

# When does a pay rise make you worse off?

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*The Government has a foolish obsession with fuel poverty*

Here's a riddle for you. How can a person move into poverty while becoming unambiguously better off?

Let's follow the fortunes of a hypothetical person named Mary. Mary lives alone and has an income of £500 a month. She spends £40 on domestic fuel and the remaining £460 on food, clothing and entertainment. Now suppose that Mary's circumstances change in two ways. First, her monthly income goes up to £600. Secondly, the price of fuel doubles, while the price of food, clothing, and entertainment stays the same. Is she better or worse off?

Let's do the calculation. If she is using the same amount of fuel as before, it now costs her £80 a month. Maintaining her consumption of food, clothing and entertainment will still cost £460.

This leads to a new monthly expenditure of £540 - £60 less than her new income of £600. Mary can consume exactly as she did before, but she now has a surplus that she can put away for a rainy day, or can splash out on more food, clothing and entertainment, or indeed fuel.

By any reasonable measure she is better off. Except according to the Government, which thinks that she is worse off, because she has moved into "fuel poverty" - which it defines as spending more than 10 per cent of household income on fuel.

If your income was £9,000 a month and you lived in a mansion that cost £1,000 a month to heat, you too would be in fuel poverty

Avoiding poverty should mean having a total income enough to cover fuel and other basic living costs. The proportion of that income which goes on fuel does not matter. Mary's example shows that a household can become better off even when the proportion it spends on fuel increases.

The Government's fixation with fuel poverty stands in the way of sensible policies on energy taxation. One of Gordon Brown's first acts on becoming Chancellor of the Exchequer in 1997 was to reduce VAT on domestic fuel. With the Government now committed to reducing carbon dioxide emissions, this should be reversed, with the increase to the full rate of VAT phased in gradually over a few years.

Vulnerable groups such as pensioners who would be particularly affected by an increase in fuel prices could be compensated - or indeed be made better off - by using part of the additional tax revenue. Imagine that Mary is a pensioner. Would it be a great injustice to her if she had to pay more for fuel, if at the same time she received an increase in her pension that more than compensates for it?

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