

## **Energy Policy Issues: Fuel Poverty**

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### **Background**

The purpose of this paper is to allow the Board to consider and endorse the proposed priorities for our fuel poverty policy work, in particular given the context of the Interim report from the Hills Review of Fuel Poverty.

Unlike energy policy in general, fuel poverty policy is devolved. Consumer Focus Wales and Consumer Focus Scotland therefore address Welsh and Scottish Government policies. Colleagues across the nations work closely, particularly on reserved policies that affect all three nations.

While there is some public focus on social tariffs, winter fuel and cold weather payments as means of alleviating fuel poverty, this paper draws attention to some of the more complex mechanisms by which support could be provided to fuel poor households. This is an acronym-rich environment in which the details of different schemes and their value to consumers can be difficult to grasp. This paper tries to provide a guide through the different initiatives and identify which ones we believe have the most potential to help consumers.

### **What we do**

A broad range of our activities help fuel poor, low income and vulnerable energy consumers.

- Evidence-based advocacy of policies to tackle fuel poverty
- Advice to Government, Ofgem and fuel companies on fuel poverty policies
- Second tier advice service to vulnerable consumers (Extra Help Unit)
- Support for community and advice services to vulnerable consumers
- Work with Ofgem and fuel companies on such issues as debt, disconnection, social tariffs, Priority Service Registers, energy efficiency and smart meter 'extra help'.

We also carry out a range of related activities that either directly or indirectly help fuel poor, low income and vulnerable energy consumers, as well as meet other policy objectives, for example:

- improving competition within, and regulation of, energy markets can help reduce energy prices
- securing a better deal for off-gas consumers (many of whom are fuel poor)
- supporting consumers make the transition to a low carbon world, particularly through improving the energy efficiency standards of their homes
- empowering vulnerable consumers (a joint project with Citizens Advice)
- advocating policies to tackle financial exclusion (which can help low income energy consumers take advantage of cheaper energy deals)
- working with Waterwatch and Ofwat to learn from and encourage best practice across the water and energy industries

## The Fuel Poverty Workstream

Our work on fuel poverty addresses the three main causes of fuel poverty, namely poor energy efficiency standards of homes, high fuel prices and low income. We have focussed in the main on the first two causes, although the recent, and influential, report we commissioned from the Institute of Fiscal Studies (*The spending patterns and inflation experience of low-income households over the past decade*) addressed the third.

Increasingly we have emphasised energy efficiency policies. While fuel poverty requires coordinated action on all three causes, far-reaching energy efficiency programmes are capable of dramatically reducing the problem. For example, research we published in 2009 (*Raising the SAP – tackling fuel poverty by investing in energy efficiency*) showed that a programme to retrofit the homes of fuel poor households to reach the standards of homes built today would reduce fuel poverty by 83 per cent.

This focus is less dramatic and confrontational with industry over price setting, but provides a focus on those mechanisms which are more likely to provide sustainable answers to fuel poverty.

Consumer Focus is highly regarded in the promotion of policies to tackle fuel poverty, particularly with respect to our emphasis on evidence-based advocacy. The Appendix gives an overview of our past work and successes. The remainder of this report focuses on current activities.

### Who are the fuel poor?

According to the current definitions there are over 6 million households in the UK who are in fuel poverty.

The term 'fuel poverty' is often used to describe the circumstances of vulnerable and low income energy consumers, although there are some differences. Some vulnerable and low income consumers are not 'fuel poor', according to the standard definition of 'fuel poverty'<sup>1</sup>, for example 47 per cent of households in the lowest 3 income deciles in 2010 were not fuel poor<sup>2</sup>. Similarly, some fuel poor consumers are not 'vulnerable' according to the Government's definition of 'vulnerability' – older people, disabled people and young children. For example, 17 per cent of the 'fuel poor' in 2010 were single person households under 60 (although some of these may have been disabled)<sup>3</sup>.

The Government announced in its 2010 Spending Review that it intended to commission an independent advisory review of the fuel poverty target and definition. It subsequently appointed Professor John Hills of the London School of Economics to lead this review which aimed to "take a fresh look at the fuel poverty target and definition. The Government has said that it wishes to focus its available resources where they will be most effective in tackling the problems of underlying fuel poverty."<sup>4</sup>

Professor Hills has published an interim report which gives an overview of the definition and measurement of fuel poverty<sup>5</sup>. The final report is expected in January 2012.

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<sup>1</sup> The Government's current definition of fuel poverty is a household that needs to spend more than 10 per cent of its income on fuel to maintain an adequate level of warmth and meet its other energy needs. The Hills review proposes changing this definition – see later.

<sup>2</sup> Preston et al (2010), *A 'now-cast' of fuel poverty in 2010*, Consumer Focus

<sup>3</sup> Preston et al, *ibid*

<sup>4</sup> Further information at: [www.decc.gov.uk/en/content/cms/funding/fuel\\_poverty/hills\\_review/hills\\_review.aspx](http://www.decc.gov.uk/en/content/cms/funding/fuel_poverty/hills_review/hills_review.aspx)

<sup>5</sup> The report is available at [www.consumerfocus.org.uk/files/2011/06/The-definition-and-measurement-of-fuel-poverty-Dr-Eldin-Fahmy.pdf](http://www.consumerfocus.org.uk/files/2011/06/The-definition-and-measurement-of-fuel-poverty-Dr-Eldin-Fahmy.pdf)

We have played a key role in convincing the review team that there is something distinct about fuel poverty and that it is not purely a reflection of general poverty, The report examined two aspects of fuel poverty:

1. consumers who cut back on fuel expenditure, and as a result suffer cold homes, and
2. consumers who try to maintain fuel expenditure and as a result either go into fuel debt or forego expenditure on other essential goods and services.

The report stated that “a particular feature of fuel poverty is its relationship to the energy efficiency standards of the housing stock and the adequacy of heating systems and appliances. For any given level of income, households have *an unequal capability* to convert income into adequate warmth due to the considerable variation in the standards of their homes. This is distinct from, and additional to, those deprivations associated with insufficient income itself.”

We submitted a range of Consumer Focus policy statements and research reports to the review and have maintained close dialogue with John Hills and DECC review team. We also coordinated a meeting with John Hills, DECC and supporters of the End Fuel Poverty Coalition. The interim report of the Hills review proposes a new definition of fuel poverty which it refers to as the ‘low income, high energy costs’ indicator. It also proposes supplementing this with a ‘fuel poverty gap’ indicator, which is intended to provide a measure of the depth of fuel poverty. The proposals have taken on board a number of Consumer Focus recommendations, such as taking housing costs and household size into account when measuring income and measuring ‘distance travelled’ with respect to assessing interventions (the new ‘gap’ indicator).

The proposals in the interim report are currently under consultation. We have convened a meeting of ‘fuel poverty experts’ to discuss the proposals and possible improvements. The final stage of the review is likely to have an important influence on Government fuel poverty policy after it reaches its conclusions in January 2012.

### **Advocating a better deal for fuel poor consumers**

Our main activity in this area is the support we provide to the End Fuel Poverty Coalition (EFPC), which brings together a wide range of organisations in support of the Fuel Poverty Charter<sup>6</sup>. The Coalition continues to grow in membership. A number of professional bodies have recently joined, for example the Chartered Institute of Environmental Health and UK Public Health Association, as well as large health charities, e.g. British Lung Foundation, Macmillan Cancer Support.

The EFPC played an important role in building support for minimum energy efficiency standards within the private rented sector, now an important element of the current Energy Bill. Its next priorities are to update the Fuel Poverty Charter to take account of the current policy landscape and to support advocacy for the recycling of EU ETS auction proceeds to consumers.

DECC officials and politicians have welcomed the EFPC’s contributions, particularly with respect to providing a unified perspective on key fuel poverty issues.

### **Identifying resources for tackling fuel poverty**

Our focus is therefore on optimising use of existing or potential future resources.

Previous Consumer Focus work has identified the scale of resources required for tackling fuel poverty. ‘*Raising the SAP*’, for example, estimated that £24bn of expenditure was required over a 6 year period if the Government was to hit its statutory 2016 target to eliminate fuel poverty<sup>7</sup>.

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<sup>6</sup> See [www.endfuelpoverty.org.uk](http://www.endfuelpoverty.org.uk) for full list of supporters and copy of Fuel Poverty Charter.

<sup>7</sup> The 2000 Warm Homes and Conservation Act and 2001 UK Fuel Poverty Strategy placed a statutory duty on Government to eliminate fuel poverty, as far as reasonably practical, in England by 2016.

Current estimates of the resources required to ‘fuel poverty proof’ homes – raise energy efficiency standards to guarantee most occupants are taken out of fuel poverty – suggest between £30bn to £60bn is required given today’s level of fuel poverty. This is obviously a difficult ‘ask’ given the current economic climate, but these considerations are important and should complement our planned work on enabling consumers and decision makers to consider the difficult, but necessary trade-offs that face us in reforming the energy market.

We are exploring three avenues:

- Ensuring the new Energy Company Obligation (the replacement to CERT and CESP in 2013) makes an important contribution to tackling fuel poverty
- Making the case for the recycling of Emission Trading Scheme auction proceeds to energy consumers, particularly low income consumers, in the form of energy efficiency improvements to homes
- Reforming the way in which companies recover ECO costs from consumers

### **The role of the Energy Company Obligation (ECO) in tackling fuel poverty**

The Government’s 2010 Spending Review stated the Government’s intention to end funding for Warm Front in 2013. Instead it intends to rely on ECO, which alongside Green Deal forms part of the current Energy Bill’s package of measures. ECO is the scheme that will provide assistance to low income households and those priority households where the benefits of Green Deal measures will not offset the costs.

For the first time in over 30 years there will be no public funding for energy efficiency grants in England. By contrast, the Scottish and Welsh Governments have committed to maintaining their equivalent programmes beyond 2013. Furthermore, energy companies and thus energy consumers will now bear lead responsibility for tackling fuel poverty through energy efficiency. We continue to advocate a publicly funded energy efficiency programme for low income energy consumers.

Suppliers will meet the costs of ECO through a levy on energy consumers’ bills. Since not all consumers benefit from the existing CERT/CESP programmes, one group of consumers is effectively subsidising another groups’ benefits. Specific groups of consumers that have lost out under CERT and its predecessors include low income consumers and those living in ‘hard to treat’ homes (homes that are expensive to insulate and/or heat). Furthermore, levies have a bigger impact on low income consumers than better off consumers because fuel costs represent a much higher proportion of low income consumers’ budgets<sup>8</sup>.

#### **What is CERT**

The Carbon Emissions Reduction Target (CERT) was introduced in 2008 and requires all domestic energy suppliers with a customer base in excess of 250,000 to make savings in the amount of CO<sub>2</sub> emitted by householders. CERT is the third phase of a programme that has been running since 2002, and was previously known as the Energy Efficiency Commitment. It is due to be replaced by the Energy Company Obligation (ECO) in January 2013.

Suppliers meet this target by promoting the uptake of low carbon energy solutions to household energy consumers. Suppliers were already required to meet 40% of their total target by delivering measures to a ‘Priority Group’ of vulnerable and low income households, including those in receipt of eligible benefits and pensioners over the age of 70. An additional target has been introduced to require that 15% of the savings be achieved in a subset of low income households (a Super priority group) considered to be at a high risk of fuel poverty.

Suppliers recover the costs of the measures delivered from customer bills. It is estimated that the current cost of CERT is £46 per annum.

CERT has been a very cost effective carbon abatement policy which has reduced insulation costs through market transformation, provided equity through the priority group and super priority group mechanisms and has helped encourage energy companies move towards an energy services delivery model (a long standing goal of Government policy) – selling both energy and energy saving measures as a package.

Government statements in defence of the Warm Front cut and eventual abolition argued that ECO will provide a much higher level of funding than Warm Front to improve the energy efficiency of low income consumers' homes. However, more recent statements suggest that the Government sees the main role of ECO as underpinning Green Deal finance and transforming the solid wall insulation industry, with fuel poverty alleviation taking a more limited role. Consumer Focus has concerns that<sup>9</sup>:

- The policy demands placed on ECO will lead to either unacceptably high levies (implying extensive cross subsidies and increased fuel poverty due to higher bills) or a failure to meet any of the demands adequately
- ECO is not an appropriate substitute for Warm Front. Quite apart from funding issues, suppliers will decide what measures to provide, the level of subsidy for measures and the level of client contribution. This will lead to considerable consumer confusion and potentially substantial differences between suppliers.
- Unless some form of trading is introduced, the current 'big 6' energy suppliers are likely to dominate the energy services and Green Deal markets, thus reducing competition.
- Solid wall insulation is extremely expensive. If ECO is used to subsidise this measure for Green Deal finance consumers, only a small number of better off consumers are likely to benefit.

### Proposed position

We are therefore not inclined to support a substantial increase in the notional ECO levy, ie beyond current CERT/CESP levels. We also favour the initial targeting of ECO at low income consumers to address past imbalances and with the express aim of reducing costs, particularly with respect to solid wall insulation. This will allow a lower level of subsidy to later be extended to a much larger group of consumers with the eventual aim of reducing subsidy altogether (market transformation).

### **Recycling EU ETS auction proceeds**

There is considerable evidence that the Green Deal finance mechanism and accompanying Energy Company Obligation are not sufficient to meet the statutory carbon budget and fuel poverty targets. A large, and growing, number of organisations consider proceeds from the auctioning of EU ETS revenues could go a long way to filling the gap. Deutsche Bank has estimated that EU governments will receive around 60 billion euros pa once the third auction round starts in 2013.

A 2008 European Parliament Directive recommended that at least 50 per cent of revenues from ETS auctions should be devoted to environmental protection, including improved insulation and heating. Germany, Hungary and Poland have already agreed to recycle revenues to energy efficiency programmes. The Australian government has taken a similar stance with respect to its nascent carbon trading scheme. In 2008, Ofgem suggested that the £9bn windfall the electricity industry received from the free allocation of tradeable emission permits should be used to fund aid for fuel poor households<sup>10</sup>.

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<sup>9</sup> See a summary of our Green Deal policy asks, a number of which address fuel poverty, at '*Making Green Deal a fair deal*' at [www.consumerfocus.org.uk/files/2011/03/Green-Deal-policy-summary1.pdf](http://www.consumerfocus.org.uk/files/2011/03/Green-Deal-policy-summary1.pdf)

<sup>10</sup> Ofgem (2008), 'Market is sound – Ofgem assures Chancellor', *Ofgem press release 16/1/2008*

Energy consumers' bills will undoubtedly increase as the ETS is ratcheted upwards. By 2020, it is estimated the ETS will add £55pa to the average British consumer's electricity bill<sup>11</sup>. This will lead to further upward pressure on fuel poverty levels. The impact of the ETS could be mitigated by recycling the scheme's revenues to consumers, particularly those on low incomes, in the form of energy efficiency improvements. However, the UK Government currently does not support this due to long-standing Treasury opposition to hypothecation.

### Proposed position

We consider that since energy consumers are effectively paying for the ETS through increased electricity bills, steps should be taken to compensate consumers in the form of help with energy efficiency improvements. This will also help complement the Green Deal and ECO and make it more likely for the Government to meet its carbon and fuel poverty targets.

### **Recovery of environmental and social policy costs**

Consumer Focus led a sub-group of the Fuel Poverty Advisory Group (FPAG) to explore the potential for reform of supplier's recovery of social and environmental policy costs. The sub-group included fuel suppliers and Ofgem. The group considered in particular the current approach to recovering CERT costs with a view to amending this approach when ECO comes into play. To help support the group's analysis, Consumer Focus commissioned background research which modelled a range of possible reforms with respect to impact on consumers' bills<sup>12</sup>.

Suppliers currently recover CERT costs from consumers in the form of a flat rate charge per household. This is because the Government sets suppliers' CERT targets according to the number of consumers each supplier has. This approach is different to other environmental policies, such as the Feed In Tariff and Renewable Obligation, in which targets relate to the amount of energy consumed.

### Proposed position

Our research found that if suppliers recovered ECO costs in the same way as other environmental programmes, there would be a positive impact on most low income consumers' bills. It would also better reflect the 'polluter pays' principle, ie consumers with higher consumption levels and thus higher carbon emissions pay more towards the costs of reducing those emissions. The positive impact of the proposed reform arises from the close relationship between income and energy consumption.

The FPAG working group recognised that there is a small minority of low income high energy users. Ofgem-commissioned research provided details of which groups of consumers fall into this category<sup>13</sup>. The FPAG sub-group therefore proposed a range of measures to mitigate the impact of the proposed reform on these consumers. FPAG has submitted its report to the Government with the aim of influencing the forthcoming consultation on Green Deal and ECO (due late October).

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<sup>11</sup> Preston et al (2010), *Distributional impacts of UK climate change policies*, Eaga CT

<sup>12</sup> We have not published this research. However, Eaga Charitable Trust is about to publish a related research report: ACE (2011), *Costs of the ECO: the impact on low income households*, Eaga CT (note: CF's fuel poverty officer is a trustee of the Trust)

<sup>13</sup> White et al (2010), *Understanding 'high use low income' energy consumers*, Ofgem

## Examples of CF impact on fuel poverty policy

Past successes of our fuel poverty work include:

- Building support for the private members fuel poverty bill in 2009. Although not successful, the Government did subsequently introduce policies that directly relate to specific elements of the bill, for example 'mandated price support' and a proposed Warm Homes Standard for social housing.
- Encouraging a wide range of poverty, environmental, consumer and membership groups to sign up to and support the 'Fuel Poverty Charter', launched in the House of Commons in March 2010.
- Securing increased public funding for Warm Front in 2009 at a time when many other programmes were being cut.
- Securing retention of Warm Front in 2010, albeit at a much reduced level, when many commentators expected it to get cut altogether.
- Government mandating of social price support (now referred to as the Warm Home Discount) in 2010 – a long standing policy of CF and its predecessor policies – which ended much of the previous lottery of supplier discretion over social support.
- The Government's introduction of the super priority group within the fuel companies' Carbon Emissions Reduction Target (CERT) programme in 2010 – we provided detailed evidence that this group was particularly vulnerable to fuel poverty.
- The production of up to date fuel poverty statistics, based on detailed modelling and updating of the Government's official fuel poverty statistics which are always two years out of date. Our statistics are widely quoted by partners and the media.
- Government recognition that the Green Deal finance mechanism would not work for low income consumers since these consumers did not make sufficient savings to cover the Green Deal charge. This has led to the Government's current proposals, set out in the Energy Bill, to provide support for these consumers through an affordable warmth element within ECO.
- The 2010 Energy Bill's proposals to introduce minimum energy efficiency standards for private rented homes. Our support for the reform, including detailed evidence of its likely positive impact on fuel poverty, helped convince the Government of the case for reform.