

Bare necessities

Towards an improved framework for social tariffs in the UK

Sam Robinson
John Asthana Gibson

SMF

Social Market
Foundation

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EXECUTIVE SUMMARY

This report examines the case for social tariffs and how they can be improved.

- Previous SMF research has shown the urgency of the cost of living crisis and highlighted the need to ensure vulnerable households can access essential goods and services. This report explores the case for ‘social tariffs’ – a discount applied to essential goods and services for a particular group of eligible households – as a policy intervention to support this objective, by means of:
 - A thorough literature review
 - A nationally representative survey of 4,000 people
 - Data analysis of the 2019-2020 Living Costs and Food Survey (‘LCFS’)
 - Three focus groups with people on low incomes
 - A public policy roundtable with industry experts
- Ideally, there would be no need for social tariffs, either because households would have sufficient earnings to comfortably afford their essentials, or because the social security system would be both more comprehensive and considerably more generous than at present. While these are worthwhile policy goals, neither directly ensures access to essentials and are both are challenging in the current fiscal and political environment.

There is a good case for social tariff intervention in markets like water, energy, broadband, public transport and car insurance.

- State intervention in markets through social tariffs should be based on the objective of ensuring affordable access to essentials whilst limiting the impact on market mechanisms and effectively targeting support. To decide where social tariffs should be applied, we used several principles.
- First, to merit intervention, a good should be considered essential. Our polling and focus groups found that the public view a broad range of goods and services as essential, including energy, food, and public transport.
- Second, the good in question must represent a significant burden on household incomes.
- Third, the market should display limited competition or a failure to secure affordable access to essentials. There should be clear limitations to ‘shopping around’ for better deals.
- Finally, there are additional considerations to be taken into account owing to the qualitative nature of the good in question. These follow four themes:
 - Market structure, particularly the presence of a natural monopoly
 - Economic ‘knock-on effects’ on households, such as access to employment opportunities
 - Wider impacts on other policy priorities, such as net zero or public health
 - The heterogeneity of the good – how different the options are, and how much consumer choice matters

- On this basis of affordability, we conclude that case for social tariff intervention is strongest for:
 - Household utilities (water and sewerage, gas and electricity)
 - Broadband
 - Public transport (i.e. bus and rail travel)
 - Car insurance

Social tariffs need to be well-targeted, consistent and automatically applied to maximise their value.

- Current social tariff schemes in the UK suffer from three main weaknesses: poor targeting, inconsistent eligibility and generosity, and low take-up.
- To address these issues, social tariff schemes need to be designed so that they reach households outside of the benefits system whilst directing support to those that need it most, pursuing consistency across schemes, and ensuring eligible households can easily take them up.
- Fully realising the potential of social tariffs will be a significant undertaking and this ‘ideal scenario’ represents a long-term ambition.
- However, there is plenty of scope to improve social tariffs in the shorter term by setting a more coherent regulatory framework.

The ideal scenario: a single, unified social tariff in essentials

- The best approach is to base eligibility on household income, coupled with a ‘bills-to-income ratio’, meaning any households spending over a certain proportion of their income on their essentials, and with a household income below a certain threshold, would receive a social tariff in a suite of goods covering water, gas, electricity, broadband, bus travel and rail travel as well as vehicle insurance.
- To implement this ‘single unified social tariff’ effectively, there are significant challenges to overcome regarding data availability and accuracy. HMRC ‘Real-Time Information’ (RTI) data can be used in conjunction with DWP data and supplier data to build a better picture of both affordability challenges and household eligibility for social tariffs. We propose that a new unit within DWP should have secure access to this data.
- To maximise the reach of social tariffs and avoid the disappointingly low take-up rates we see in existing social tariffs, we propose that once a household is deemed to be eligible for a social tariff, the scheme is applied automatically across all the relevant goods and services, with opt outs for households that do not wish to participate.
- If possible, this new suite of social tariffs should be funded by general taxation. This is for two reasons. First, funding via general taxation will ensure that the burden on households is progressive. Second, it will minimise the possibility of postcode lotteries emerging. A limitation of the current non-risk-pooled system of cross-subsidy is that support varies depending on the finances of the provider.

The second-best scenario: short-term priorities for improving social tariffs

- Our preferred framework for social tariffs will require political will and new data architecture to work effectively. To respond to more immediate cost of living pressures, there are still several initiatives that can be undertaken to improve social tariff provision in the short term in the UK.
- To ensure consistency between social tariff schemes in terms of eligibility and generosity, a stronger regulatory framework for social tariffs should be put in place. This framework would:
 - Minimise divergence between social tariff schemes in terms of eligibility and generosity.
 - Reduce barriers to accessing social tariffs such as exit fees and encourage better promotion of existing schemes.
 - In the absence of taxpayer funding, develop a better defined reconciliation scheme for cross subsidies in sectors such as water and broadband, modelled on the Warm Homes Discount, in order to ensure better funding models that effectively pool risk between providers.

CHAPTER ONE – INTRODUCTION

There is a widespread consensus that no person should go without essential goods and services, those that are needed to live a decent life. Despite this, there have long been concerns about the ability of free markets to supply these fundamental entitlements to all at affordable prices.

The recent cost of living crisis has exacerbated the difficulties experienced among low and middle-income households in affording essential goods and services, with many families cutting down on or even going without essentials such as heating, electricity and food. In light of this, there has been growing interest in policy solutions to address the unaffordability of essential products.

The case for intervention on the cost of essentials

In August 2023, the Social Market Foundation published an interim report on this matter.¹ The report sought to understand public attitudes on the question of what counts as ‘essential’ and people’s experiences of the markets for these essentials; gauge public opinion on issues relating to the costs of essential products; and to better understand societal views on proposals for social tariffs, discussed in the section below.

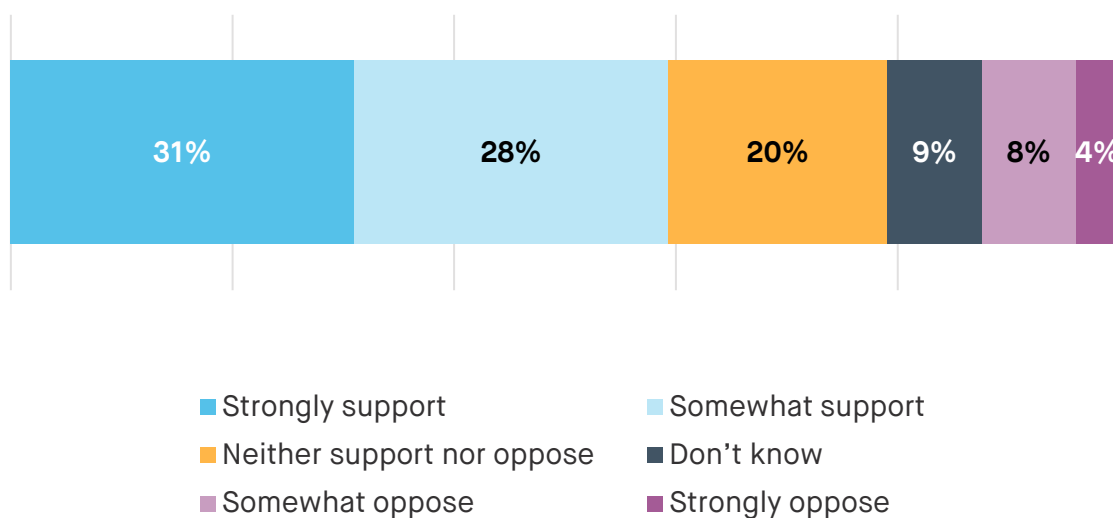
This research found that in the public mind there is a broad definition of ‘essential’. People consider a range of commonly used goods and services as either essential to everyone or essential to some people. Our findings confirmed that many people, particularly those on low incomes, have struggled to access essentials at affordable levels in the past few months, and significant numbers of people spend large proportions of their income on essential goods and services. Nearly 3 in 10 (28%) households say that affording essentials is ‘quite’ or ‘very’ difficult for them. For those deeming themselves to be financially struggling, this figure rises to 75%.

Whilst markets for essential items work well for most people, with most households ‘shopping around’ and finding better deals when they do, our analysis exposed the limitations of market competition to enable everyone to access essentials at affordable prices. A significant minority find these key consumer markets difficult to navigate, and the proportion of people able to find better prices when shopping around decreases with income. Even when people do shop around for items, a significant proportion still find those items are very difficult to afford.

These findings have highlighted the extent of the problems households face accessing essential goods and services, and have illustrated the need for intervention to tackle these problems. Our polling has found that a majority of people think there currently is not enough support to help struggling households afford essentials.

Finally, the research found broad support for the idea of social tariffs to help remedy this issue. Overall, nearly 6 in 10 (59%) of those polled support the idea (see Figure 1 below). This broad pattern was stable across different demographic groups: in all demographic groups, a similar proportion of respondents expressed support for the idea of social tariffs.

Figure 1: Polling results to the question: 'To what extent do you support or oppose the idea that certain households should be given discounted rates for essential goods and services (known as a 'social tariff')?'



Source: Opinium polling. Base: 4,000 respondents.

The focus of this report – why social tariffs?

To ensure households are able to access essentials affordably, there are two broad policy responses: increasing the incomes of households that are struggling to afford essentials or reducing the cost of their essentials.

In this report, we focus on the latter approach, specifically on 'social tariffs'. By this we mean **a discount (rather than a payment) on the prices of essential goods and services targeted at a particular subset of households**. To qualify as a social tariff, it is necessary that a scheme targets a particular group of households through some form of eligibility criteria. This distinguishes social tariffs from universal interventions such as price controls, regulation, or tax cuts.

Social tariffs can be seen as a form of price discrimination, when firms charge different consumers different prices for the same good/service, typically in an effort to increase revenues and achieve profit maximisation. For the purposes of this report, we focus on social tariff schemes that are explicitly encouraged, regulated, or mandated by government to force firms to price discriminate in favour of certain groups.

Admittedly, social tariffs are not the only policy lever available to alleviate the cost of living pressure on households. A different strategy for increasing the incomes of struggling households is to use economic policy to increase household earnings. This might be done by increasing the minimum wage significantly. Indeed, recent increases to the minimum wage have largely not had adverse effects on employment.² However, doing so substantially further and faster than the Low Pay Commission recommends carries with it greater risk of impacting on the wider economy. Furthermore, focusing only on the minimum wage would leave many struggling households out of scope: recent estimates suggest that only around 5% of workers are currently on the minimum wage.³

Another priority for improving the situation on the cost of living and access to essentials is addressing stagnant real wage, which stood at £507 on a weekly basis in June 2023 and has not increased since 2007: at the end of that year, it stood at £513.⁴ There is an urgent need to raise average real wages across the UK, and doing so would address affordability challenges. However, raising earnings sustainably will require improving the UK's productivity, which has also increased little since 2007.⁵ This is a multifaceted challenge encompassing many policy areas from education to transport. It would take a considerable amount of time for the needed structural changes to the UK economy to take place and feed through to household earnings. Furthermore, both raising the minimum wage and taking action to increase earnings across the UK would not be a solution for out-of-work households.

Increasing the incomes of households through changes to the social security system is another alternative strategy for addressing the cost of essentials. Though it is a worthwhile policy goal, it does come with some challenges.

First, the social security system – that is, benefits such as Universal Credit, Personal Independence Payments, Jobseekers' Allowance, Employment and Support Allowance and so on – misses many households who might require support. On an equivalised income basis (that is, accounting for household size and composition) there are more than 900,000 households in the bottom income quintile who do not receive benefits.⁶ Indeed, previous SMF research has highlighted the problem of the 'missing middle' – households forecast to spend over 10% of their after housing costs (AHC) income on energy yet do not claim social security – in the context of energy poverty.⁷

Second, increasing the generosity of the social security system is likely to carry substantial fiscal cost. Current spending on Universal Credit and legacy benefits alone is expected to be £77.5 billion in 2023-24, up from £72.0 billion in 2022-23.⁸ At least in the short term, containing fiscal costs is an important consideration for designing policy interventions to address the affordability of essentials.

Another consideration is the increasing proliferation of economic shocks in recent years. The existing social security system, chiefly Universal Credit, was highly effective in getting support to households quickly, for example in the case of the '£20 uplift' during the pandemic. But such measures were ad-hoc, one-off responses to economic shocks. Indeed, the high inflation during 2022-2023 showed some of the limitations of the UK's existing systems as an automatic stabiliser: the process for uprating benefits like Universal Credit was widely criticised for lagging increases in inflation, with the consequence that for several months low-income households saw a real-terms decrease to their benefits, right at the stage when they most needed additional support.⁹ Looking beyond the immediate challenges faced by households later this year, these recent developments have highlighted the need for the UK to put in place more robust frameworks to respond to future cost of living crises.

There are political aspects to this debate too. In recent political history, politicians from both major parties have been reluctant to increase benefits because holding benefits down has been seen to be electorally popular (that said, favourable public attitudes towards welfare have become more common over the past decade¹⁰). On the other hand, our research has found that there is broad public support for the idea of social tariffs: ensuring disadvantaged families' access to essentials does seem more sellable than handing out benefits to the poor. Social tariffs could form a politically palatable solution to this issue of deprivation and poverty.

We do not argue in this report that increasing earnings and reforming the social security system are unimportant or undesirable policy objectives. Furthermore, we do not suggest that social tariffs will be a 'silver bullet' solution to the extensive problems of poverty and deprivation afflicting many in the UK – there are many on very low incomes who do not have access to essential services at all, many of whom will not benefit from discounts. With that said, social tariffs, if they are designed well and coherently, can offer a targeted way of addressing the specific problem of ensuring access to essentials for considerable numbers of low-income households. They can also act as an additional 'automatic stabiliser' to aid household finances during times of economic strain. Furthermore, given the lack of appetite to spend large amounts of public money in these challenging times for public finances¹¹ – we believe that social tariffs can offer a politically and fiscally feasible way of ensuring affordable access to essentials.

Summary

Having determined that in many cases, markets are failing to provide people with essential goods and services at reasonably affordable prices, and that there is considerable public appetite to address this issue with social tariffs, in this report we assess more specific aspects relating to the design of social tariff policies, and the range of moral, economic and practical considerations that would deliver a good social tariff. The report will make policy recommendations to achieve the short-term goal of improving existing social tariffs, and will set out a roadmap to achieve the long-term goal of a single, unified social tariff for a number of essentials.

The methods used in this report are as follows (please see Appendix for more detail on methodology):

- Desk research and literature review
- In-depth interviews with policy experts
- Roundtable discussion with industry figures and policy experts
- Focus groups with low income individuals
- Nationally representative polling with 4,000 respondents
- Data analysis and modelling of the 2019/20 Living Costs and Food Survey (LCFS)

The report is structured as follows:

- **Chapter Two** reviews existing social tariff schemes in the UK and other countries and assesses their effectiveness.
- **Chapter Three** outlines the key considerations and trade-offs that will have to be addressed when designing new social tariff interventions.
- **Chapter Four** discusses policy options for new social tariff interventions, considering what would constitute a long-term 'ideal scenario' for a new social tariff framework and what would represent plausible second-best options for social tariff policies that can take place in the shorter term.

CHAPTER TWO – SOCIAL TARIFFS SO FAR

Social tariffs are not a new idea. There are many social tariff schemes currently in operation, both in the UK and in other countries. These social tariff schemes cover a wide range of markets, from utilities to groceries and transport. This chapter provides examples of social tariff schemes operating in different markets, before discussing how well UK social tariffs – chiefly those in broadband and water – have performed.

Public transport

Public transport is a market that is often targeted by social tariffs. Across a number of EU states, discounts for public transport use are available to those who are on low-incomes or are in receipt of state benefits. Belgium and Germany are two countries where social tariffs exist in the market for public transport.

In Belgium, measures are taken to improve access to train, bus and tram services for people who benefit from enhanced reimbursement status for healthcare (defined by being low-income or in receipt of benefits).¹² They can be granted a ‘Preferential Reimbursement Discount Card’ which provides a reduced tariff, for use on both trains (with a nationwide 50% discount) and buses (where discounts vary by region).¹³

In Germany, several federal states have some form of social tariff in place for urban and regional public transport networks.¹⁴ These ‘social tickets’ provide discounted time travel cards, usually for one month, eligible to those on a range of state benefits. Social tickets are administered by regional transport authorities, and the size of discounts on public transport use varies between cities.

In the UK, there are a number of transport discount schemes already in place that can be seen as forms of social tariffs. Most, unlike the above examples in Europe these schemes are not explicitly designed to enable low-income people to afford access to public transport. An example of one that does is the Jobcentre Plus Travel Discount for fares on London’s transport services.¹⁵ Principally available for unemployed people on Jobseeker’s allowance or Universal Credit, it provides a discount of 50% pay as you go fares on all of TfL’s transport types, and enables beneficiaries to buy discounted national rail tickets too.

However, most transport discount schemes in the UK are targeted by age group. The 16-25 and 26-30 railcards provide a third off rail fares for people in those age groups, though eligible individuals need to apply and pay for the railcard to receive the benefits.¹⁶ There are also discount schemes for travel in place for people who reach the State Pension age, who can apply for a bus pass that allows them free travel on local buses.¹⁷ Pensioners in London are able to get a ‘freedom pass’ which grants them free train, tube and bus travel around the capital (disabled people are also eligible for a freedom pass). Freedom passes are funded by London councils.¹⁸ We consider these schemes to be de facto social tariffs in transport, and whilst they are poorly targeted in terms of supporting those that struggle to afford transport, these schemes often have other aims besides ensuring access to transport (e.g. addressing social isolation amongst the elderly or encouraging domestic tourism).

Groceries

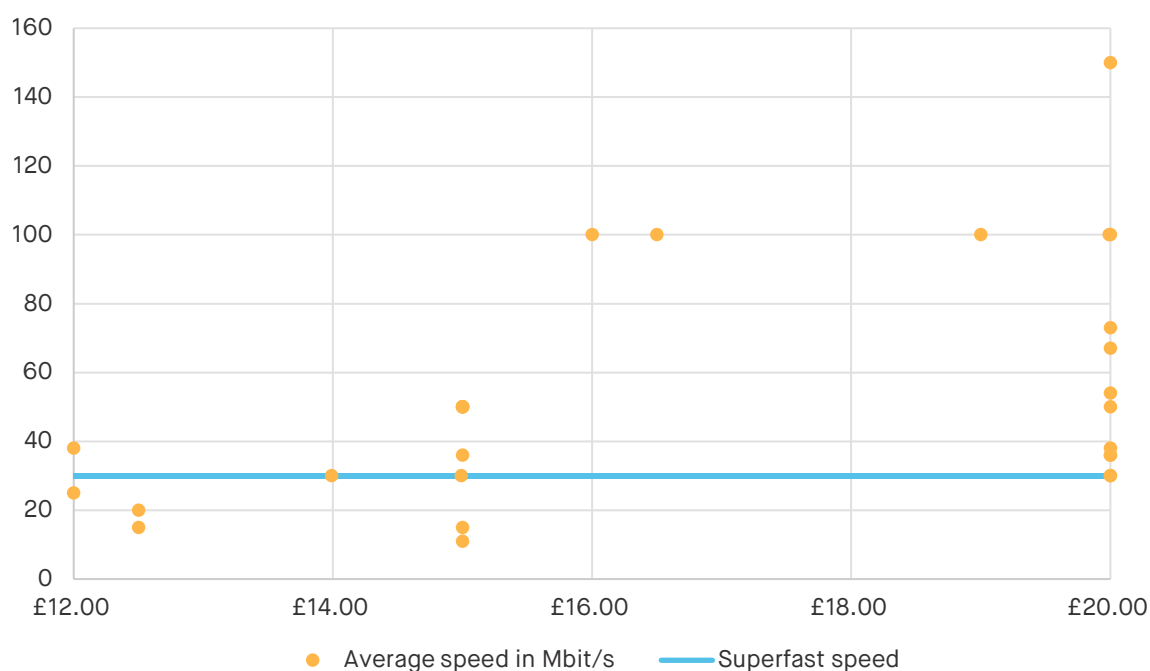
In Spain, the Valencian Government recently launched a programme offering €90 food vouchers, to be spent in any supermarket or food store between April and July 2023, to low-income individuals whose household income amounts to less than €21,000 a year.¹⁹ Recipients must be residents of the Valencian Community (an autonomous region) and below pension age. The scheme was granted individually, so multiple members of a household unit could claim the voucher as long as their household income fell below the €21,000 threshold.

The closest equivalent to this scheme in the UK is the Healthy Start vouchers initiative. This scheme provides food vouchers to certain low-income households. Families in receipt of Universal Credit or legacy benefits can apply if mothers are more than 10 weeks pregnant or have children under four years old, and who have monthly earned income from work under £408.²⁰ The voucher provides £4.25 each week for pregnancy from the 10th week or for children between one and four years old, and £8.50 each week for children from birth to age one. It can only be used for certain fruits and vegetables, plain cow's milk and infant formula.²¹

Broadband

In 2022, the Department of Culture, Media and Sport and Ofcom encouraged all broadband providers in the UK to voluntarily introduce a social tariff for low-income customers.²² Over 20 providers now supply social tariffs to customers, although prices and internet speeds vary from package to package. Some providers offer deals from as little as £15 per month. This could represent a saving of more than £180 per year, which is around 50% compared to the average cost of broadband.²³

Eligibility for broadband social tariffs is based on being in receipt of universal credit, meaning roughly 4.2 million households across the United Kingdom are able to access a social tariff for broadband. While eligibility criteria for broadband social tariff schemes are quite uniform across companies, there is some variation in the price and average speeds offered, as Figure 2 below shows.

Figure 2: UK Social Tariff schemes in broadband by monthly price and average speed

Source: Ofcom, “Social tariffs: Cheaper broadband and phone packages”. SMF calculations. “Superfast speed” is defined here as 30 Mbit/s, in line with the Ofcom definition.

Water

The Flood and Water Management Act 2009 introduced social tariffs in the UK water market.²⁴ Every water company in the UK offers a social tariff, although water companies have considerable discretion in how they deliver them, including flexibility when it comes to the level of discount provided and specifying who is eligible. In addition to these social tariffs, there is also the WaterSure scheme, which provides support to households on benefits who have high needs for water (e.g. have lots of school-aged children).

Table 1 highlights some existing social tariff schemes in water and gives examples of some of the different design criteria – both in eligibility and generosity – that regional schemes provide.

Table 1: Examples of water social tariffs in the UK

Provider	Price/Discount	Eligibility
Affinity Water	Annual bills capped at £115.10.	Household income less than £17,005, or being in receipt of a range of benefits.
Bristol Water	Discounts of up to 88% on the average annual household bill.	Low income households who are assessed as being in financial difficulty.
Severn Trent Water	Annual bills reduced by up to 90% depending on circumstances.	Household income below £20,048.
Yorkshire Water	Annual bills are capped at £350.	Low income households with an annual water bill of more than £350.

Source: CCW: “Help with bills, Social Tariffs”

Energy

Energy (gas and electricity) is another common target for social tariff interventions. Indeed, a social tariff in energy has existed in Belgium since 2002.²⁵ Eligibility is typically based on household income and/or receipt of state benefits. The discount the social tariff offers can be generous: in September 2021, households on the social tariff paid 67% less for gas and 29% less for electricity than the average.²⁶ The Belgian social tariff is an example of a well-integrated system for social tariff: households are auto-enrolled onto the scheme, with the federal government notifying energy suppliers which of their consumers qualify for a social tariff, based on the administrative data they hold. In 2020, roughly 10% of Belgian households were on the social tariff schemes in electricity and gas.²⁷ During the pandemic, the social tariff scheme was temporarily expanded to also include anyone with a gross income below €20,000, which significantly increased the number of households covered by the scheme.²⁸

A form of social tariff scheme in the UK energy market is the Warm Homes Discount (WHD), a rebate on energy bills given to certain eligible households. The WHD started off as a patchwork of voluntary social tariffs, with different tariffs and different types of support from various companies. By 2010, there were ten different social tariffs, including those run by each of the ‘Big Six’ energy providers.²⁹ However, the voluntary nature of the schemes, and the lottery of support that entailed, meant the programmes failed to have an impact on fuel poverty, which doubled between 2001 and 2009.³⁰ The government decided to move from a tapestry of voluntary commitments to a statutory scheme in 2009, with a single, regulated Warm Home Discount coming into effect in 2011. Moving from voluntary social tariffs to a mandated scheme meant that firms no longer seek to maintain a competitive advantage by choosing not to offer support to at-risk customers.

Eligibility for the WHD is split into three groups. The first assists less well-off pensioners, whilst the second prioritises rebates to low-income households that are more likely to have high energy costs. The third element is Industry Initiatives, which provides wider support to customers who are in or at risk of fuel poverty through a variety of activities, such as energy advice and energy debt write off. Through data matching with DWP to identify customers on pension credit and other benefits, the WHD automatically reduces recipients' bills.

The value of this scheme to eligible households in 2022 has been estimated to be £506 million.³¹ The scheme is funded through energy bills, with suppliers recouping the total value of their obligation, plus any administrative costs they incur, through higher prices (adding around £19 to a typical energy bill in 2022/23).³² While rebates under the WHD are funded by cross-subsidy, there is a reconciliation process to fairly distribute the costs of running the scheme across providers in the sector. For a comparatively low cost for bill payers, the scheme effectively and automatically supports over two million financially vulnerable people.³³

The WHD is one of a number of schemes to help people afford the cost of household gas and electricity. Another is the Winter Fuel Payment, consisting of an automatic payment to those in receipt of the state pension (or certain other social security benefits). This scheme is estimated to cost the taxpayer around £2 billion annually.³⁴

Assessing current social tariff schemes

Whilst our fieldwork found that peoples' experiences of the social tariffs in the water and broadband markets are broadly positive, our research has also identified a number of key issues with their current operation.

Take-up

One of these issues is to do with the take-up of social tariff schemes. Ofcom research has found that in April 2023, only 220,000 (5.1%) of the 4.2 million households eligible for broadband social tariff deals have claimed them. Social tariff schemes will have a limited impact on families' finances if most people eligible do not claim them.

There are several factors behind observed low take-up. Low levels of consumer awareness of social tariffs may be in partly responsible for the low rates of take up. Indeed, previous SMF research showed that a third of Universal Credit recipients have not heard of social tariffs for broadband.³⁵ The most common reason given for not claiming a social tariff by those in our survey by those who believed they were eligible is that they did not know how to do so.³⁶

However, informational barriers – i.e. low awareness – cannot entirely explain low take-up rates. Indeed, our interim report on social tariffs found that a majority (58%) of people have heard of social tariffs in broadband, while 44% know about existing social tariffs in water.³⁷ Our focus groups indicated that there are some attitudinal barriers to take-up of social tariffs, with some respondents feeling that social tariff schemes deliver a lower level of service than 'normal' schemes and therefore being reluctant to take them up, even if they know that they are eligible for them.

A lack of regulatory underpinning may also be limiting the take-up of social tariffs. Providers make little or no profit on social tariffs, which means there's little or no economic incentive to compete for social tariff customers by providing high-quality, well-promoted deals.

Postcode lotteries

A further issue is with current social tariffs is the variation in what's offered by providers. This is a problematic aspect of social tariffs in the water industry, where the regionally monopolised nature of water companies and considerable freedom they have in designing social tariffs means there is essentially a 'postcode lottery' of support available.

Different companies impose different forms eligibility criteria for their social tariffs, and the discounts vary between providers too, partly because firms have different customer bases with different economic characteristics. A roundtable participant with expert knowledge of social tariffs in the water industry highlighted how there are "some companies which have less than £5 to spend on cross-subsidy annually from each contributing customer, and there are other companies which have more than £20 to spend per contributing customer".

These differences mean that two similar households in a similar financial situation may receive different levels of support by virtue of their place of residence. Take the example of two different households, each earning a total household income of £17,500 per year and neither being in receipt of benefits. Both may have a similar family composition and similar water needs. However, consider that one family lives in Reading (Thames Water customer), a short distance away from the other living in Basingstoke (South East Water customer). Due to the different eligibility criteria imposed by these different companies, the family living in Basingstoke qualifies for social tariff support, having their bills capped at around £140 per year. Meanwhile, the family living in Reading earns more than Thames Water's eligibility threshold, meaning they do not receive support. This case study illustrates how the monopolised nature of the water industry, combined with water companies' flexibility in administering social tariffs, can lead to a postcode lottery between areas.

Targeting

Perhaps most pressingly, the eligibility criteria of some existing social tariffs have given rise to concerns that those in need may be 'falling through the cracks' and missing out on support they deserve. A report by National Energy Action highlighted the experience of a household with three children in receipt of tax credits, making them eligible for WaterSure but live in a block of flats which cannot be metered, and also earning too much as a household to qualify for their company's social tariff scheme.³⁸ As such they have no support available despite their outgoings placing them into a negative budget. This example elucidates the issues of eligibility and how basing eligibility on proxies for deprivation, such as benefits, can entail that people miss out on support when they might be in need of it.

A further aspect of targeting relates to the question of who should receive public support to access essentials. Most would agree that support should be targeted towards those who need it most, or in other words, the poorest and most vulnerable in society, and that those who can pay, should pay. This issue of fairness is complimented by the more practical problem of minimising the cost of these schemes.

The differences between the WHD and the Winter Fuel Payment, although not a social tariff scheme in the strict sense, nicely illustrates this issue of directing support. Eligibility for the WHD is based on being a low-income household, or one under some form of financial distress/ vulnerability. As such, the WHD can be considered a reasonably well targeted support measure. The Winter Fuel Payment, on the other hand, automatically provides support to all those over the state pension age. The Resolution Foundation has pointed out that 3.7 million pensioner households (~45%) are in the top half of the income distribution for the whole population – meaning the WFP is a poorly targeted support scheme.³⁹ That makes it very expensive, costing the taxpayer around £2 billion over the 2022-23 winter. Subsidising better-off households' energy bills is not just an unfair use of public money, but also costs the government significant sums of money that could likely be better spent elsewhere.

CHAPTER THREE – CONSIDERATIONS FOR DESIGNING A NEW SOCIAL TARIFF FRAMEWORK

The previous chapter outlined the main social tariffs schemes currently in operation and discussed some of the limitations in current approaches, mainly around take-up, postcode lotteries and targeting issues. To improve the effectiveness of social tariffs, it is important to consider the shortcomings of existing schemes and identify the main trade-offs that face social tariff interventions. Doing so is the purpose of this chapter.

The scope of social tariffs

The first consideration is how widely a social tariff should be applied; in other words, **which** goods warrant intervention with social tariff policies.ⁱ This is important not only to clearly delineate the objectives of a social tariff scheme, but also to ensure that any social tariff intervention – particularly if it is supported by taxpayer money – is well-targeted and proportionate.

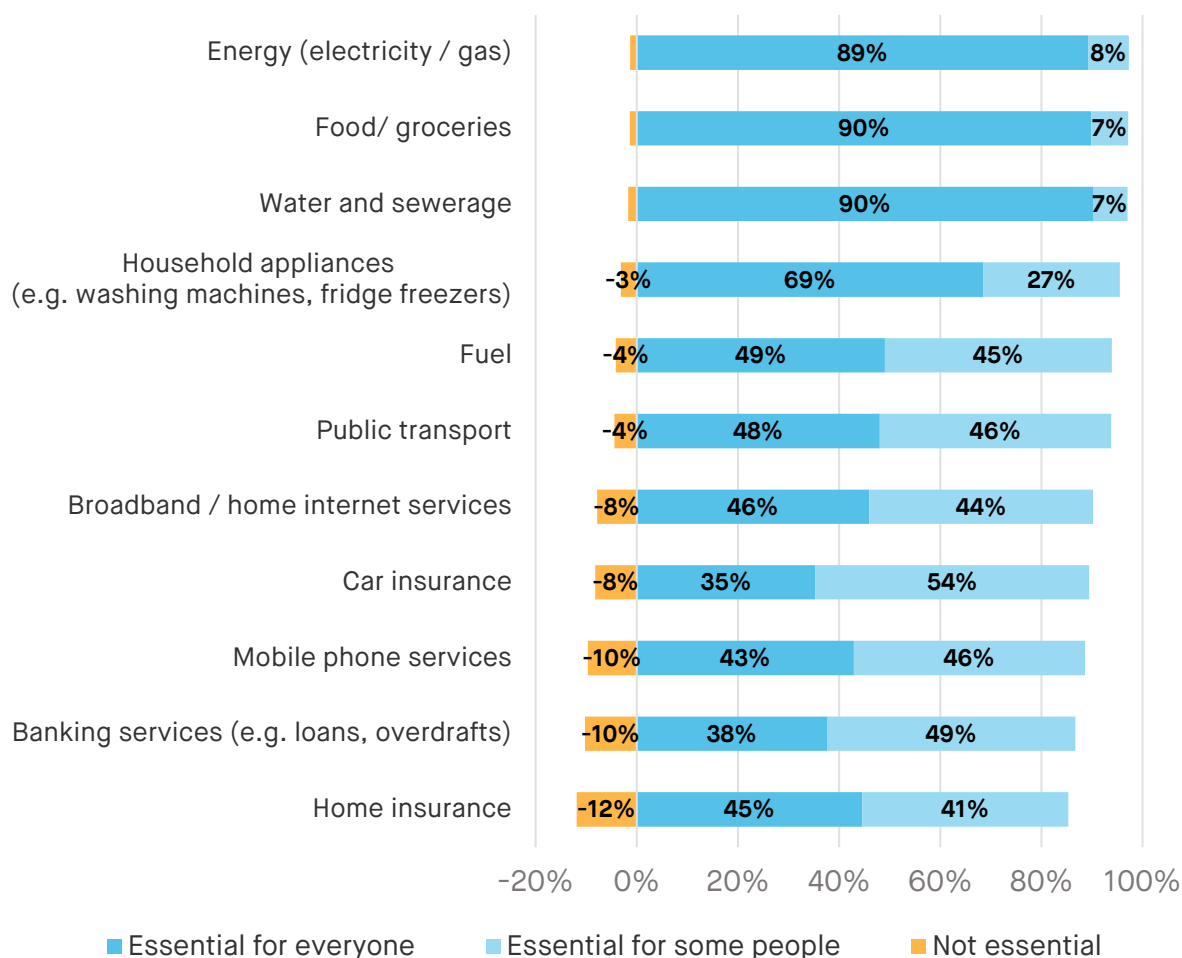
The primary objective of social tariffs is to ensure that essentials can be accessed affordably across society; to ensure that no one is going without basic items they need. Admittedly, in practice, the objectives of social tariffs need to co-exist with other important policy goals, such as fiscal realism and facilitating the transition to net zero.

Defining 'essential'

First, it must be concluded that a certain good is indeed essential. Our polling on this matter has found that the public view a wide range of goods and services as essential, either to everyone or at least to some people, and these findings were backed up in our focus group discussions. Some items, such as energy, food and water, are universally classed as essential. It should also be noted that there are many items that are absolutely essential to some people but are completely irrelevant to others (e.g. glasses for the visually impaired). For the purposes of this report, we focus on widely used goods that can be considered essential for large numbers of people across society. Figure 3 summarises the results from our interim report on social tariffs around what goods and services the public views as essential.

ⁱ This is not to say that goods that do not fall into this category cannot have social tariffs; businesses frequently provide offers to certain groups of customers, for example a student discount on a haircut or a restaurant meal. By 'warrants intervention with social tariff policy' we mean items that, given their importance to broad sections of society, require a fiscal and/or regulatory intervention to ensure affordable access to them.

Figure 3: Polling results for the question: “Which of the following goods and services do you consider to be essential for a typical person living in the UK?”



Source: SMF, “Social tariffs and the cost of living”.

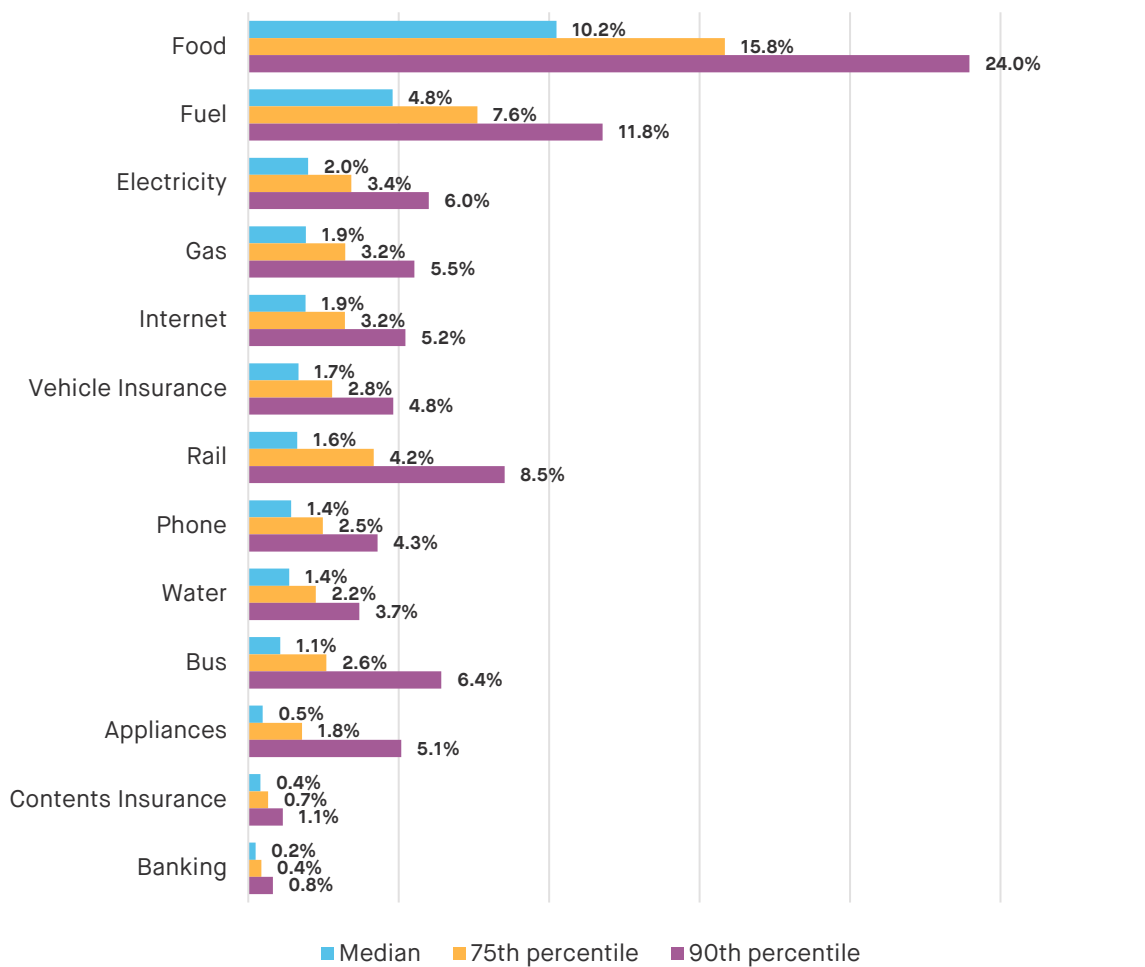
Affordability

Being essential is a necessary but not sufficient condition for there to be a good case for social tariff intervention on a particular good or service. If free market competition succeeds in providing essentials to customers at reasonably affordable prices, intervention might bring limited benefits to consumers or, at worst, bring unintended consequences for markets. As such, there should be evidence that markets are failing to provide an essential good or service at reasonably affordable prices. If a particular essential good or service has met these criteria, social tariff policies could be an effective measure to ensure those struggling financially can access and enjoy it.

To assess affordability challenges with particular goods, we primarily used data from the Living Costs and Food Survey to explore the proportion of household income being spent on each product or service.

Figure 4 below displays summary statistics from the LCFS on the proportion of disposable AHC incomeⁱⁱ spent among users of those goods (omitting zero values).ⁱⁱⁱ Specifically, it presents the median, 75th percentile and 90th percentile of proportional spending. The chart shows that food is by far and away the biggest expenditure, accounting for nearly a quarter of the incomes of the highest spenders, and around a tenth of the typical household. The second biggest category of spending is fuel: 10% of drivers spend over 11.8% of their income on fuel (though it is worth noting that many disadvantaged households don't run a car). Energy, gas and internet access each account for a similar proportion of income for the typical household.

Figure 4: Proportion of AHC relative spend by good, by income percentile



Source: SMF analysis of 2019–2020 Living Costs and Food Survey.

ⁱⁱ This income figure has not been equivalised, in order to give more accurate pre-policy spending proportions for households. Data is unweighted.

ⁱⁱⁱ We decided to omit zero values to give a more accurate representation of what the burden of these goods on household goods actually is. For example, public transport – bus and rail travel – is only used by approximately a quarter of households in the LCFS dataset. Without taking this into account, this would suggest that the median spend on public transport is zero. Presenting the data in this way makes little sense for assessing the impact for households that rely on the essential item in question.

Additionally, previous SMF research looked at the proportion of people in our polling who both said that they tend to 'shop around' for a good, and also that they find that particular good difficult to afford to assess the extent to which market competition is able to ease affordability concerns.⁴⁰ This showed that in several important markets, in particular in food, energy, broadband, fuel and household appliances, a significant proportion of people on low incomes struggle to afford those items, despite shopping around for them.

Additional considerations

There are several important additional considerations that have to be taken into account in conjunction with quantitative evidence around affordability.

The first of these is market structure and competition. Some goods we have analysed are natural monopolies, where the ability of people to shop around is significantly limited or non-existent. Water is the most salient example of this, as people are covered by a regional water provider and cannot shop around for water at all. Public transport also shares some of these characteristics: though there is some competition among bus providers, typically a household will only have access to a limited number (or indeed just one) bus provider serving them. Rail travel is also covered by regional franchises, meaning households typically do not have a choice of rail company to use for everyday purposes.

Affordability challenges represent the immediate economic impact of a good on a household. But it is also worth considering the economic knock-on effects on households that not having access to something brings. Access to transport – whether by car, bus or rail – brings with it significantly expanded employment, health and social opportunities. Ensuring access to such essentials can be costly for whoever is funding them, yet there can be considerable unseen costs of not intervening.

To illustrate this point, consider broadband. An estimated 6% of households do not have internet access.⁴¹ There are clear knock-on effects from not having broadband: a wide range of employment opportunities, services, information are hosted online. In more concrete terms, research has found that, compared with the least digitally engaged people, the most digitally engaged people pay £228 less on their bills per year, and manual workers with high digital engagement can earn £421 a month more than their less digitally engaged peers.⁴² The consequences of a lack of access to broadband also came into sharp relief during the COVID-19 pandemic, when schools went online: many children in low-income households, which were unable to afford broadband, fell behind in learning as a result of being unable to access or complete educational materials.⁴³

A third issue relates to how differentiated or commoditised a good or service is – i.e. whether there is substantial meaningful variation between the options on the market. To take an example, water and sewerage provision is very similar across the country; there are few, if any, relevant differences between the product received by one household compared to the product received by another elsewhere. In contrast, the category of 'food and groceries' encompasses a vast range of products, while individuals themselves have an equally vast range of dietary preferences and needs. In this category of food and groceries, consumers are likely to attach considerable

value to consumer choice, whereas they are likely to attach less value to consumer choice in the market for household water services, for example. That said, this doesn't undermine the case for food social tariffs entirely. The case study from Valencia cited earlier provides evidence that social tariffs can be applied to markets where products exhibit a large degree of heterogeneity.

There are more practical questions around the heterogeneity of goods in a market, beyond the degree of choice desired by consumers. If a good varies widely, then it is potentially more complex and difficult to administer a social tariff scheme. Besides such operational issues, the variety of a product poses more substantive questions. Taking the example of food and groceries further, there is a tension between providing a blanket discount on any foods, as in the case of the Valencian case study – which would make a scheme simpler and more comprehensive – versus restricting what is covered by the scheme, as is the case with initiatives such as Healthy Start Vouchers. This issue has relevance to other markets too. Consider the notion of social tariffs in the broadband market. Heterogeneity exists in terms of internet speeds afforded by different broadband providers. Should a social tariff provide access to one singular scheme, or give discounts to recipients across any broadband product available? Implementing a basic scheme could restrict consumer choice, and potentially give rise to concerns of inferiority that already plague the take-up of existing social tariff schemes. But giving discounts across a range of products may have implications for the feasibility of administering such a scheme. In sum, there is a risk in markets where products vary widely that social tariffs could be extremely complex to implement or overly paternalistic if they have to distinguish between different versions of the product.

A final consideration for deciding the scope of social tariffs relates to the interaction of such schemes with other policy agendas. In isolation, it might seem desirable to improve the affordability of certain products widely deemed as essential. However, doing so might rub up against other objectives, and in particular efforts to discourage the use of such goods.

The obvious example here is car fuel (petrol/diesel). Fuel represents a critical essential for many people's mobility, especially those in rural areas less served by public transport, and one where we have found spending to account for significant proportions of AHC income. However, subsidising the use of polluting fuels the UK Government is explicitly attempting to transition away from would be at odds with the net zero agenda, and as such, social tariffs for this essential product would be in clear tension with the objectives of environmental policy. On the other hand, social tariffs for public transport services would complement, rather than conflict with, existing policy agendas. Under the same logic, implementing a blanket discount on all foodstuffs from supermarkets might conflict with health policy goals of reducing access to certain products damaging to peoples' health (sugary drinks, fatty foods, etc).

Table 2, below, summarises the findings of this chapter. A fuller circle represents a stronger economic case for social tariff intervention based on our interpretation of the evidence presented.

Table 2: The case for social tariff intervention in different markets

Good/Service	Affordability	Market structure & competition ^{iv}	Homogeneity of products	Additional notes
Food	●	◐	◐	Potential operational complexity
Fuel	●	◐	●	Tension with environmental policy
Energy (Electricity and Gas)	●	◐	◐	-
Internet	●	◐	◐	-
Vehicle Insurance	◐	◐	◐	Tension with environmental policy. Legally mandatory for car ownership.
Rail	◐	●	●	-
Phone	◐	◐	◐	-
Water	◐	●	●	-
Bus	◐	●	●	-
Contents Insurance	◐	◐	◐	-
Banking	◐	◐	◐	-
Household appliances	◐	◐	◐	Purchases are 'lumpy' rather than regular, leading to significant operational complexity. ^v

Source: SMF analysis.

^{iv} This column refers to both qualitative observations on the market structure in this good – for example, whether it is a natural monopoly – and quantitative evidence collected from our polling on the extent and effectiveness of 'shopping around' in that particular market.

^v Unlike most of the other goods we have reviewed, household appliances are not a regular outgoing for households. Appliances such as fridges, freezers or microwaves break down infrequently, and it cannot be predicted when they will do so. Additionally, in the case of renters it is typical that the landlord bears responsibility for sourcing new appliances and replacing broken down ones. Both of these factors make implementing a social tariff for household appliances difficult, if not administratively unfeasible.

Defining eligibility

A further consideration for policymakers is eligibility criteria for social tariffs. There are three broad approaches to answering this question that are currently employed in social tariff schemes in water and broadband.

Three strategies for deciding eligibility

The first approach relates to the burden essential items have on a household's income. This approach prioritises delivering support to people having to spend an unreasonable proportion of their income on bills for essentials or because they have characteristics that make them more vulnerable, such as a disability. Indeed, some water providers use this approach to target support specifically at households deemed to be in water poverty. In 2019, the water sector in England made a Public Interest Commitment to make bills affordable as possible for all households with water and sewerage bills more than 5% of their disposable income by 2030.⁴⁴ Providers such as Thames Water – who provide support to low-income households through their WaterHelp scheme – have been trialling social tariff schemes using this 5% metric.⁴⁵

A second approach revolves around household income thresholds. Several existing social tariff schemes, again often in water, use household income thresholds to determine eligibility. The thresholds set under these water social tariff schemes in water vary, but they typically fall between £17,005 and £21,000.

The third main approach to deciding eligibility, which is the standard model in broadband social tariff schemes, uses benefits receipt as a flag for eligibility. Claimants typically have to be in receipt of one of Universal Credit, Employment and Support Allowance, Jobseeker's Allowance, Income Support or Pension Credit to qualify for a social tariff.

Each of these strategies for deciding eligibility come with important trade-offs. These can be summarised as:

- **Targeting need.** In an ideal scenario, social tariffs would reach every household that genuinely needs support with their bills and exclude any households that do not. In practice, this is difficult to achieve, both conceptually and practically. An eligibility strategy based solely on a bills-to-income ratio, for example, could encompass households that are financially well-off yet exhibit a high bills to income ratio because of high or inefficient consumption.

Benefits can be a useful proxy for financial hardship, but there are a significant number of households in the bottom income quintile who do not receive income from benefits and therefore would not be in scope of a social tariff designed in this way.

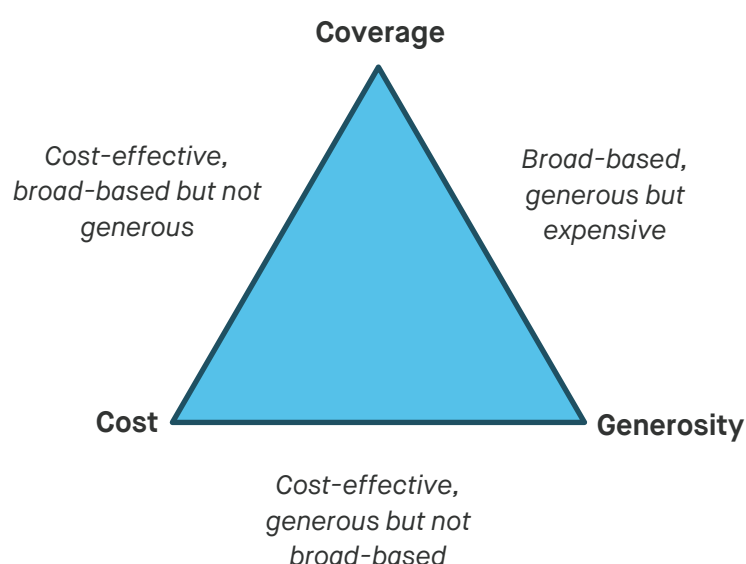
Relying on income is a good overall method of targeting support. However, it may not fully take into account additional needs such as disabilities. Furthermore, using 'hard' income thresholds risks creating cliff edges, where households earning even £1 over the threshold are disqualified from support, even though their income is very similar to households receiving support.

- **Administrative burden.** Another consideration is the practicality of implementing different eligibility approaches. Benefits receipt provides a relatively straightforward yes/no flag that can be easily integrated into social tariff schemes, even though as discussed above this comes at the expense of effective targeting.

On the other hand, using income or a bills-to-income ratio as an eligibility criterion requires more detailed household-level data. The most obvious solution is to use near-real time information (RTI) on household incomes held by HMRC and share it with providers. But even then, there are logistical issues and privacy concerns around data sharing between HMRC and providers of essential items. To add to the challenge, this RTI data exists on an individual and not a household level. Furthermore, HMRC data should in most cases be up to date, but may have gaps and limitations – for example for people listed at the wrong address. In the absence of data sharing, existing schemes that use income as the main criterion tend to require households to manually upload documents showing proof of their income. This places a high informational burden on households who, if they are accessing multiple social tariffs, may have to upload the same documents multiple times to different providers.

- **The breadth/generosity/cost trade-off.** Social tariff policies have to strike a balance between targeting support towards as many people as deserve to be receiving discounts on essentials, providing a level of support that will make a significant difference to household budgets, and the cost to the government, companies and/ or consumers of providing those discounts. This trilemma poses the question of whether a social tariff should aim to concentrate extensive support on a narrow group of extremely vulnerable households, or provide more broad-based, but less comprehensive, support. This trade-off is illustrated below in Figure 5.

Figure 5: The cost/generosity/coverage trilemma



Source: SMF analysis

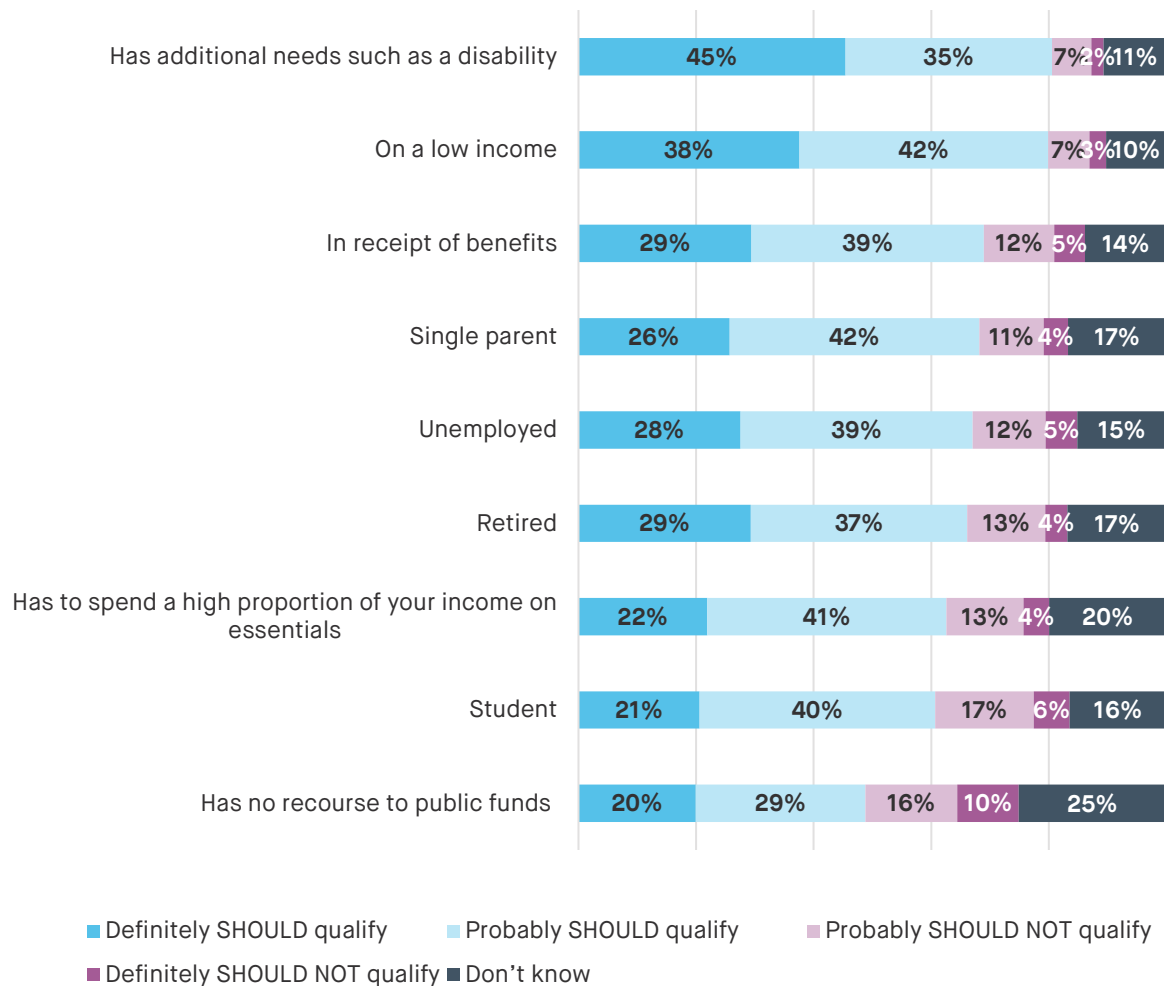
Given the limitations of each of these models for deciding eligibility, some social tariff schemes use a combination of criteria. Proposed schemes in water, for example, sometimes use a bills-to-income ratio to decide eligibility, but caps support at a certain level of income.

Public attitudes to eligibility

In our focus groups, we found that there was relatively more enthusiasm for a system which primarily used income (rather than benefits, largely for the reasons discussed above) to decide eligibility, but with additional criteria such as receipt of disability benefits to allow social tariffs to account for additional needs that households may have.

Our polling suggested that the public see a wide range of groups as being deserving of support on the cost of essentials, as shown below in Figure 6.

Figure 6: Polling results for the question ‘Who do you think should qualify for support with the cost of essentials?’



Source: Opinion survey. Base: 4,000 respondents.

As the previous chart illustrates, there is broad public agreement that social tariff support should be directed towards those who are in some way financially worse off and those with extra needs. The polling found that most agreed with the idea that income should be the criteria for eligibility rather than benefits, and this view was reinforced by our focus group findings. Interestingly, there was relatively weaker support for social tariff eligibility being granted to students or older people, as existing ‘de-facto’ social tariffs such as the Freedom Pass do.

Participants expressed the view that support should be targeted at those in poverty and eligibility based on income, acknowledging that not everyone in financially difficult circumstances claims benefits, agreeing that basing eligibility on receiving benefits would mean people ‘fall through the cracks’ and go without support. “It would be a better idea if it was based on your income, rather than whether people are on certain benefits or not”, one participant argued. “It would make it fairer for everyone”.

Focus group participants also broadly agreed with the idea that those with greater needs should qualify for social tariff support. Those with disabilities were identified as key targets for support, as in many cases, it is necessary for disabled people to spend much larger proportions of their income on essentials than non-disabled people. One participant argued that social tariff schemes should “make allowances for if someone is very unwell or has a disability”. Participants also suggested that those suffering from mental health problems should be eligible for social tariff support. Having children was considered to be another criteria on which social tariff support should be based, with participants citing the extra financial burden households with children face and the dire long-term impact of children going without certain essentials. One expressed their sadness at the thought of “parents who rely on school meals for their kids’ main meals, because they can’t go shopping and find the yellow labels”.

Another issue explored in the focus groups was data sharing. A number of participants raised worries around the security of personal data and the risk of fraud. Yet they also acknowledged that a degree of data sharing is necessary in order for administrators to ensure people are or are not eligible for social tariff support. One recognised that “you have to give a certain level of information so they can base it on peoples’ needs”. Overall, the consensus was that data sharing is a necessary evil: inevitable to ensure support is targeted effectively, but to be kept to a minimum to safeguard privacy and security.

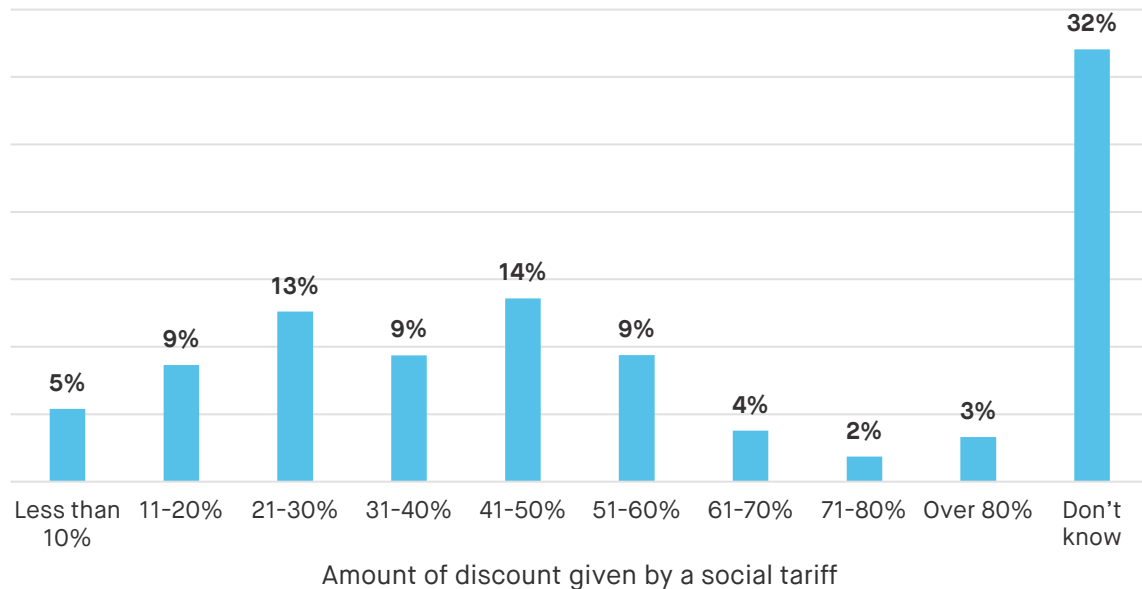
How to design discounts

A further concern relating to the setting up social tariffs is **how** to design discounts on goods and services. One aspect of this is the extent of the discount itself. Again, a trade-off between impact on the affordability of items and the cost of schemes exists; the greater the discounts, the more people can afford essentials and the likelier the social tariff is to have a material impact on household finances, yet the more it costs whoever is funding them.

Public attitudes to discount design

Public attitudes do not offer an especially clear guide to how large social tariff discounts should be, as Figure 7 below shows. In addition, a significant number of people did not know what amount a social tariff discount should be.

Figure 7: Polling results for the question 'What % discount should social tariffs provide to make essentials affordable for people on low incomes?'



Source: *Opinium survey. Base: 4,000 respondents*

Reflections from our focus groups and our public policy roundtable broadly suggested that discounts should be enough to ‘make a difference’ to household finances. This revealed a concern that, if discount rates for social tariffs are set too low, they will not make a notable difference on any of the primary objectives by which a social tariff should be judged, such as affordable access to essentials, poverty rates and so on. One participant argued that if social tariff discounts are small, then the “impact is greatly diminished”.

Broadband was offered as a specific example of this in our roundtable. While discussing issues around observed take-up rates in broadband social tariffs, some roundtable participants suggested that there may be a perception that broadband social tariffs do not give a significant enough discount to enable extremely vulnerable households to access broadband. Among other households, there may be a perception that social tariffs, with the application process they entail, might not be ‘worthwhile’ given the discount offered.

Interactions and the poverty trap

A further concern around designing discounts relates to the possibility of creating ‘cliff edges’ for individuals as they climb the income ladder. For people on means-tested benefits, qualifying for discounts on essential goods could serve to reinforce the ‘cliff edges’ that already disincentivise benefit claimants to work and earn more. Not only do those who start earning more lose their benefit payments, but they will get the ‘double whammy’ of having to pay more for essential goods and services (which typically make up significant chunks of their household spending).

This is a criticism that has been made of other recent interventions to support households with the cost of living, notably packages of ‘Cost of Living Payments’ including the Energy Bill Support Scheme and the £150 council tax rebate for bands A–D. The Work and Pensions Committee launched an inquiry into the Cost of Living Payments in April 2023, noting that “[Cost of Living Payment eligibility criteria] can also act as a ‘cliff edge’ where... those earning £1 above the qualifying threshold lose out on hundreds of pounds of support”.⁴⁶

This risk of reinforcing the poverty trap should be taken seriously, given the enormous potential costs to individuals and society at large. One potential answer to this issue is ‘tapering’ or ‘staggering’ discounts in order to mitigate the risk of ‘cliff edges’ faced by individuals, although this comes at the cost of potentially significant operational complexity.

How to fund social tariffs

Another aspect of social tariff design involves the funding of the schemes. As we have discussed, a number of factors such as the extent of the discounts and broadness of eligibility criteria have a bearing on the cost of social tariffs. But how they are funded has implications for both the political feasibility and underlying fairness of social tariff policies.

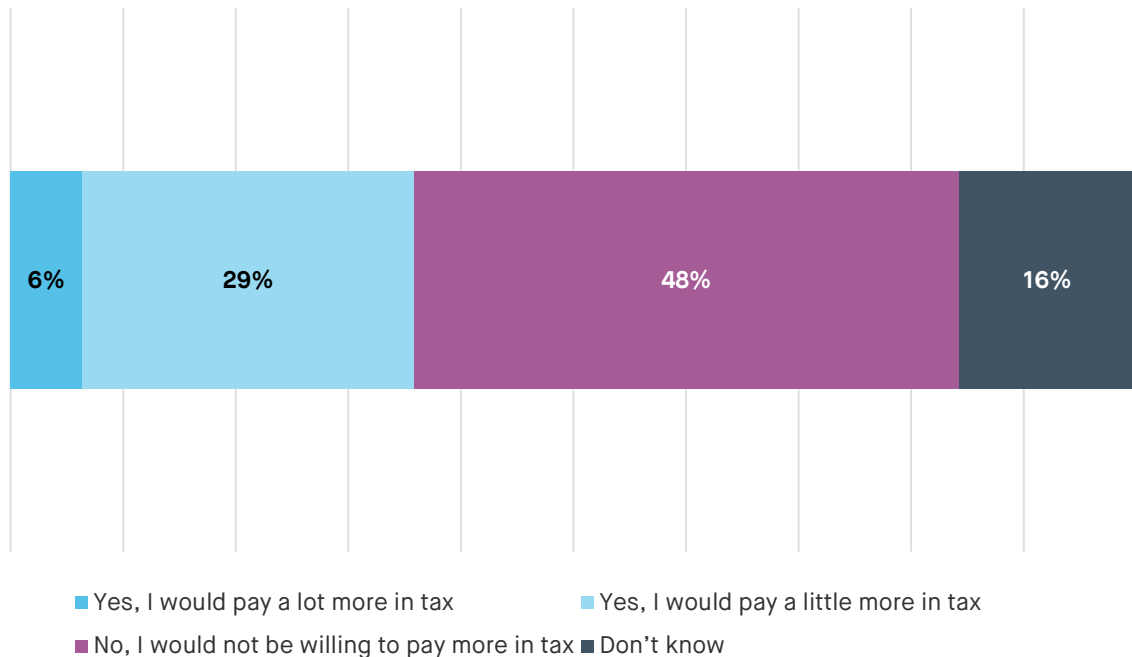
To fund social tariff discounts for low-income individuals/households, one (or a mix) of three things can happen. Either the government funds them through general taxation, companies fund them out of their profits, or other customers fund them through cross-subsidy (i.e. better off consumers pay more for their bills to cover the discounts for social tariff recipients).

Weighing the options

When considering arguments of fairness, funding social tariff policies through general taxation is arguably the most appealing option due to the ‘progressiveness’ baked into the policy. In other words, due to the broadly progressive nature of how the government raises money through taxation, social tariffs are inherently funded progressively (i.e. the better off contribute more than those less so). In our roundtable discussion, funding through general taxation was widely seen as a good ‘ideal scenario’ and the best available funding model for social tariffs that is both plausible and progressive.

That said, using taxes as an approach to funding social tariffs has its downsides. The biggest challenge among these is political feasibility. As can be seen in Figure 8 below, a plurality of people would not be willing to *personally* pay more in tax in order to fund social tariffs. As we will discuss later, there is broad support for funding social tariffs through general taxation, but there is limited willingness from individuals themselves to pay higher taxes. This finding demonstrates the potential political challenge of persuading people to fund social tariffs through their tax bills.

Figure 8: Polling results for the question 'Would you be willing to pay more tax if this went towards supporting people on low incomes to afford essential goods and services?'



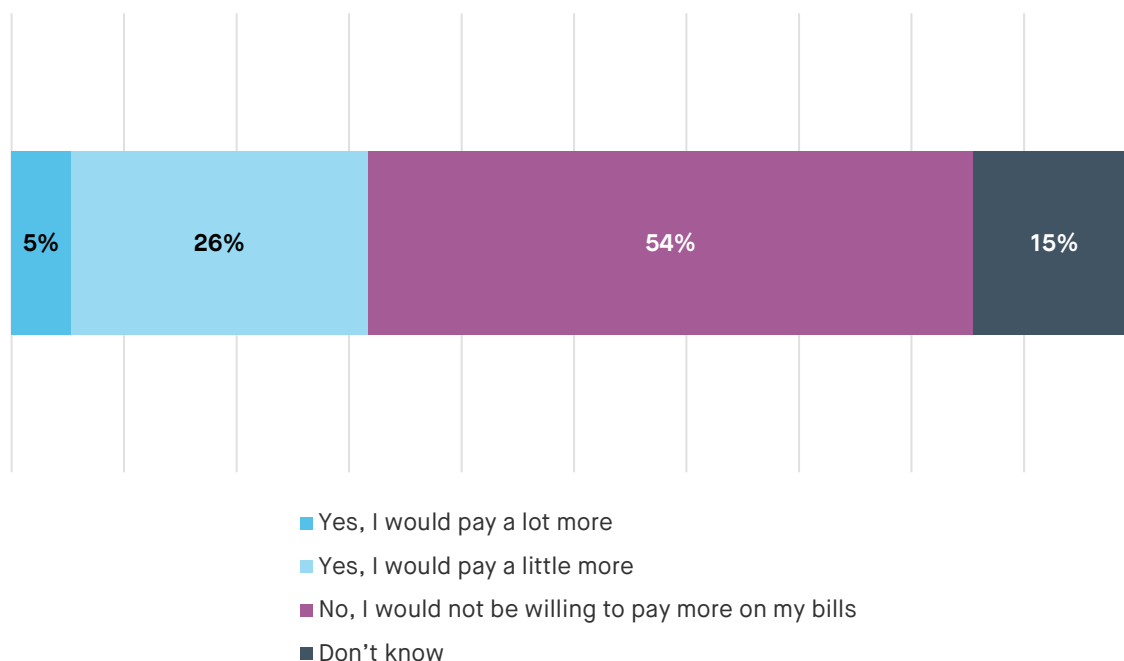
Source: Opinium survey. Base: 4,000 respondents.

If social tariffs are funded through cross subsidy, a progressive 'tax-style' funding approach is theoretically possible. But it is only possible if the prices paid by those not eligible for social tariffs vary with the income of said consumers. Doing so would be administratively complex, as companies may know relatively few details about households outside the scope of social tariffs. Typically, companies that fund their social tariffs through cross-subsidies (in the UK, mainly water companies) do so on the basis of consultation with their customer base to assess how much consumers are willing to contribute in cross subsidy to support social tariffs. Guidance on water social tariffs states that there should be broad acceptability for a proposed cross-subsidy among customers, evidenced through engagement.⁴⁷

A sophisticated, progressive cross subsidy regime could be more politically difficult for companies to establish than a flat-rate cross subsidy. A flat rate cross-subsidy, which is the likeliest outcome of using this funding approach, is a less progressive approach, as the cross-subsidy amount would account for a lower proportion of income for higher-income households than lower-and-middle-income households.

We also observe a similar political challenge for cross subsidies as with taxes, shown in the chart below. Here, a majority of respondents in our polling said that they would not be willing to pay more on their bills to support a social tariff scheme. Again, this finding should be taken in context: as will be discussed below, there is stronger opposition to the idea of personally paying more in bills than there is to the general principle. And willingness-to-contribute research among water providers demonstrates that, in practice, people are already willing to an extent to financially support a cross-subsidy scheme. Market research carried out on behalf of Wessex Water, Bristol Water and Bournemouth Water found that 38% of their customers are willing to contribute at least £2.00 per month to fund social tariff schemes for less well-off customers.⁴⁸

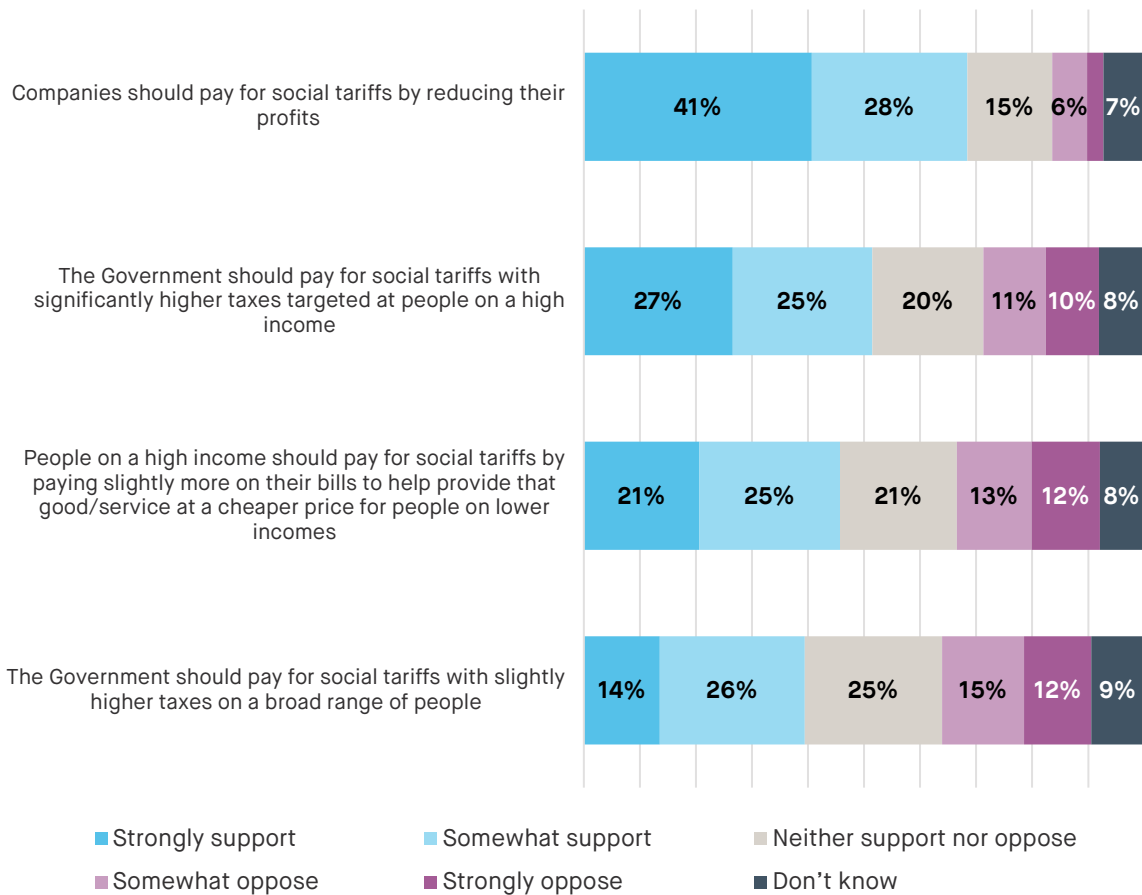
Figure 9: Polling results for the question ‘Would you be willing to pay more on your bills for an essential good or service if this went towards supporting people on low incomes to afford that particular good or service?’



Source: Opinium survey. Base: 4,000 respondents.

Our polling has found that funding social tariff discounts out of companies' profits is the most popular approach, shown in Figure 10 below, and focus group participants generally supported this approach. This suggests that such an approach could be politically feasible with voters.

Figure 10: Polling results for the question 'Below is a range of different options for how social tariffs could be funded. To what extent do you support or oppose each of these options?'



Source: Opinium survey. Base: 4,000 respondents.

Since Russia’s invasion of Ukraine in February 2022, there has been significant media scrutiny of the record profits of companies across a number of industries. Particular attention has been drawn to the utility sector, and especially electricity and gas suppliers. In July 2023, as consumers faced some of the highest energy bills on record, it was reported that Centrica, the parent company of British Gas, saw a nearly ten-fold increase in its annual profits.⁴⁹ According to some estimates, Britain’s energy suppliers are set to take in £1.7 billion in profits over the next 12 months.⁵⁰ Meanwhile, companies in the water industry paid £1.4 billion in dividends in 2022, up from £540 million the previous year.⁵¹

The public response has been understandably angry. In focus group sessions we ran, a number of participants made accusations of corporate greed, arguing that the high costs of living they were facing were in part down to companies heavily inflating prices. These feelings of injustice go some way to explaining the broad public support for funding social tariffs out of company profits.

Such an approach could be pursued: at least some companies are making sufficient profits just now to fund reasonably generous social tariffs. Many of the sectors we discuss are also price regulated, which means there are regulatory instruments which could be used to ensure company profits are redirected to fund social tariff provision. Work by Citizens Advice has found that in several sectors, regulators have overestimated the cost of capital, based in part on the way cost of capital is calculated and partly through ‘aiming up’, i.e. choosing a value towards the top end of their range of estimates. This has led to consumers paying unnecessarily high bills.⁵² Citizens Advice has suggested a number of ways to lower bills for consumers, such as using more conservative estimates for the cost of capital. The gains from this approach could be used to fund social tariff provision.

There are other ways of using regulatory price setting to channel funds from company finances towards social tariffs. For example, the ‘totex’ (‘total expenditure’) mechanism sets an allowance for companies to cover forecast necessary costs. If a company underspends its allowance, the efficiency gains are shared between the company and customers.⁵³ Conversely, if the company overspends to deliver necessary services, it can recover part of the costs from customers.⁵⁴ Such approaches are used in a number of sectors such as energy.⁵⁵ The intention of this is to drive efficiencies by providing incentives to companies to spend below totex allowances. But the existence of the totex cost-sharing mechanism provides one potential regulatory lever for funding social tariffs: the proportion of totex underspends companies are allowed to keep could be reduced, while funding for social tariff support is increased.

However, there are some practical problems that arise from the approach of funding social tariffs out of company profits. One is that comprehensively funding social tariffs would likely be very costly for firms. Some providers have already voiced concerns over using company profits as a primary basis for expanded social tariffs. For example, BT estimates that existing social tariffs, if taken up by all eligible recipients, could cost the broadband industry up to £2 billion, and has argued that “the model in its current form is unsustainable”.⁵⁶

Whilst some sectors could conceivably burden the costs of social tariffs through accepting lower profits (consider that BT alone reported before-tax profits of £1.7 billion in the last financial year)⁵⁷, doing so may give rise to some unintended consequences arising from the potential behavioural response of firms. There is a risk that firms could raise prices on all non-social tariff consumers, which in the case of a single ‘flat’ price rise for all consumers not eligible for social tariffs, would not be as progressive as general taxation because the cross-subsidy amount would account for a lower proportion of income for higher-income households than lower-and-middle-income households. Firms could be incentivised to reduce the generosity or narrow the eligibility of existing social tariff schemes they provide, or simply exit the market as a result. There is also the question of whether reducing profits may affect other activities that benefit consumers in the long run, such as capital expenditure or greater efficiency, in some industries. Returning to the example of totex cost sharing mentioned above, it is possible that reducing the proportion of totex underspends companies get to keep weakens incentives for companies to pursue efficiency; it is an

open question whether the longer-term effects of this outweigh expanded provision of social tariffs through profits. All of these outcomes are hard to predict, but should not be discounted entirely when pursuing an approach for funding social tariffs based on company profits.










Another challenge to the company profits approach is how to ensure consistent and long-lasting social tariff provision, particularly in the context of fluctuating company profits and varying profit margins across companies in a sector. A key advantage of tax-funded provision or risk-pooled cross subsidy frameworks is that they are to a considerable extent insulated from market volatility, although that is not to say that they are immune from all volatility (as with all forms of public spending, electoral pressures may influence a tax-funded social tariffs model). In the absence of extensive co-ordination, relying heavily on company profits presents a potential risk that social tariff support may fluctuate over time as companies respond to downturns in their markets or wider economic conditions.

A second issue centres on deciding where and how much using company profits to fund social tariffs is appropriate. The goods and services we have discussed above cover a wide range of different industry dynamics, different pricing models and different margins. While in certain sectors there may be a strong case for reducing company profits to fund social tariffs, particularly where there have been unearned 'windfall' profits, in other markets such a case may be weaker.

While it is possible to use company profits to fund social tariffs, then, there are important practical challenges to acknowledge around how to differentiate the approach between different industries, mitigating against the possibility of unintended consequences, and ensuring such a model is stable and co-ordinated. Furthermore, the political feasibility of this funding approach may be more limited than the public attitudes our research has uncovered might suggest. With both main parties focusing on economic growth as a policy priority, curtailing firm profitability in this way may not be seen as unambiguously politically attractive.

To summarise, no funding model for social tariff is without its drawbacks. The table below shows graphically our interpretation of the evidence around different funding models and how they perform on the metrics of progressivity, financial feasibility (by which we mean how likely this funding model is to be financially sustainable) and political feasibility. Fuller circles represent a stronger case.

Table 3: Assessing different funding models for social tariffs

Model	Progressivity	Financial feasibility	Political feasibility
General taxation			
Cross-subsidy			
Company profits			

Source: SMF analysis.

Harmonisation of social tariff schemes

Besides considerations around how to design social tariffs *within* different markets, it is also important to consider the interactions *between* different social tariff schemes. Put another way, there is a question around the extent to which it is desirable and feasible to consolidate distinct social tariff schemes in various markets into a unified framework.

The status quo: varied support

As discussed in the previous chapter, at present there is a wide variety of social tariff schemes operating in different markets. There are arguments in favour of this arrangement. Typically, social tariffs in the UK are funded via cross subsidy, meaning they are funded through company finances. If companies have to fund social tariffs via cross subsidy (or, in some rare cases, through their own profits), then there is a pragmatic argument for differing social tariff schemes: social tariffs are by necessity constrained by the financial situation of the companies providing them.

Different social tariff schemes may also reflect different customer bases. In water, social tariff cross subsidies are decided based on willingness-to-pay research and consultation with customers. In practice, the agreed cross subsidy amounts seen in water are the maximum amount companies can apply without seeking additional approval from their customer base.⁵⁸ But there are observed variations in willingness to pay for cross subsidies between different water providers and different socio-demographic groups of customers. For example, in the market research cited earlier, the average (mean) ‘willingness to contribute’ to social tariff schemes was found to be £1.50 per month among Wessex Water customers, £1.79 among Bristol Water customers and £1.83 among Bournemouth Water customers.⁵⁹

However, having a variety of different social tariff schemes carries significant disadvantages. First, and most importantly, the existence of multiple design schemes for social tariffs entails a ‘postcode lottery’ of support, in which households in similar financial circumstances can miss out on support simply because of where they live, as noted in the previous chapter.

Second, a variety of social tariff schemes with differing eligibility criteria and designs presents an informational barrier to households who might apply. Put another way, it makes the process of working out one's eligibility status, and how to apply, for a social tariff more involved and time-consuming than it would be if social tariffs were broadly similar across the country.

Single social tariffs

The other end of the scale is a 'single social tariff'. There are two basic versions of this. One is a sector-wide single social tariff, which would harmonise different social tariff schemes in order to ensure that eligibility criteria and generosity were uniform across the providers in a given sector. Such a framework has already been proposed for the water sector, and was one of the key recommendations arising from an independent review of the water sector conducted by the Consumer Council for Water (CCW).⁶⁰

A sector-wide single social tariff could be accompanied by a central funding pot for cross subsidies in order to promote risk-sharing between providers. The CCW recommended setting up a single social tariff in water which would entail creating one central funding pot across England and Wales, which uses a customer cross-subsidy at a level which allows the eradication of water poverty at the 5% level.⁶¹

A more ambitious version of this idea is to further consolidate social tariffs in different sectors to establish a suite of social tariffs. Such a 'single unified social tariff' would see a system in which social tariffs across multiple sectors have the same design features (eligibility and generosity), with any household meeting the eligibility threshold for such a scheme receiving social tariffs in all the goods and services covered by the scheme.

A middle way? Regulatory frameworks for social tariffs

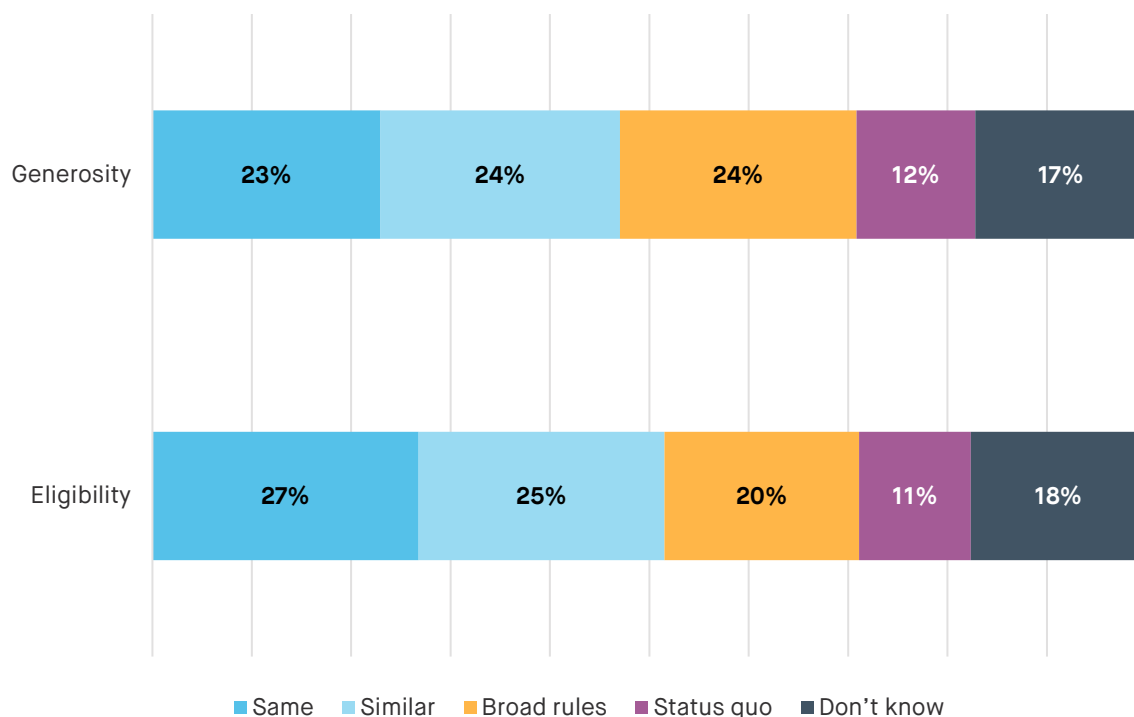
A third option is to set up a system that lies somewhere in between the current 'patchwork', voluntary approach to social tariffs and a unified, single social tariff. This would entail allowing companies a degree of discretion in how they design and implement social tariffs, but accompanying this with regulation to stipulate minimum standards in eligibility, generosity and quality of provision.

Our fieldwork has shed light on public attitudes to the question of harmonisation. In our polling, we asked respondents to indicate their preferences on how similar social tariff schemes should be across the country, in terms of both eligibility criteria and generosity. The options included:

- The same for all companies ("Same")
- Similar, but there should be some degree of flexibility ("Similar")
- There should be some broad rules, but companies should be able to design their own schemes within these rules ("Broad rules")
- Companies should be free to design their own rules that reflect their customer base ("Status quo")

Figure 11 below shows the response to this question. The public are clearly divided on the question of how far harmonisation of social tariffs should go – a similar proportion think social tariff schemes should be the same (23%) as those that think that there should simply be some broad rules (24%) – but these results indicate that there is agreement that a purely voluntary approach is not desirable, with only one in ten respondents saying that companies should be free to design their own social tariff schemes.

Figure 11: Polling results for the question 'Which comes closest to your view on how similar social tariff schemes should be around the country?'



Source: Opinium survey. Base: 4,000 respondents.

These findings from our polling suggest that some degree of action to deliver more convergence among social tariff scheme designs would be popular with the public.

CHAPTER FOUR – DISCUSSION

The previous chapter discussed the key design parameters and debates that need to be resolved when developing a new social tariff intervention. This chapter turns to providing some answers to these questions, by identifying which goods should be prioritised for a social tariff, before setting out what an ‘ideal’ scenario for social tariffs would look like as a long-term objective as well as outlining some credible shorter term steps that can be taken to improve social tariffs in the UK.

Introduction: defining the scope of social tariffs

The first consideration is the scope of social tariffs, or in other words, which markets warrant intervention. As we have seen, a range of goods and services can be considered essential in nature, and for many of those, affordability is a pressing challenge for many households. Looking at affordability and public attitudes on what constitutes ‘essential’ alone, we might conclude that virtually all the markets assessed should have social tariffs. However, once we have looked at a range of additional considerations, certain markets can be ruled out, or at least deprioritised, for intervention of this kind.

Lower priority markets

Take food and groceries, where there is the greatest pressure on household budgets after housing costs. Through the lens of affordability alone, this market arguably has the greatest case for social tariffs. However, when we consider the additional criteria for social tariff schemes, most notably the degree of heterogeneity seen in this market, it is not clear that social tariffs would be an optimal solution to problems in this sector. Due to the vast range of products sold in supermarkets, varying hugely in type, quality and price, implementing a social tariff would entail great administrative complexity if a scheme was to be selective about what specific products are covered by social tariffs. Additionally, the state risks making paternalistic interventions that go against the personal choices of individuals, who have a large variety of dietary preferences and needs. On the other hand, if there was a blanket social tariff on all grocery products, then such a policy might conflict with other policy aims such as reducing access to certain harmful food products.

Furthermore, whilst the Valencian case study of social tariffs for food from supermarkets illustrates that such a policy is possible, this was (and was intended to be) a short-term (three month) solution to an immediate cost of living problem. Due to the large costs involved in running such a scheme, it is unlikely that a government would be willing to make it a permanent solution to the problems of unaffordability in this market. Given the considerable level of household spending on food and groceries, meaningful social tariffs in this market are likely to prove extremely costly. As an example, we estimate that a 33% discount on food and groceries for any households claiming benefits (UC, ESA, PIP or DLA) would cost around £5.5 billion.⁶² For these reasons, we can conclude that there is a comparatively weak case for social tariff intervention in the market for food and groceries.

Fuel for car travel is another essential good with considerable concerns around affordability. However, here there is significant tension with another key policy agenda of encouraging people to switch to more environmentally friendly forms of transport. Subsidising the use of a polluting fuel would encourage greater use of that fuel, consequently inflicting negative effects on air quality and efforts to reduce carbon emissions. As such, we are minded to eliminate motor fuel from the list of markets where there is a good case for social tariff intervention.

For contents insurance and banking services, whilst widely considered essential services, these goods do not rank highly when it comes to affordability concerns: spending on these goods represents the lowest proportion of spending of AHC income of all the goods we assessed. The absence of affordability concerns mean there is a relatively weak case for social tariff interventions in these markets based on current spending, with alternative market interventions likely to be more effective.⁶³ That said, there is a possibility that some people are unable to access these items due to financial barriers, although alternative reasons, such as a lack of product awareness and limited consumer demand, seem to be more significant factors.^{64 65} Further efforts to promote financial inclusion could be valuable in ensuring access to them.

Markets for household appliances, whilst making up a greater proportion of household's spending, are not appropriate targets for social tariff intervention either. This is because appliances like fridges and washing machines, tend to be infrequently bought. Administering a social tariff on purchases of these products would bring significant operational complexity because purchases of appliances cannot typically be predicted as they are not regular in the same way that, for example, a water tariff would be.

Having eliminated the essential goods for which social tariffs are not suitable, we can now turn to the markets where there is the strongest case for social tariff intervention.

The highest priority markets for intervention

On balance, we conclude that the strongest case for social tariff intervention lies in the markets for energy (electricity and gas), broadband, water, and public transport (rail and bus travel).

Household energy is perhaps the market with the greatest case for intervention of all those assessed. An absolutely essential product, and one with a significant degree of homogeneity, energy accounts for amongst the greatest AHC income household proportional spend of all the goods we assess. With many households at risk of fuel poverty, social tariffs could be an effective way to ensure access to essential household energy.

Household water and broadband services, markets where voluntary social tariffs already exist, are also markets where the case for social tariff intervention is strong. Water is a highly homogenous product and one where the monopolised nature of the water industry means consumers cannot 'shop around' to find better prices. Social tariffs are warranted in the market for broadband due to the problems of affordability affecting households in this market, and in large part because of the potential consequences of going without digital connectivity in modern society.

The same is true for public transport. Given its role in providing access to educational and employment opportunities, ensuring poorer households' access to public transport is critically important to efforts seeking to improve the ability of poorer households to get richer. Subsidising public transport use for eligible groups also encourages people to shift to more environmentally friendly forms of transport, assisting government efforts to decarbonise the economy and improve air quality.

Vehicle insurance is somewhat more complicated as it accounts for a notable chunk of household expenditure, and is legally mandatory in order to travel by car. However, whilst a social tariff for car insurance would serve to decrease the cost of driving for recipients and would therefore conflict with the policy aim of discouraging car travel, unlike fuel it does not scale proportionately with use. Whereas cheaper fuel might encourage people to drive more, cheaper motor insurance only makes a difference to people's decision over whether to get or keep a car in the first place – and so has less impact on the margin. Given the prevalence of the poverty premium in the car insurance market⁶⁶, and the importance having a car to some people's access to employment and educational opportunities (especially those in rural areas), we conclude that there is a relatively strong case for social tariffs in car insurance.

This is not to say that social tariff intervention categorically *should not* happen in the other markets we have examined, rather that intervention in the markets we have identified has a stronger overall case and is more actionable. For the markets that we have identified as being fit for social tariff intervention, the government should move to implement these policies to ensure access to these essentials for households struggling to access them. However, there are a number of further aspects to social tariff design that need to be addressed prior to implementation.

Having identified the strongest candidates for what goods should be covered by a social tariff scheme, we now turn to the substantive questions around what a good policy design for social tariffs would look like.

Long term ambitions: towards an ideal social tariff framework

Outlining an 'ideal' social tariff scenario

As Chapter Three established, the main problems with social tariffs centre on poor take-up, inconsistent eligibility, and poor targeting. From this, we conclude that a new framework for social tariffs – in other words, an 'ideal scenario' for social tariffs needs to exhibit the following features:

- **Well-targeted.** By this we mean that a social tariff scheme needs to target households most in need of support, whilst at the same time minimising the fiscal cost and the extent to which the scheme supports households who do not need it.
- **Consistent.** An ideal social tariff scheme needs to limit the extent to which eligibility varies for different goods in order to limit complexity. A natural consequence of this objective is that there will need to be some degree of harmonisation between social tariffs in different markets.

- **Accessible.** A well-performing social tariff scheme should limit barriers to accessing social tariffs and ensure high take-up to maximise its impact. We argue that the best way of doing this is auto-enrolment.

Weighing the case for different eligibility systems

No eligibility system is perfect. However, our research – in terms of our focus groups, polling, and insights from the public policy roundtable we held in September 2023 – is clear that, while using the benefits system is simple and administratively straightforward, a system that both takes into account need and targets support more efficiently at the most vulnerable households would represent a significant improvement.

Basing social tariff eligibility on benefits, as existing social tariffs in broadband do, does target social tariff support towards less well-off households. However, it does so in a crude way. There are many households who do not claim benefits despite being on low incomes and being eligible for support. The Joseph Rowntree Foundation has estimated that 4 in 10 households in the poorest fifth of the population do not receive benefits, for reasons such as being unaware of entitlement, the stigma attached to claiming benefits, bad experiences of assessment processes, and a complex benefit administration putting people off.⁶⁷ Our own estimates from the LCFS suggest that as many as around 938,000 households in the bottom quintile of equivalised income are not in receipt of benefits.⁶⁸ By basing the eligibility for social tariff support on whether individuals/households receive benefits payments will mean some households will inevitably ‘fall through the cracks’ and be deprived of support when they are in need of it.

Basing eligibility on income is a better way to target support. It will mean that being able to receive social tariff discounts on essentials is not impacted by arbitrary factors (such as not claiming benefits due to the challenges of navigating a complex welfare system). Household income more accurately describes the ability of a household to purchase essential goods, and therefore income, not receipt of benefits, should be a key element social tariff schemes consider in determining eligibility.

However, whilst income accurately reflects the resources a household can devote to purchasing essential goods and services, it still doesn’t explicitly take into account households’ essential needs. Consider the example of two households with the same income, the first being composed of an adult with three young children, and the second being a single individual in their twenties. It is evident that the first household will require considerably more provision of essential goods than the second (e.g. more water to keep children clean, greater broadband use to ensure their digital connectivity). Basing eligibility on income alone would disregard the differing needs of households.

Using equivalised income as an eligibility criterion would therefore better approximate household need than using raw household income to decide eligibility. But to truly target need, the amount households spend on essential products relative to their income must also be considered. Doing so will ensure that households who have to spend significant proportions of their low incomes on essential goods get support. It will also mean that support does not go to those households who might well be on a low income, but due to lower essential needs, do not struggle to access essential goods and services.

Effectively targeting support in this way could lower the cost of social tariff support, and thus allows for greater discounts to have a meaningful impact on the household finances of those who are in the most need of support. Furthermore, by imposing an absolute maximum income threshold for which households can access social tariff support, the small proportion of households on higher incomes that spend considerable proportions of their income on essentials can be excluded from social tariff schemes, ensuring that support is not provided to those who do not absolutely need it.

To illustrate this point, Table 4 below shows our estimates, using LCFS data, of the fiscal cost in billions of a range of approaches to social tariffs covering water, gas, electricity, broadband, rail and bus travel and vehicle insurance. These include: using benefits (including Universal Credit and disability benefits); using equivalised household income thresholds at different levels; and, using a bills-to-income ratio. These ratios take into account the proportion of equivalised income that the 'core' household goods of water, gas, electricity and broadband account for; for example, if a household has an equivalised income of less than £20,000 (which encompasses the bottom half of the equivalised income distribution) and spends above the specified proportion of this on the core household goods, they would qualify for social tariffs. Ratios of 15%, 17.5% and 20% have been included for illustrative purposes only, though are intended to reflect high thresholds of spending that would capture the top 10-25% proportions of spending.^{vi}

^{vi} The 90th percentile proportional spend (meaning only 10% of households spend more on these essential goods as a proportion of income) is 21.8%, while the 75th percentile is 14.3%.

The reason we use ‘core household goods’ to calculate the bills/income ratio is because of the distinction between goods, such as water or broadband, which are almost always shared between members of a household, and individual level goods which are purchased instead by individuals. For example, people buy bus tickets for themselves individually, whereas they purchase broadband to be used as one household. An additional reason is that bills for household-level goods are more likely to be stable. In contrast, spending on transport could vary significantly, for instance if people have to make unexpected trips or are using public transport to get to job interviews one month. As such, eligibility for a bills-to-income ratio would be assessed by means of the household goods we outline above, and automatically administered, while social tariffs for individual goods – public transport and car insurance – would be conditional on being part of a household eligible for social tariffs for energy, water and broadband. As opposed to the automatically administered household good social tariffs, individuals would need to manually apply for social tariffs for individual goods, providing evidence that they are eligible. This could, however, be implemented through existing architecture such as railcards.

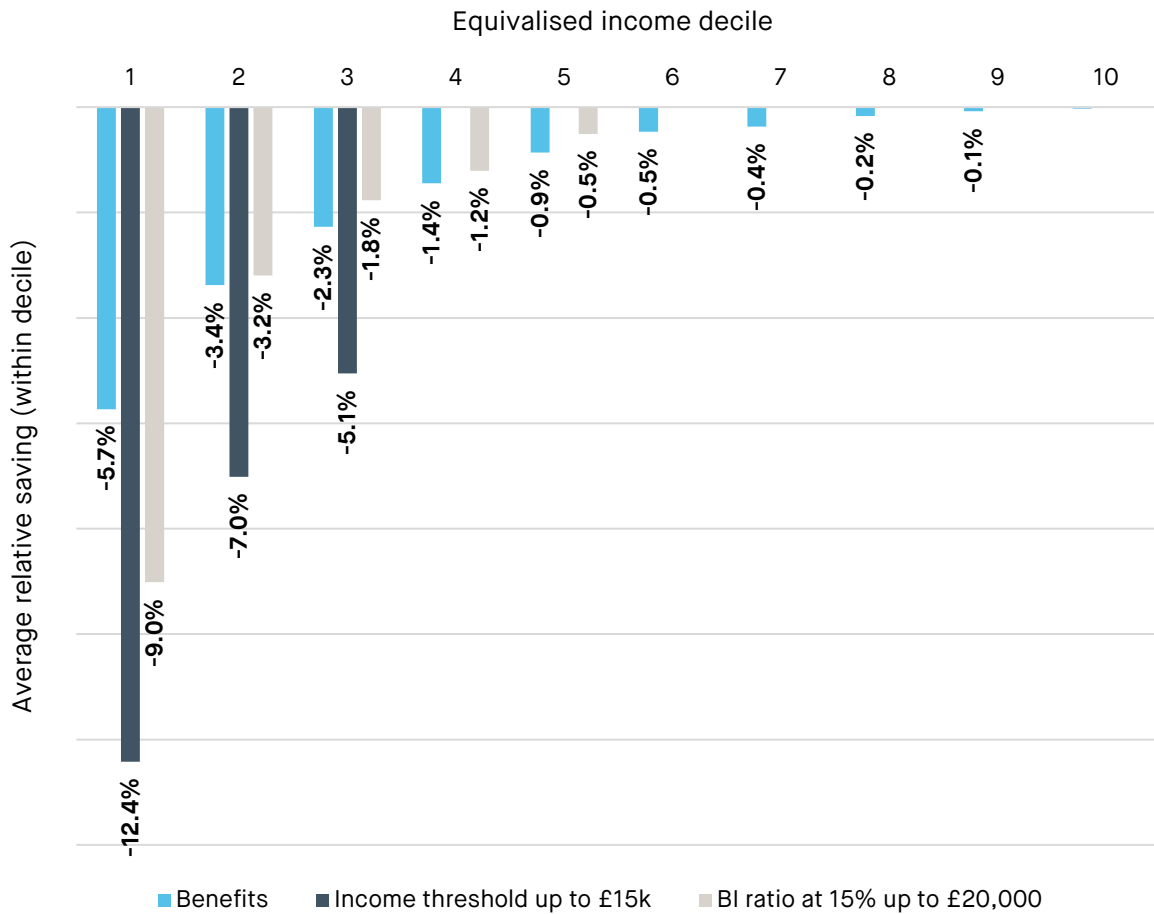
Table 4: Modelling different scenarios for social tariffs covering water, energy, broadband, public transport and car insurance

	Benefits	Equivalised income thresholds		Bills-to income ratios (before housing costs)		
	UC + PIP/DLA/ESA	Income threshold up to £20k	Income threshold up to £15k	Bills-to income ratio: 20% up to £20k	Bills-to income ratio: 17.5% up to £20k	Bills-to income ratio: 15% up to £20k
Discount	Fiscal costs (£ billion)					
20%	£2.9	£6.7	£3.8	£1.8	£2.1	£2.4
33%	£4.8	£11.1	£6.2	£2.9	£3.4	£4.0
50%	£7.3	£16.8	£9.4	£4.4	£5.2	£6.1
	Coverage (millions of households)					
HHS benefitting	5.3	13.2	8.0	3.4	4.3	5.6

It is worth emphasising that these figures are indicative estimates and there are caveats that need to be taken into account. But they illustrate the point that using a bills-to-income ratio could help to keep down the fiscal costs of social tariff provision relative to other options for deciding eligibility, especially at higher discount levels.

Furthermore, such an approach could be more targeted than the status quo. Consider Figure 12 below, which shows the average relative savings (the average savings from social tariffs divided by the average income) by equivalised income decile. The chart shows what average relative savings could look like under different eligibility criteria, with a social tariff covering water, broadband, energy and rail/bus travel at a 33% discount.

Figure 12: Comparing the distributional impact of different eligibility systems, Relative impact of combined social tariffs with 33% discount under different eligibility criteria



As the chart shows, both an income threshold and a bills-to-income ratio with income cap represent a better approach than benefits receipt for targeting support at households with the very lowest income. As Table 4 shows, though, using an income threshold on its own could quickly become fiscally expensive, meaning there is a case for incorporating a bills-to-income ratio on affordability grounds.

From first principles, then, a bills-to-income ratio with an income cap would be an ideal approach to resolving the issues and trade-offs outlined in chapter three. Such a system would achieve the key objectives of reaching wider than the benefits system, whilst also having a better proxy for financial need. An eligibility criteria of this kind will ensure that support is generous but well-targeted, ensuring that the financial cost of social tariff schemes are minimised.

Having explored what an ideal approach to social tariffs could look like, we turn to practical concerns: namely, how a new system could be implemented, how it could be funded, and the extent to which harmonisation can and should occur.

Implementing a bills-to-income ratio

While the idea of a bills-to-income ratio is appealing, it is worth noting that implementing a bills-to-income ratio effectively has several challenges that make it more of an ‘ideal scenario’ and a long-term project than a plausible way of improving social tariffs in the short term. These challenges are substantial and should be acknowledged.

One aspect of the challenge is ensuring a significant improvement in data sharing. A consequence of using a combined bills-to-income ratio to assess eligibility is that doing so will require knowing both household income and outgoings on essentials. This would mean that data from suppliers and households would need to be consolidated into one place. In principle, this could be done if government brought together income data from DWP and HMRC. The Digital Economy Act 2017 allows HMRC ‘Real Time Information’ data to be shared with other bodies in the public interest.⁶⁹ For example, one trial of the framework saw HMRC share information about individuals’ earnings with the Department for Education and three local authorities as part of a social impact bond scheme.⁷⁰

It is worth acknowledging that HMRC data does have limitations insofar as it is largely based on individuals, not households. Therefore, it will require some data matching to effectively target social tariffs. Currently, there is only a legal duty for firms to tell HMRC about addresses for new employees, with no requirement for firms to provide up-to-date information on where their employees live. This would have to be amended for effective data sharing to take place.

It is also worth noting that this approach of using HMRC incomes data is deemed to be sufficient for the WHD scheme, which makes use of income data to consider eligibility based on tax receipts.⁷¹ This process, though, also has scope for improvement, given the reliance of WHD eligibility on the tax credits legacy scheme. To ensure better targeting, HMRC would have to go beyond the current eligibility approach taken in the WHD and base eligibility directly off income.

A further issue with this approach is that Houses in Multiple Occupation, or ‘house shares’, will be considered as single households under this system, with the incomes of constituent members combining to form ‘household income’. This is somewhat problematic, as one working individual could push the household income above the eligibility threshold, whilst the other individual in a flat may have no income, but would be ineligible for support. That said, house shares would in most cases share the costs for household-level goods such as energy or water.

To summarise, the key issues around data sharing from the government side centre on ensuring up to date addresses and ensuring HMRC data reflects household income.

On the other side of the equation, suppliers – water companies, energy companies, broadband companies and so on – hold data on customer bills. To maintain public trust, we do not recommend that HMRC household income data is shared with suppliers; a better approach would be for suppliers to share data on household bills with government, which can then inform suppliers of who should be eligible for social tariffs.

A more significant challenge is properly taking into account housing costs. This is an important issue when it comes to properly reflecting a household's financial situation. To illustrate this point, an outright owner and a renter may both have a moderate bills-to-income ratio when a before housing costs (BHC) approach is taken. But the renter's AHC bills-to-income ratio may be significantly higher as a result of their monthly outgoings.

Furthermore, due to variation in housing costs around the country, there is likely to be corresponding variation in peoples' bills-to-income ratios, by virtue of where they live. So by setting a countrywide BHC bills-to-income eligibility criteria, it is likely that many people will go without support despite being in similar financial situations with recipients in different parts of the country.

One way to get around this would be to ask applicants to provide evidence of their housing costs (i.e. rent/ mortgage payments), so that AHC bills-to-income ratios could be calculated. This is the approach taken in certain social tariffs such as Bournemouth Water's 'WaterCare' scheme, which assesses eligibility based on information given by households.⁷² However, doing so adds additional layers of complexity to a system which is likely to have the most impact when it is easy and simple to use. It would also eliminate the possibility of automatically administered social tariffs, which given problems with take-up of existing schemes, we find to be an ideal scenario. As such, requiring people to submit evidence of their housing costs, while ensuring a more accurately targeted system, would come with some significant disadvantages and miss an opportunity to improve on the present system for social tariffs in terms of complexity.

On the other hand, completely omitting the single greatest essential cost on peoples' budgets – housing – would be an equally misguided approach. In what can be considered a compromise between simplicity and effective targeting, the bills-to-income eligibility criteria, and the income cap, could vary by location to reflect geographic variance in housing costs. To do this in the most targeted way possible, specific bill-to-income ratios and caps could be set for all households within specific Lower-layer Super Output Areas, the most granular administrative geographical level at which housing cost data is available. There is still variance in housing costs at this neighbourhood level, and this system will be unable to accurately distinguish between the different circumstances faced by a renter and neighbouring mortgage free homeowner. However, such variance in housing costs will be considerably less than setting ratios and caps at larger geographic areas. Moreover, there is scope for organisations such as the Valuations Office Agency to work with the Government to provide more accurate estimations of the housing costs faced by households in local areas. Doing this is undoubtedly a complex task for the government to undertake, and should be considered a long-term objective.

Defining the funding model

A second question around implementation is how to fund new social tariffs. As the discussion in chapter three made clear, each potential funding model for social tariffs has some drawbacks.

Overall, funding social tariffs from general taxation is the ideal approach. It is the most progressive option for funding social tariffs. And given that it would not need to rely on company finances, it is arguably the most workable option as well: it would be more insulated from market downturns and financial turbulence among providers, and avoid any unintended consequences that limiting company profits may bring. There is also the secondary benefit that using taxes to fund social tariffs makes the emergence of a ‘postcode lottery’ of support much less likely because companies, in the absence of a national risk-pooling scheme, would not need to set up social tariff schemes in line with their financial situation.

We therefore conclude that general taxation would be the ideal funding model for social tariffs and is our preferred solution. However, as noted in chapter three, using general taxation does come with its own challenges – notably, political feasibility given our evidence on public attitudes and the UK’s current fiscal position.

The risk of cliff edges

As discussed in chapter three, implementing social tariffs on essential goods carries the risk of creating ‘cliff edges’ for individuals as they climb the income ladder, thus disincentivising those individuals from working and earning more. Basing eligibility on income rather than benefits has the advantage of avoiding the case of the ‘double whammy’ of simultaneously losing benefits and social tariff discounts as individuals move above the means-tested threshold for benefits receipt.

However, cliff edges will still be present under a system based on bills-to-income eligibility. As we have seen, a social tariff scheme could ‘taper’ or ‘stagger’ discounts to mitigate the effect of cliff edges. Here, social tariff recipients will be categorised further into different groups – or ‘bands’ – based on their household income. The poorest social tariff recipients receiving the largest discount, and that discount decreasing the closer households get to the income eligibility threshold cap. Doing this will smooth the ‘cliff edges’ faced by households as their income grows, but will add a degree of operational complexity to the process (although under an automatically administered social tariff scheme, it is certainly not an impossible task).

There is a trade-off between reducing the operational complexity of schemes and mitigating the impact of cliff edges on individuals. A flat discount on all social tariff recipients entails greater simplicity for those charged with setting up a social tariff scheme, whereas banded discounts could effectively smooth cliff edges faced by households and better incentivise poorer households to work more in order to increase what’s left for households at the end of the month, after taxes, benefits and bills have been paid. Policymakers should explore the potential for social tariff discounts to be banded, or ‘tapered’, to reduce the risk of social tariffs creating or at least reinforcing cliff edges for households.

Harmonisation

As discussed in chapter three, there are a variety of approaches to harmonising social tariffs. A single unified social tariff model brings several advantages. Such a model directly addresses one of the key problems of social tariff schemes as they exist at present, which is inconsistent support.

However, setting up a single unified social tariff would be a complex endeavour and require extensive co-ordination and would represent a long-term project.

Short-term priorities for social tariffs

The discussion above set out broad parameters for an ideal framework for social tariffs. Admittedly, this ideal scenario is difficult to implement and doing so would take time and resources. As discussed, there are several significant logistical challenges that would have to be overcome to ensure good quality data sharing and targeting. This begs the question of what can be done to improve social tariffs in the UK in the more immediate term. This is important to consider, especially in order to respond to the current economic situation and the likely challenges over the course of 2023 and 2024.

Much of the work to build an ideal social tariffs framework will require new levels of data sharing and integration; these new frameworks may admittedly take years to fully materialise. But there is still scope to improve social tariffs in the UK with existing tools. In the shorter term, there is a good case to drive greater convergence between social tariff schemes. It is important to do this in order to reduce postcode lotteries and simplify social tariffs.

This could be done through a regulatory framework setting parameters for social tariff designs. Currently, social tariff designs are largely voluntary and left to the discretion of providers. However, to ensure greater consistency between social tariff schemes across the country, sectoral regulators such as Ofwat and Ofcom could set minimum standards for eligibility and generosity in social tariffs. In the immediate term, this could involve regulators setting out what they consider to be appropriate or model social tariff designs in their sector. That said, this approach is still limited if social tariffs remain voluntary: without sufficient economic incentives, there will still be a risk that social tariff support in competitive markets is diluted or phased out.

To complement this work, regulators in competitive markets (that is, markets that are not characterised by natural monopolies such as energy and broadband) can also focus on lowering barriers to applying for social tariffs. Specific steps that could be taken in this regard include encouraging better promotion of existing social tariff schemes and taking action to remove exit fees for switching to a social tariff scheme. Admittedly, some of these immediate steps are being taken by regulators such as Ofcom, which has recently written to broadband providers setting out ways in which social tariffs in broadband could be more prominently signposted and emphasising the need to waive early termination charges for moving to a social tariff scheme with a rival provider.⁷³ Given the sluggish take-up of broadband social tariff schemes, however, there is evidently a limit to which better promotion encourages take-up of existing social tariff schemes.

There is also a need for intervention in markets where there currently are no social tariff schemes in operation. Insurance markets stand out in this regard. Previous work by the Social Market Foundation has found that insurance is becoming increasingly unaffordable for those on low incomes as they are charged “a poverty premium” – with the research finding car insurance firms discriminating on price against low-income consumers on the basis of where they live.⁷⁴ As there currently are no social tariff

schemes in these markets, there is a strong case for alternative forms of immediate intervention to help low-income households access the essentials they provide, prior to the implementation of full social tariff schemes. Interventions such as state-backed insurance products for people on low incomes, stricter regulations on pricing and insurance vouchers could be effective measures over the short term. In these markets, preparatory work among regulators and companies will be needed to introduce social tariffs.

A stronger step, achievable in the medium term, would be to set out mandatory, enforceable requirements that specify minimum standards for social tariff provision. In practice, this could mean requiring each provider in a sector to have consistent eligibility criteria, for example a formula-based approach to deciding household income thresholds for social tariffs. Doing so would also ensure a level playing field in markets, as no provider would be able to gain a relative advantage by not providing social tariffs.

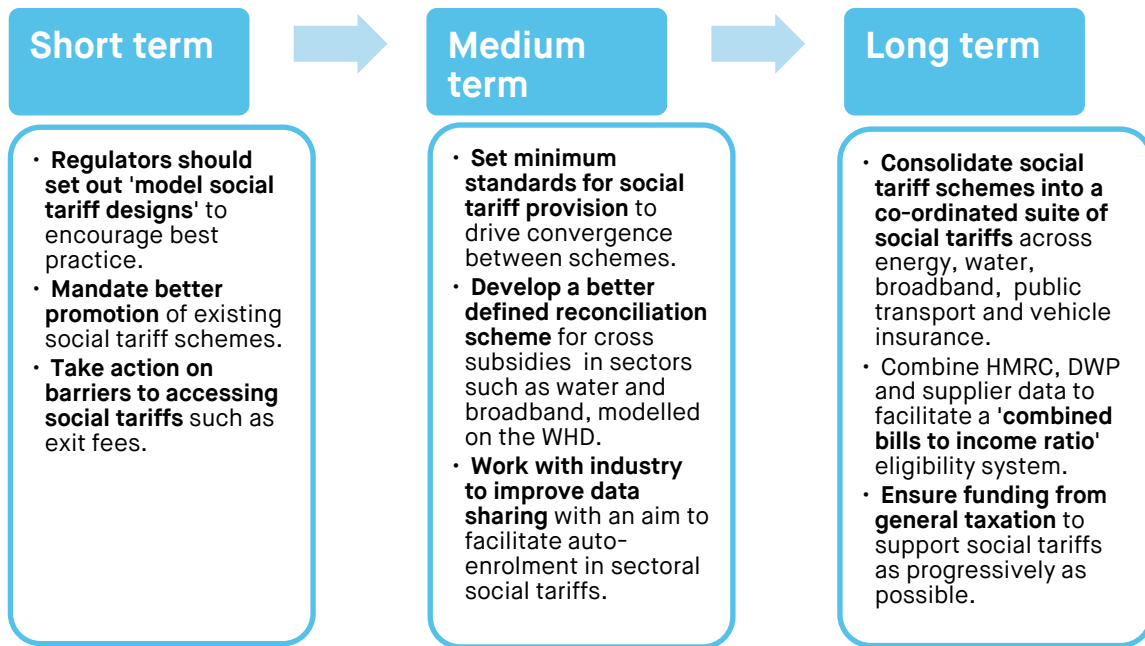
However, it is important that a move to fully regulated social tariffs is accompanied by a better defined funding framework for their provision in order to avoid unintended consequences for businesses and markets. It is likely that a compromise approach that relies on different forms of funding may be necessary to achieve a politically feasible solution. Relying solely on company profits comes with significant challenges for the reasons discussed in chapter three. In the absence of funding from general taxation, this will require a more formal reconciliation scheme for cross subsidies to ensure that costs can be equitably shared across industries, as is the case with the Warm Homes Discount.

Finally, although our preference is for a suite of social tariffs based on a combined bills-to-income ratio, there is no reason that steps to ensure better data sharing between government and suppliers, with a view to enabling auto-enrolment, should not take place. As examples of social tariffs in other countries such as Belgium (discussed in chapter two) show, auto-enrolment on the basis of benefits receipt is feasible.⁷⁵ And closer to home, schemes such as the Warm Homes Discount set a precedent for auto-enrolled support. Even if auto-enrolment on the basis of a combined bills-to-income ratio is not feasible in the short or medium term, a form of auto-enrolment based on proxies of low income is more achievable. Given the importance of auto-enrolment to guaranteeing high take-up and therefore the effectiveness of social tariffs, work to facilitate auto-enrolment for social tariffs should be a priority.

Conclusion: setting out a roadmap for social tariffs

This chapter has set out an overarching objective for social tariffs: a unified suite of social tariffs in key household goods and public transport, using a combined bills-to-income ratio to assess eligibility. As the discussion above has made clear, there are very significant challenges that need to be overcome to reach this ideal stage. But along the way, there are key steps that can be taken in the short and medium term to strengthen existing social tariffs. Figure 13 below summarises the measures discussed in this chapter.

Figure 13: A roadmap for social tariffs in the UK



APPENDIX – METHODOLOGY

During this project, we made use of both qualitative and quantitative research methods, which are listed below.

Focus groups

Over the course of this project we held three online focus groups hosted on Zoom, held exclusively with participants from low-income backgrounds across the UK. The three focus groups each looked at different elements of the debate around implementing social tariff policies. The first, held on 31st May 2023, tried to elicit participants' views on existing cost of living support and the current operation of markets for essential goods and services. The second, held on 20th June 2023, attempted to better understand views on existing social tariffs in markets for household water and broadband, and on the idea of them applying in a greater range of markets. The third focus group, held on 4th September 2023, sought to gain an insight into attitudes towards more detailed aspects of social tariff design, discussing features such as eligibility criteria, the extent of discounts and on data sharing between providers and government departments.

Public polling

We conducted public polling with a nationally representative sample of 4,000 people in partnership with Opinium. The poll was conducted online, with the fieldwork taking place between 30th June and 3rd July 2023.

The polling used the following cross-breaks:

- Gender
- Single year age
- Region
- Working status
- Ethnicity
- Urban/rural area
- Parent/ Childless
- Disability
- Financial (in)security (comfortable, coping, struggling)
- Job type
- 2019 past vote
- Household income (equivalised)
- Benefits receiving
- Housing tenure

Data analysis and modelling

To make estimates on the impact of social tariffs, and compare possible policy designs, we have drawn on modelling from the LCFS. This allows us to roughly estimate the fiscal impact of social tariffs, as well as their distributional impact on household finances. With that said, there are several caveats that should be noted.

First, the data we have used comes from the 2019-2020 Living Costs and Food Survey. More recent editions of the dataset exist but given the extent to which COVID-19 influenced household spending patterns we decided not to use these more recent editions to ensure that the data provided a more accurate reflection of household spending behaviour. It must be acknowledged that household spending patterns are likely to have changed considerably since 2019-2020. A more recent analysis that more accurately captures current patterns of spending would be a welcome contribution to this research area.

Second, we have used a static modelling approach which does not take into account behavioural changes resulting from price reductions following the introduction of social tariffs. Doing so is complicated: not only is it difficult in principle to estimate accurately the scale of behavioural change, but the scale of behavioural change varies for each good we analyse. For example, even a market such as transport has a wide range of estimates for price elasticities, not only varying between different economic studies but also the mode, purpose and distance of transport.⁷⁶

We compare different potential social tariff schemes on several metrics. These include:

- **The fiscal cost.** This is calculated as the aggregate household savings a scheme would deliver and therefore the overall cost that providing the social tariff scheme is likely to entail, be that through general taxation, cross-subsidy or company finances.
- **Distributional household impacts.** We examine the impacts of policy scenarios by equivalised income decile, both in absolute terms and relative terms.
- **Number and distribution of gainers.** To assess how broadly a social tariff scheme would apply, we also look at the number of households who would gain from the policy, as well as the proportion within each decile that would gain.

Public policy roundtable

On 5th September 2023 we held an online public policy roundtable over Zoom. This discussion, which was held under the Chatham House rule, covered questions around which markets are appropriate for social tariff intervention, how to target social tariffs, how (and whether) to link social tariffs together, and how social tariffs compare with other possible cost of living interventions. Attendees at the roundtable included consumer groups, public policy experts, business representatives and third sector organisations.

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