Measuring the Poverty Penalty in the UK

People with limited financial resources can face additional costs for essential goods and services. This is a challenge for the new British government to address, and a problem that must be reflected in government statistics, say Kingsley Purdam, Sam Royston and Graham Whitham.

August 2017

Draft

Forthcoming in Significance
Introduction

The morning after the UK’s June election, while Prime Minister Theresa May was doubtless rueing the decision to gamble her slim parliamentary majority, and Labour leader Jeremy Corbyn was revelling in his party’s increased vote share, the political commentariat was busy working out what could be learned from the way people had voted. The consensus, by and large, was that many people were tired of the politics of austerity, the cuts to public spending, reductions in certain benefits, rising costs of living and wage growth lagging behind inflation.

But people on low incomes have another reason to feel worse off: the “poverty penalty”. This penalty, also called the “poverty premium”, can take different forms, including: being sold products which are of inferior quality, being priced out of the market and not being able to access certain products, and facing higher costs for the same goods and services.¹

The argument that the “poor pay more” is well known: it was examined in the 1960s by Caplovitz in the USA,² it has been researched previously in developing countries and, in the UK, a number of recent studies have sought to quantify the additional costs faced by people with limited financial resources. However, despite this, official data on poverty do not take account of the poverty penalty – meaning that people may be financially worse off in practice than is reflected in the figures.

An underestimate?

In the UK, the most commonly used measure of poverty – relative poverty – is defined in terms of those households who have less than 60% of the median household income (taking account of household size). In 2015/16, the median income was £413 per week (for a childless couple, after housing costs), putting the poverty threshold at £248 per week. Government statistics suggest that 20% of individuals, or 13.5 million people, live below the poverty line.³

While relative poverty can capture levels of inequality, it is not directly related to absolute living standards and can increase as a result of changes in the distribution of incomes, even when living standards are rising. So, an alternative way of is in terms of material deprivation – the ability to afford certain items. In the UK the Minimum Income Standard (MIS), led by the Joseph Rowntree Foundation, is based on a specific list of goods and services that people think of as essential based on public consultation. The MIS includes the costs of: food and drink, clothing, housing, domestic fuel, water rates, household goods and services (eg a cooker, a washer and furnishings), personal goods and services (prescription charges, dental care, toiletries and sanitary towels), transport, and social and cultural participation (hobbies, going out for a meal, going to the cinema, taking a holiday and buying birthday presents).

Research using the MIS suggests that more than 19 million people in the UK do not have the financial resources for an adequate standard of living – this is six million more than the number of people estimated to live in relative income poverty. The gap between the level of the MIS and the income levels of those people on low pay and welfare benefits has also increased in recent years.⁴ But while measures of poverty based on material
deprivation can capture the affordability of goods and services they still do not fully capture the potential extra costs that result from the poverty penalty.

So how big is the poverty penalty? Research by Save the Children compared the costs of a selection of goods and services depending on whether they were paid for in advance, bought in cash or bought using high-interest credit. The results suggest that the poverty penalty amounts to £1300 per year for UK households with limited financial resources. A similar investigation into living costs in Tower Hamlets in London found that households with limited financial resources pay around £1000 per year more for essential goods and services. Another study, which focused on households with 70% of the median income after housing costs, estimated that the poverty penalty could amount to between £350 and £750 per year depending on household type, but could also be as high as £1860 for some households. At the same time it is important to understand how people, including those people with limited financial resources, make spending decisions and the different pressures they can face (see “Decisions under pressure”).

Decisions Under Pressure

People’s financial decision-making is affected by circumstance, preference, understanding of risk, future orientation, consumption pressures and lack of alternatives. Research has shown how people with limited financial resources are often making decisions between different losses. It is notable that there is a demand for increased financial skills training among the UK public, and initiatives to support people in developing these financial skills should be continued – including, for example, the Improving Financial Confidence programme and the Mind Your Money project, which has supported social housing tenants in increasing their financial skills and reducing their debts. However, while people with limited financial resources may know the cost of goods and services, they may also be excluded from different ways of purchasing because of these limited financial resources.

Following up this work, new research by the University of Manchester compared the costs of a selection of goods and services, both online and in local shops and supermarkets, in a case study area in an economically-deprived neighbourhood in the north-west of England. We used real prices collected directly from the shops and from online retailers. In part, our methodology replicates that used by the Office for National Statistics (ONS) for the calculation of the Consumer Price Index (CPI). However, our specific focus was on the costs potentially faced by people with limited financial resources in an area of economic deprivation.

Differences in costs for people with limited financial resources

As Table 1 highlights, people with limited financial resources can face considerable extra costs for essential goods and services such as a cooker, a washing machine or energy supply.
### TABLE 1 Cooker, washing machine and energy costs

<table>
<thead>
<tr>
<th>Essential goods or services</th>
<th>Typical cash/direct debit price</th>
<th>Potential overall cost when bought on credit/prepayment meter</th>
<th>Cost Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Essential household item: Cooker. Cash purchase compared to rent-to-buy on credit</td>
<td>£299 (cash)</td>
<td>£1,014 (total paid over 156 weeks)</td>
<td>£715 (239% increase)</td>
</tr>
<tr>
<td>Essential household item: Washing Machine. Cash purchase compared to rent-to-buy on credit</td>
<td>£249 (cash)</td>
<td>£1,404 (total paid over 156 weeks)</td>
<td>£1,155 (464% increase)</td>
</tr>
<tr>
<td>Energy: combined annual electricity and gas bill paid by direct debit compared to prepayment meter.</td>
<td>£1,114 (annual cost paid by monthly direct debt)</td>
<td>£1,350 (annual cost paid by prepayment meter)*</td>
<td>£236 (21% increase)</td>
</tr>
</tbody>
</table>

Note: The quotes were taken from leading high street providers and a market leading energy supplier. *The prepayment meter costs were calculated prior to the transitional cap on charges introduced in April 2017 (bit.ly/2tvP1BH)

Rent-to-buy purchases, such as a cooker, a washer and energy via prepayment meters, are typically bought by people on low-incomes and those with less cash available. Even if the weekly payments are affordable, they work out much more expensive in the longer term, with interest rates of over 100% per annum. Some rent-to-buy shops also require the purchase of product insurance, warranties and service contracts.

We also examined the costs of a weekly basket of basic household provisions by comparing the prices of two small independent local convenience stores and two large supermarkets, both based within the same study area. Table 2 compares the costs of a basket of regularly bought goods.
TABLE 2 Comparing the costs of a sample of basic household provisions in a case study area in the north-west of England, UK

<table>
<thead>
<tr>
<th>Household Provision</th>
<th>Large supermarket 1</th>
<th>Large supermarket 2</th>
<th>Local independent convenience store 1</th>
<th>Local independent convenience store 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Milk (1 pint)</td>
<td>49p</td>
<td>49p</td>
<td>50p</td>
<td>79p</td>
</tr>
<tr>
<td>2. Bread (1 loaf)</td>
<td>£1.00</td>
<td>£1.40</td>
<td>£1.50</td>
<td>£1.40</td>
</tr>
<tr>
<td>3. Butter (500g)</td>
<td>£1.70</td>
<td>£1.80</td>
<td>£1.99</td>
<td>£1.89</td>
</tr>
<tr>
<td>4. Eggs (half dozen)</td>
<td>£1.00</td>
<td>89p</td>
<td>£1.50</td>
<td>£1.39p</td>
</tr>
<tr>
<td>5. Potatoes (per/kg)</td>
<td>67p (per/kg)</td>
<td>47p (per/kg)</td>
<td>62p (per/kg)</td>
<td>70p (per/kg)</td>
</tr>
<tr>
<td>6. Cereal (500g)</td>
<td>£1.80</td>
<td>£2.00</td>
<td>£2.35</td>
<td>£2.29</td>
</tr>
<tr>
<td>7. Orange Juice (500ml)</td>
<td>80p</td>
<td>79p</td>
<td>£1.39</td>
<td>£1.39</td>
</tr>
<tr>
<td>8. Apples (per/kg)</td>
<td>£1.60 (per/kg)</td>
<td>£1.50 (per/kg)</td>
<td>£1.69 (per/kg)</td>
<td>£1.90 (per/kg)</td>
</tr>
<tr>
<td>9. Tea (80 tea bags)</td>
<td>£2.30</td>
<td>£2.00</td>
<td>£2.45</td>
<td>£2.45</td>
</tr>
<tr>
<td>10. Washing up liquid</td>
<td>£1.50 (530ml)</td>
<td>£1.00 (530ml)</td>
<td>£1.39 (500ml)</td>
<td>£1.29 (500ml)</td>
</tr>
<tr>
<td>11. Baby milk powder (900g)</td>
<td>£9.99 (900g)</td>
<td>£9.99 (900g)</td>
<td>£6.99 (450g)</td>
<td>£11.99 (900g)</td>
</tr>
<tr>
<td>12. Baby nappies (24)</td>
<td>£4.50 (24)</td>
<td>£8.50 (52)</td>
<td>£4.99 (22)</td>
<td>£4.99 (18)</td>
</tr>
</tbody>
</table>

Calculated total cost for equivalent basket of goods £27.12 £26.09 £34.80 £34.13

Note: The individual items and the brands were selected to reflect example core purchasing typical of many individuals and families in the UK based on the CPI. All the products were identical in terms of brand and where possible in terms of size, or if not were calculated to be equivalent.

The price gradient is clear: comparing the average prices in the two local shops and the two large supermarkets we find that there is an £7.86 (30%) higher cost for the exact same branded products and equivalent quantities. For a family living with limited financial resources this would be a substantial cost over a month and a year. The cost differences are also a potential underestimate given the in-store promotions available in many large supermarkets.

While no one is forced to use a local shop rather than a large supermarket, access, transport and financial liquidity constraints for bulk buying can be issues for those people with limited financial resources. Of course, given the business models of small shops and the economies of scale of large supermarkets, price differences are perhaps inevitable. Smaller shops also have less room for stock and often only sell smaller versions of certain products. Even so, many of the goods are pre-priced by the manufacturers and wholesalers with the prices included in the packaging design.

Overall, we estimate that the poverty penalty faced by people with limited financial resources could add up to £1650 per household per year, but this would vary by household type and the definition of essential goods and services used. In addition, there can also be a cumulative dimension to the poverty penalty. If a person takes out a high-interest cash loan and uses it to buy goods and services at additional costs – such as gas and electricity prepayment cards – then the gross differences in cost are compounded.

Addressing the problem

The National Living Wage, the new transitional cap on prepayment meter charges and the regulations to govern cash-loan companies (see “Dealing with debt”) will help address some of the challenges facing people with limited financial resources, but are unlikely to
tackle long-term poverty. The average cost of living in the UK is expected to rise well above welfare benefit rates in the coming years, which will put more pressure on household budgets, and the number of people living in relative poverty is expected to increase.9-10

Dealing With Debt

Dealing With debt
A recent House of Lords Select Committee review of financial exclusion and evidence on the record levels of personal debt highlight the financial vulnerability of many people in the UK. Survey research suggests 40% of the working population have savings of £100 pounds or less.12 Research by the charities Step Change and The Children’s Society found that 18% of households with children were in arrears on at least one household bill.13 Meanwhile, 95% of parents in arrears stated that their financial situation caused them emotional distress, and 58% of children aged between 10 and 17-years-old reported feeling worried about their family’s financial situation. The rapid growth in the payday lending market has also highlighted the limited financial resources of many people. Payday loan companies have been criticised in the past for advertising to children and not having adequate affordability assessment procedures (bit.ly/2vxOf89). The Financial Conduct Authority has introduced new requirements for affordability checks and has also closed a number of companies down. However complaints about payday loan companies have continued to rise and new forms of high interest credit are raising concerns amongst debt charities (http://bbc.in/2sieky).

So, what can the new government do and what can people do to help themselves?

Firstly, it is important that the existing official measures of poverty take account of the poverty penalty and the different costs people with limited financial resources can face. This will provide a more accurate picture of the scale of poverty in the UK. The poverty penalty could then be used to inform policy-making in relation to the levels of welfare support and minimum wage levels. Ongoing research by the ONS into the development of an index based on household payments and prices could be a step towards this.

Secondly, in terms of tackling the poverty penalty directly, it is clear that the new British government needs a joined up and collaborative approach towards reducing long-term poverty, addressing the lack of competition and inequities in the marketplace and improving peoples financial decision-making skills. More specifically, it could restart the Crisis Loan scheme (which was a government supported interest free loan fund for families in urgent financial need), to avoid people turning to high-cost credit. Alternative and more affordable sources of credit do exist in the UK, including credit unions, however the sector needs to grow significantly before it can offer an effective nationwide alternative to high interest lenders. In addition, initiatives aimed at improving people’s financial decision making need to be continued.

Finally, there are also many things that businesses could do to help eradicate the poverty penalty and we would support the new government establishing a commission to consider how businesses, including manufacturers, can improve the availability and affordability of essential goods and services, and how the more predatory aspects of the market can be
better regulated in order to support people with limited financial resources so that they can have an adequate standard of living.

Removing the poverty penalty could free up money to be spent on other essential goods and services, as well as social and cultural activities, which some people may be going without. For now, though, the cumulative disadvantage of additional living costs faced by those with limited funds remains a barrier preventing families and individuals from improving their long-term financial circumstances.

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**Note:** This article is based ongoing research by the University of Manchester. It was presented at the All Party Political Group On Poverty and End Child Poverty Campaign at Westminster in January 2017.
References