fuel price rises without the need to interfere in the market or invest excessive amounts of public money. However, this voluntary support had limited success. It was not well targeted on fuel poor households, and the fact that it was voluntary created a scattergun effect.

The social tariff provides additional protections to the price cap for low income energy customers. It provides a solution for consumers who experience the poverty premium.

## THE INTRODUCTION OF OTHER PROTECTIONS

In 2011, the social tariff was replaced by a new price protection, the Warm Home Discount (WHD) scheme. This scheme is now automatically targeted at low income households providing a £150 rebate every year. The scheme is embedded in legislation until 2026.

In 2018, the CMA recommended introducing a price cap for prepayment users, where suppliers could charge a maximum unit rate and standing charge. This was then made available to other vulnerable energy customers through the Default Tariff price cap which integrated the different caps for different energy customers.

The price cap has been positive for energy customers. It resulted in good outcomes and lower prices. However we are in a much different situation now with the cost of living crisis. We need additional protections to help those households unable to afford the price of energy.

## SOLUTIONS TO THE COST OF LIVING CRISIS

The Government's response to the cost of living crisis has been to raise money for emergency measures, helping households in the short term to cover their bills. A longer term solution now needs to be found to make energy bills affordable.

The WHD and the price cap provide important functions in the energy market. But together, as they are currently structured, they are not enough to protect those energy consumers most vulnerable to sharp price increases, which is why a new targeted social tariff is now needed in the energy market.

For the social tariff to provide the protections needed for consumers, it must meet the following minimum requirements.

### **The new social tariff must:**

- **Be additional** to the Warm Home Discount and Default Tariff Price Cap. These policies perform different functions that cannot be replicated by a social tariff.
- **Be mandated across all suppliers:** this will mean that those who qualify for a social tariff do not lose out because their supplier has not gone as far as other suppliers.
- **Be targeted at those most in need:** low income and vulnerable households that use prepayment meters are currently seeing significant detriment in the market. They must be a priority group benefitting from the introduction of a social tariff.
- **Reduce costs for consumers:** at a minimum the new social tariff must help vulnerable consumers reduce their energy costs and be priced below the default tariff price cap.
- **Auto-enrol all eligible consumers:** this can be done using suppliers' existing customer data and/or via data sharing with the Department for Work and Pensions (DWP).



# THE ORDER PLAN FOR IMPLEMENTING A SOCIAL TARIFF

## A social tariff can be implemented in two ways.

The first, unilaterally through Ofgem. This could be a new tariff that would apply to all pre-payment meter customers and would not require legislation. This could be done relatively quickly.

The second way (which would follow on from the first) would require government to pass legislation. After this is passed, a larger group of low income energy customers will be eligible for the social tariff. It will take longer than the first part but is more ambitious.

Type of Social Tariff	Example of the tariff	Implementation
<p><b>Social tariff part 1:</b></p> <p><b>Implemented by Ofgem, without legislation</b></p>	<p>Bringing price cap for pre-payment users down to the level of direct debit customers, saving them £50 every year. This would meet all of the criteria set out above.</p>	<p>This could be implemented unilaterally by Ofgem, without the need for additional legislation.</p> <p>This would mirror the moves taken previously by Ofgem to create the safeguard tariff<sup>8</sup>, which applied to all households who used a pre-payment meter and/or were part of the Warm Home Discount's "core group" of beneficiaries.</p>
<p><b>Social tariff part 2:</b></p> <p><b>Implemented by government, with legislation</b></p>	<p>A bespoke price cap for low income and vulnerable energy customers, saving them hundreds of pounds when compared to the default tariff price cap.</p>	<p>To achieve such a saving, new legislation would be necessary. This could likely be achieved in the short term through either the Energy Security Bill, which will consider the long term future of the price cap, or through a Private Members Bill.</p>

<sup>8</sup> <https://www.ofgem.gov.uk/publications/ofgem-acts-cut-1-million-vulnerable-households-bills>

## FUNDING FOR A SOCIAL TARIFF

Scottish Power chief executive, Keith Anderson, told MPs that the introduction of a £1,000 deficit fund or social tariff for vulnerable customers (which, if introduced, would take £1,000 off the bills of the poorest people in the country) could be recouped either from government or consumer bills<sup>9</sup>.

### Options for funding a social tariff include:



- **General taxation.** This would mean the government raising money to fund the discounted social tariff for households identified as most vulnerable to energy price rises.
- **Cross-subsidy across the energy market.** This would mean policy costs (in other words, the costs that make up an energy bill<sup>10</sup>) are placed onto bills to fund the tariff.

If implemented, the social tariff will mean millions of people across the country pay an affordable price for their energy. It is an opportunity to make sure consumers are resilient against energy price shocks now and in the future.

<sup>9</sup> <https://www.theguardian.com/business/2022/apr/19/energy-chiefs-fear-40-of-britons-could-fall-into-fuel-poverty-in-truly-horrific-winter>

<sup>10</sup> <https://www.ofgem.gov.uk/information-consumers/energy-advice-households/costs-your-energy-bill>

## ABOUT US



Action for Warm Homes

### About National Energy Action (NEA)

NEA works across England, Wales and Northern Ireland to ensure that everyone in the UK can afford to live in a warm, healthy home. NEA also provides the secretariat for the All-Party Parliamentary Fuel Poverty & Energy Efficiency Group (FPEEG) to raise awareness of fuel poverty and stimulate cross-party debate about the need to make energy costs more affordable.

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### FAIR BY DESIGN

#### About Fair By Design

Fair By Design (FBD) is dedicated to reshaping essential services, such as energy, credit and insurance, so that they don't cost more if you're poor. People in poverty pay more for a range of products, including energy, through prepayment meters and more expensive standard variable tariffs; credit, through high interest loans and credit cards; insurance, through postcodes considered higher risk; and payments, by not being able to benefit from direct debits as they are presently structured. This is known as the poverty premium.

Fair By Design collaborates with regulators, government, and industry to design out the poverty premium. Our Venture Fund provides capital/funding to grow new and scalable ventures to innovate the market and design out the poverty premium. Ascension Ventures manages the Fair By Design Fund.



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