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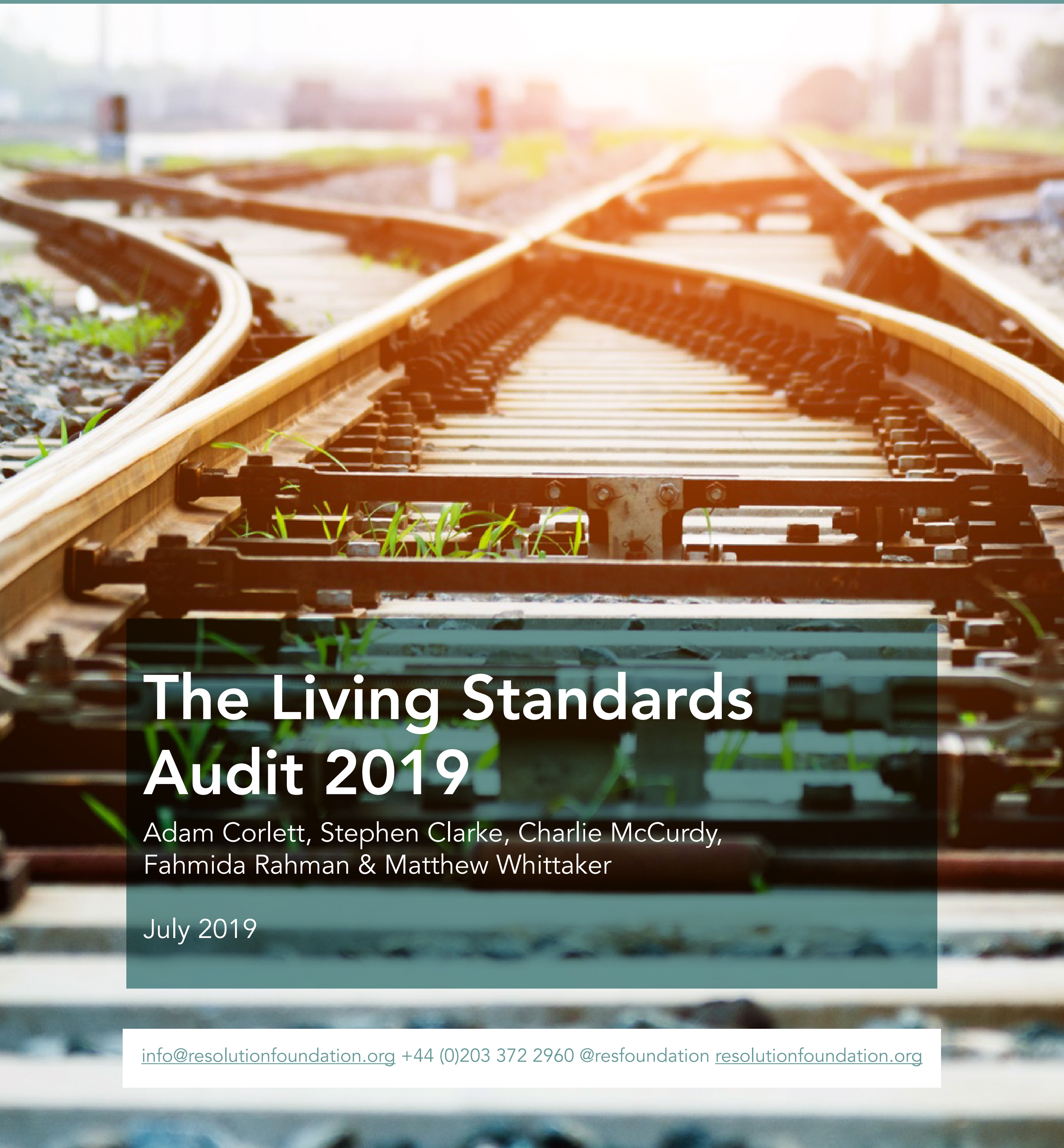

The Living Standards Audit 2019

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July 2019

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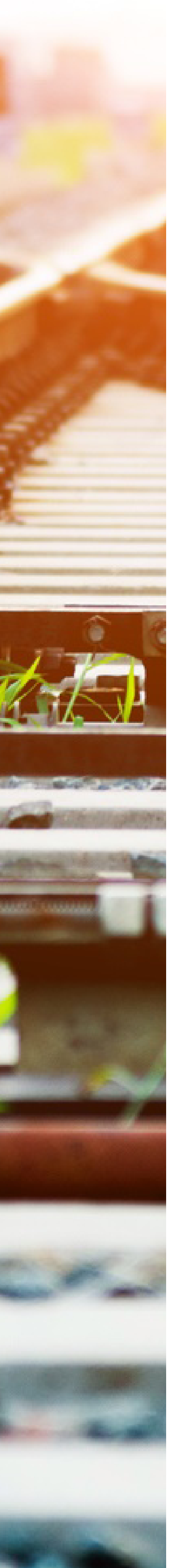

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Executive Summary

In this annual report, the latest in our decade-long series, we take a forensic look at both recent and longer-term trends in UK living standards. We consider how incomes have changed and for whom, and this year we dig deeper into what economic trends have driven those changes over the past 25 years. With a new Prime Minister arriving in Downing Street and living standards progress appearing to go backwards over recent years, we also ponder what we can learn from this detailed exploration of the past about how best to restart household income growth today.

Incomes are higher than in the past – but growth has been sporadic, and especially weak in recent years

The core of our analysis rests on detailed household survey data covering the period from 1994-95 to 2017-18. We supplement this with our modelled 'nowcast' of 2018-19, and with focus group discussions that further explore the challenges and opportunities facing low to middle income households.

At the highest level the news is good – incomes have increased considerably over the longer run. Typical annual equivalised[1] household income after accounting for taxes, benefits and housing costs grew by 50 per cent in real terms (or 1.8 per cent a year) between 1994-95 and 2017-18, reaching £23,000 by the end of the period. And the growth is even more impressive when taking a longer view, with the median income tripling from around £8,000 back in 1961.

But the growth of the past quarter of a century has been far from steady, with the post-crisis decade in particular being one in which living standards progress has faltered. Nor has income growth always been equally distributed across society. Income inequality has rocketed over the longer term and risen more modestly (from an internationally high base level) over the 25 years of interest in this report.

Reflecting differences in both the overall pace of income growth and its distribution, the period since the mid-1990s can be divided into six distinct sub-periods:

[1] Equivalisation entails adjusting for household size. A couple with no children and a disposable income (after taxes, benefits and housing costs) of £23,000 would be right in the middle of the income distribution, but for households containing more (fewer) people a higher (lower) income would be needed to provide the same standard of living.

- 1994-95 to 1998-99. This was a period of *'low-inflation recovery'*, when median income growth averaged 3.0 per cent a year. Employment continued to recover from the early 1990s recession, and inflation and interest rates remained at low levels compared to earlier decades. But, while income growth was strong, inequality rose over this period and poverty rates remained at unprecedented highs following rapid increases in the 1980s.

- 1998-99 to 2003-04. This marked a phase of *'strong, shared growth'* when median income growth averaged 3.9 per cent a year, and growth rates for low to middle income households were often even higher than this. Inequality and poverty rates fell – partly due to significant increases in the generosity of benefits for parents and pensioners.

- 2003-04 to 2007-08. The *'pre-crisis slowdown'* period was one in which median income growth dropped to an average of 1.2 per cent a year. Although a period of continued productivity growth, this was a time in which incomes grew faster for higher-income households – and especially the very top – than for lower-income non-pensioners. Overall home ownership rates began to decline, while housing costs and global commodity prices rose. In addition, benefit increases were less significant (but usually still faster than CPI inflation) and employment rates plateaued.

- 2007-08 to 2012-13. The *'crisis'* era itself resulted in median income growth of -0.8 per cent a year. Unemployment jumped and a sharp sterling devaluation – coupled with increases in global food and oil prices over this period – caused inflation to spike and allowed real-terms wages to fall. Interest rates fell to unprecedented lows, helping mortgagors. And benefit policy played a supporting role (both as an automatic safety net and through real increases) prior to 2010. As a result, relative poverty and inequality both fell.

- 2012-13 to 2016-17. The *'recovery'* years were marked by median income growth of 2.2 per cent a year on average, despite poor growth in productivity. Instead, real income growth was particularly supported by near-zero inflation – following a global oil price drop – as well as by further falls in mortgage costs. Employment also recovered with vigour, with household worklessness falling rapidly. There were large increases too in the wage floor, contributing to falling earnings inequality.

- 2016-17 to 2018-19. What might be termed the *'Article 50 (so far)'* period represented a halt to the post-crisis recovery. Including our nowcast results for 2018-19, median income growth appeared to average an estimated -0.3 per cent a year. If confirmed, that would be the weakest two-year growth on record outside of the 1970s, 1980s and 2000s recessions (that is, weaker than that recorded after the 1990s recession). Despite further rises in employment, high inflation following the post-referendum sterling devaluation led to another fall in real wages. At the same time, the benefit freeze and other welfare cuts substantially reduced the real value of working-age social security.

Across these sub-periods, some key long-term trends stand out. These include a convergence of pensioner and non-pensioner incomes, and the growing importance of female employment incomes.

Strong increases in pensioner living standards are welcome, but the fortunes of households with children should be a key concern

For non-pensioners, three of those last four sub-periods have been very weak. While the typical pensioner income grew by 25 per cent between 2003-04 and 2017-18 (averaging 1.9 per cent a year), the typical non-pensioner income grew by only 7 per cent (0.5 per cent a year). The typical pensioner income is now essentially equal to the typical non-pensioner income, at around £23,000, having been 21 per cent lower in 1994-95. And for some parts of the non-pensioner population, growth has been particularly weak. For those in their late 20s, typical incomes were lower in the three years to 2017-18 than they were in the mid-2000s.

While the general divide between pensioners and non-pensioners has closed, family composition does make a big difference to living standards. Parents (and by implication their children) are typically poorer than households without children. And singles (whether pensioners, parents of dependent children or working-age non-parents) are typically poorer than couples. These divisions by family type are even more marked in terms of the risk of poverty. For example, in a stark change in relative fortunes, couple parents up to the age of 35 are now more likely to be living in poverty than a single pensioner age 80 or over is. And over half of pre-primary school children living with only one parent are in relative poverty. It should be noted though that the typical incomes of single parents have risen faster than other working-age groups since 1994-95. And there has been a slight decline in the odds of single parenthood since the early 2000s too.

Other inequalities also remain important. In terms of housing tenure, the income of the typical mortgagor (after housing costs) is now twice that of the typical social renter. The South East (not London) and East of England have consistently remained the highest-income parts of the UK (again after housing costs), though there are signs of relative convergence between regions. And typical living standards gaps by ethnicity remain very large, though these again are generally smaller in relative terms than in the mid-1990s.

Male earnings continue to account for the largest share of overall household incomes, but gender shifts have made a big difference over recent decades

Male employment income continued to make the single biggest contribution to mean household income in 2017-18 – accounting for half (51 per cent) of average gross income across all households. Female employment income accounted for a further third (33 per cent), meaning the two combined dwarfed all other contributions (with benefit income accounting for just 6 per cent of average gross income, for instance).

But while male employment income still dominates the overall level of household incomes, between 2007-08 and 2017-18 the contribution of male employment income to growth has actually been negative. Female employment income was also affected by the crisis, but it has now surpassed its earlier levels. Over the period since 1994-95 as a whole, female employment income for the average household increased by 70 per cent (or £6,100), while male employment income increased by 44 per cent (or £7,100).

The effect is even more marked in the bottom half of the income distribution, with the average female employment income increasing over the period by 111 per cent. This was twice the rate of the average male employment income, which increased by 56 per cent, though in absolute terms both equated to a £3,400 rise.

These changes of course reflect the fact that women have moved closer to men over the past 25 years in terms of employment, hours and hourly pay. The rise in the female state pension age from 60 to 65 (to match the male age) has contributed to this. But it is not the only reason. Employment rates for single parents (largely mothers) have steadily risen, going from 43 per cent in 1996 to 67 per cent in 2018. Among couples with children the prevalence of both parents working has also risen. And among dual earning couples (with and without children), the female share of total earnings has risen: the woman is now the higher earner in over a quarter of such couples.

Although earnings are the key component of household incomes overall, benefits (both housing and non-housing related) remain a large share of income for lower-income deciles. And, in contrast to higher-income groups, for those on lower incomes housing costs – rather than taxes – are the largest outgoing.

Increased employment has also played a key role in offsetting rising earnings inequality

Looking at the full range of factors that determine disposable incomes is also important for understanding changes in income inequality. The Gini index (for incomes after housing costs) has increased slightly over the last 25 years, from 37 per cent in 1994-95 to 39 per cent in 2017-18. And our nowcast points to a further increase in 2018-19. But such increases (from a high base) are relatively slight compared to the sharp rise recorded during the 1980s. The modestness of these increases stands in contrast to a much more apparent rise in earnings inequality between working households (driven partly though not exclusively by the top 5 per cent) over the same period.

This has caused some to infer that redistribution via the tax and benefit system has done ever more work to mitigate increases in overall market income inequality. But our analysis reveals another answer instead. That is, the rise in employment and – more specifically – the decline in household worklessness. Looking across all households, rather than just working ones, we find no significant change in overall earned income inequality over the period, with the reduction in the number of households in which no one works countering the rise in inequality recorded across those households in which someone is working. Taxes and benefits do little to change this story.

Our analysis also reveals the important role played by housing costs in the overall inequality story. It is these which have ensured that a relatively flat period for market income distribution has been converted into one in which the overall Gini has drifted upwards.

Real hourly pay growth is the key driver of long-term progress, but has not played its normal role over the past decade

Despite the importance of employment to some living standards and inequality trends, our analysis confirms that it is growth in hourly wages that has driven the great majority of the overall household income rise since 1994-95, rather than growth in employment or hours worked. The financial crisis, however, was a clear turning point for living standards, and for the broader economy too.

Looking at total GDP, average annual growth plummeted from 3 per cent a year between 1994 and 2007 to just 1.1 per cent a year between 2007 and 2018. But its composition changed dramatically too. Pre-crisis, economic growth was primarily a product of rising productivity – with the year-on-year increase in output per hour worked contributing 69 per cent of the annual growth in GDP. Rising employment across the population contributed a further 24 per cent and population growth accounted for 15 per cent. As a larger share of the population worked, and produced more for each hour they worked, so the average hours worked each week by those in employment fell (from 33.3 in 1994-95 to 32.1 in 2007-08). This was a period in which the country got richer primarily by working smarter.

Post crisis however, the much slower growth in GDP was driven primarily instead by other factors – with general population growth accounting for 65 per cent of the annual growth and productivity improvement contributing just 22 per cent. Rising employment within the overall population (flowing from both increases in the state pension age and strong employment growth more generally) accounted for a further 13 per cent, but no longer could those in work cut back on their hours: the average working week in 2017-18 was unchanged (at 32.1) from its 2007-08 level – the first pause of this length in the post-WWII era.

In terms of disposable household incomes, growth has also been temporarily supported by a decline in mortgage interest costs. The fall in rates following the crash has resulted in the average housing cost-to-income ratio among mortgagors falling from 20 per cent in 2007-08 to 11 per cent in 2017-18. Coupled with a decline in the number of mortgagors, the average annual income drag from mortgage interest (across all working-age households) has fallen by £1,900. Of course, not all households have benefited from this.

With recent drivers of income growth appearing to run out of road, it's vital we learn the lessons of the past

The bad news for the new Prime Minister (and for the country more generally), is that it looks as though we are running out of road in relation to what has driven economic and income growth over the course of the post-crisis decade.

With employment already at a record high, it is hard to envisage further substantial gains on this front. As recently as 2007, the UK faced an employment gap of 5.5 percentage points relative to the top-performing advanced economies. Today that gap stands at just 2.8 percentage points. Undoubtedly there are opportunities for raising employment further – especially among groups that remain under-represented in the workforce – and this should be an ambition of the new Prime Minister. But we certainly can't rely on being able to repeat the trick of the last decade in order to generate further income growth.

There is likely only limited scope for supporting incomes via increases in average hours too. The fact that underemployment remains more elevated among single parents than among others, for example, suggests there are pockets where more could be done, and we heard from low to middle income parents who said that they'd work more hours if they were better supported by the childcare and benefits systems. But given that average weekly hours have tended to fall over time – by around one hour every four years – it is hard to see hours growth supporting overall income growth for any sustained period. We also heard from those who said that their preference was to spend more time with their children, reflecting the sentiment that sits behind that long downward march in average hours.

Meanwhile, the boost from falling mortgage interest costs has clearly run out of road, as the dramatic post-crisis fall in rates towards zero cannot now be repeated.

There is therefore no getting around the need for strong fundamentals. Strong productivity growth has long been the engine of living standards improvements. And its restoration – supported by reduced economic uncertainty – is urgently needed. Alongside growth, the next Prime Minister must focus also on distribution – with the emphasis on tax cuts for higher-income households that has characterised the leadership campaign striking precisely the wrong note. Rebalancing housing outcomes should also be a priority.

As things stand, we appear to be living through a period of both stagnant typical living standards and income falls for the poorest, with child poverty projected to approach record highs. History tells us that it doesn't have to be like this.

Section 1

Introduction

2019 is a time of considerable political uncertainty, with both the prospects for Brexit and the identity of the UK's next leader still unclear at the time of going to press. But what is clear is that the next Prime Minister should make the restoration of strong sustained household income growth a top priority – drawing a line under a decade of near-stagnation in family finances. Given this, it is useful to reflect on what the last 25 years can tell us about what has driven income growth in the past, and what has held it back more recently.

In this, our annual *Living Standards Audit*, we do just that. Alongside our regular snapshot of the current state of living standards in the UK, this year's report looks in rigorous detail at what has happened to real household incomes over the period from 1994-95 to 2018-19.

Our starting point is the Department for Work and Pensions' (DWP's) *Households Below Average Income survey*,[2] which provides representative and consistent data about all forms of household incomes (as well as housing costs) for each financial year up to 2017-18. To inform a more up-to-date discussion, we also present our latest 'nowcast' of the financial year that has just ended – 2018-19. This is an estimate based on data sources that are more timely but less focused specifically on household income changes. We supplement this analysis using qualitative discussions with low to middle income households across the UK and additional survey data, in order to explore what potential people see for further growth in incomes and economic security.

The rest of the report is set out as follows:

- **Section 2** looks at **living standards over the long run**, setting out the big picture for levels and growth of average incomes over the past 25 years and, within that, defining six distinct sub-periods which we use throughout the report.
- **Section 3** considers **living standards trends across society**, breaking down our high-level analysis by age, family type, housing tenure, region and ethnicity.
- **Section 4** focuses on **living standards across the distribution**, moving beyond trends in the average to also consider what has happened at the top and bottom of the income scale.

[2] A misnomer: all households are covered, based on the *Family Resources Survey*.

- **Section 5** digs into the **changing drivers of living standards improvements**, exploring the different sources of household income growth and how these have varied in importance over time.

- **Section 6** considers how we might meet **the ongoing living standards challenge** in the coming years, looking at what the future could and should hold given what we have learned about the past.

- **Section 7 concludes**.

Annex 1 then provides additional statistics about low to middle income households, while Annex 2 gives more detail of our methodologies.

This largely backward-looking report should be seen alongside our annual Living Standards Outlook[3], which casts forward into the near future by combining central economic projections with known policy stances. Additionally, our annual Low Pay Britain report[4] provides a very detailed assessment of trends in wages (rather than household incomes), and our new Intergenerational Audit[5] delves in great detail into the living standards experiences of different birth cohorts and generations. Future Resolution Foundation work will also look in more detail at the top end of the income distribution.

[3] A Corlett, *The Living Standards Outlook 2019*, Resolution Foundation, February 2019
[4] N Cominetti, K Henehan & S Clarke, *Low Pay Britain 2019*, Resolution Foundation, May 2019
[5] L Gardiner et al., *An intergenerational audit for the UK*, Resolution Foundation, June 2019

Section 2

Living standards over the long run

In this section we look at the broad evolution of UK-wide household incomes over the past half century, with a particular focus on the years since the mid-1990s. On all measures, it is clear that the UK is richer than in the past, with median household income growing by 180 per cent in real terms since 1961. But there have of course been ups and downs, with six distinct sub-periods in evidence since 1994-95: relatively strong growth in the 1990s; continued improvements into the early 2000s; a pre-crisis slowdown; the crisis itself; the post-crisis recovery; and another, post-EU referendum, slowdown that marks one of the weakest sub-periods of growth on record.

UK households are broadly richer than ever, but growth has not been steady

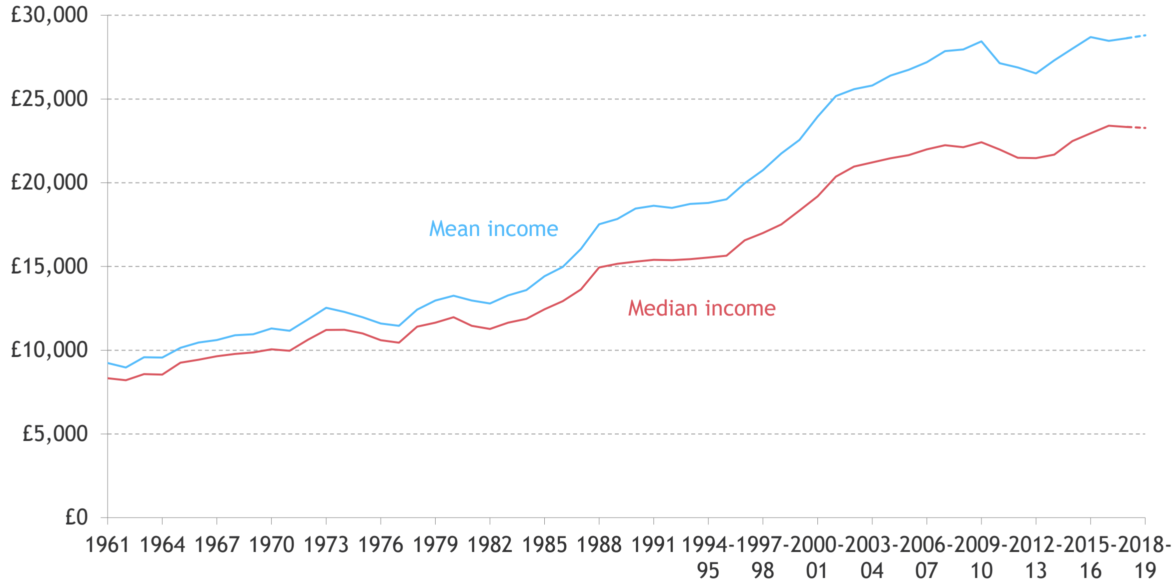
Household income isn't all that matters for living standards, but it is one of the best measures we have (with a strong link to subjective well-being, for instance).[6] As an economic measure it has advantages over GDP, and brings together the impacts of employment, earnings, pension adequacy and more. In this report, as usual, we focus on inflation-adjusted equivalised disposable household incomes. That means we account for changes in the cost of living, for the number of people living in a household, and for benefits and taxes. Housing costs are also deducted to account for disposable income differences between outright home owners, mortgagors and renters.[7]

Looking at this measure across the decades, we can see that living standards are roughly at record highs. Figure 1 shows that the average (mean) income in 2017-18 was around £29,000.[8] Typical (median) income – generally a better means of tracking changes in living standards – was around £23,000, almost triple (180 per cent higher) the 1961 figure (when reliable data begins) of around £8,000. But that impressive growth has certainly not been steady, with the impacts of recessions in the mid-1970s, early 1980s, early 1990s and late 2000s all clearly visible.

[6] G Bangham, *Happy now? Lessons for economic policy makers from a focus on subjective well-being*, Resolution Foundation, February 2019
[7] For further discussion see Box 3 in A Corlett, *The Living Standards Outlook 2019*, Resolution Foundation, February 2019
[8] In 2018-19 prices. Such figures are equivalised to account for household size, with figures being given in terms of a couple with no children. So households containing more (fewer) people would need a higher (lower) income to provide the same standard of living.

Figure 1: Average real incomes have roughly tripled since 1961

Real (CPI-adjusted, 2018-19 prices)[9] equivalised disposable household income (after housing costs)



Notes: 2018-19 values are nowcasts. UK from 2002-03, GB before.
Source: IFS, *Living Standards, Inequality and Poverty*; and RF nowcast

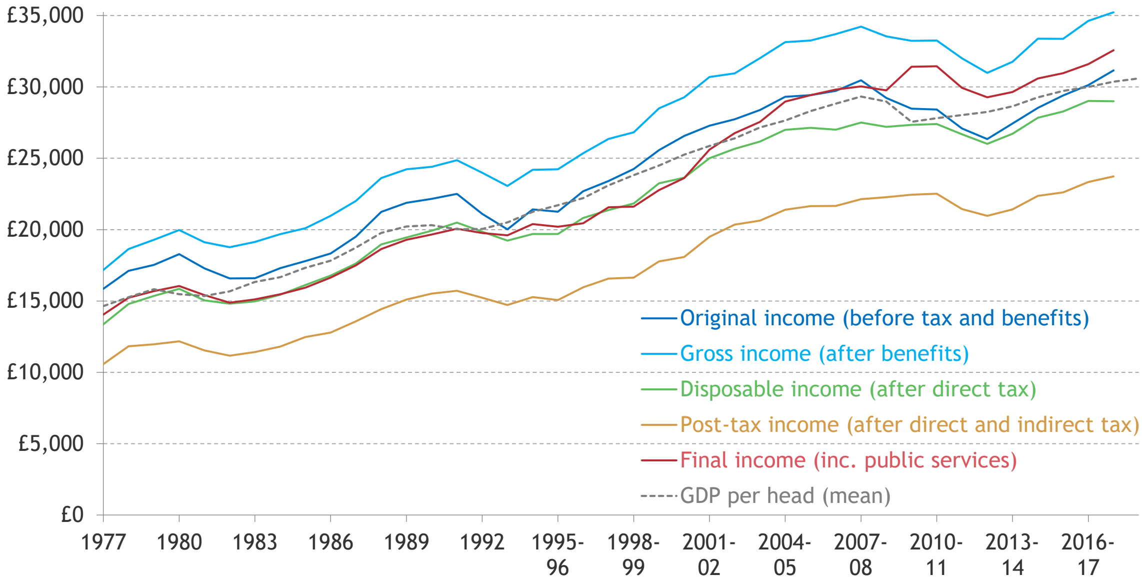
Growth has also been weak recently, with typical income falling by 0.3 per cent in 2017-18. Our nowcast (a modelled estimate using timely data sources)[10] suggests a further fall of 0.2 per cent in 2018-19. These are very poor figures, rarely seen outside of technical (GDP) recessions. Indeed, real typical income growth between 2016-17 and 2018-19 will likely have been the worst two-year period on record outside the aftermaths of the four recessions mentioned above, and quite possibly worse than the early-1990s one.

While our focus is on disposable incomes after housing costs, other income definitions show similar long-term trends, but with different insights. For example, Figure 2 includes a history of 'original income' (incomes before taxes or benefits), which highlights the large decline in real market income between 2007-08 and 2012-13. Similarly, the Office for National Statistics' (ONS's) much wider measure of 'final income' - which subtracts indirect taxes and includes the value of public services and other subsidies - shows faster income growth in the 2000s. This reflects the fact that more money was spent on public services in this period. Overall though, the long-term trend is broadly in line with our preferred income measure.

[9] To deflate incomes after housing costs, a variant of CPI that excludes housing costs (to avoid double counting their impact) is used throughout this paper. This is the same approach taken in the DWP's *Households Below Average Income*.
[10] See Annex 2 for more details.

Figure 2: Most income measures move broadly in step in the long term

Real (CPI-adjusted, 2018-19 prices) median equivalised disposable household income (before housing costs)



Notes: UK. GDP per head is in chained volume measure market prices, June 2019.
Source: ONS, *Effects of taxes and benefits on UK household income*

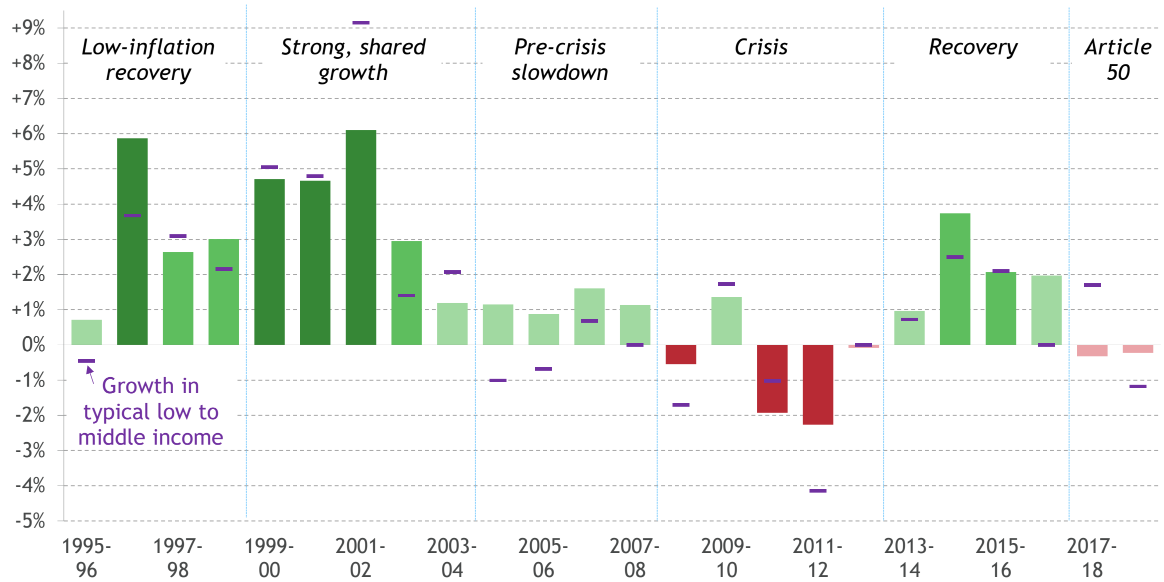
The past quarter century can be characterised by six distinct sub-periods of income growth

In this report we focus on living standards since 1994-95. This is when the best data (the DWP's Households Below Average Income survey) is available, and covers a span of 24 years (25 including our 2018-19 nowcast) and five prime ministers.

As with the longer period set out in Figure 1, incomes have grown markedly over this timeframe. Real-terms median income rose by 50 per cent between 1994-95 and 2017-18, or an average of 1.8 per cent a year, for instance. Once again though, that growth has not been steady. As Figure 3 shows, incomes fell in five years of this period (all of them after 2007-08); while in eight years (though only once in the last 16) annual growth exceeded 2.5 per cent.

Figure 3: Income growth has been uneven over the last 25 years

Annual real growth (CPI-adjusted) in median equivalised disposable household income (after housing costs), overall and for low to middle income non-pensioners



Notes: 2018-19 values are nowcasts. UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income*; IFS, *Living Standards, Inequality and Poverty*; and RF nowcast

Given these growth fluctuations, it makes sense to break our analysis into key sub-periods. We define these on the basis of both the typical income changes described above and changes in the distribution of income. We give particular weight to the experience of (working) low to middle income non-pensioners (defined in more detail in Annex 1). Income growth rates for this group are also shown in Figure 3.

We notate the six sub-periods as:

- 1994-95 to 1998-99:[11] **'low-inflation recovery'**, when median income growth averaged 3.0 per cent;
- 1998-99 to 2003-04: **'strong, shared growth',** when median income growth averaged 3.9 per cent;
- 2003-04 to 2007-08: **'pre-crisis slowdown'**, when median income growth averaged 1.2 per cent (and was negative for the typical low to middle income non-pensioner);

[11] Throughout this report, this terminology refers to the base year and end year of sub-periods. However, in terms of growth, 1994-95 is not included – it is merely a baseline for 1995-96. Similarly, growth in 1998-99 (relative to the year before) is included in the first sub-period (1994-95 to 1998-99) but not the second (1998-99 to 2003-04).

- 2007-08 to 2012-13: **'crisis',** when median income growth averaged -0.7 per cent;
- 2012-13 to 2016-17: **'recovery',** when median income growth averaged 2.2 per cent; and
- 2016-17 to 2018-19:[12] **'Article 50 (so far)'**, when median income growth averaged an estimated -0.3 per cent.

Further sections explore these sub-periods in some detail, summarising what characterises them and what lessons can be learned from each. Subsequent sections also take us further beyond the median – which only represents one point in the income distribution - to consider the experience of different groups and parts of the income distribution. We begin in the next section by looking at divisions by age, family type, housing tenure, region and ethnicity.

[12] It is likely that 2019-20 may ultimately fall into this category too, given that Article 50 has been extended to at least 31 October 2019 and 2019-20 is the third impactful year of the benefit freeze.

Section 3

Living standards across society

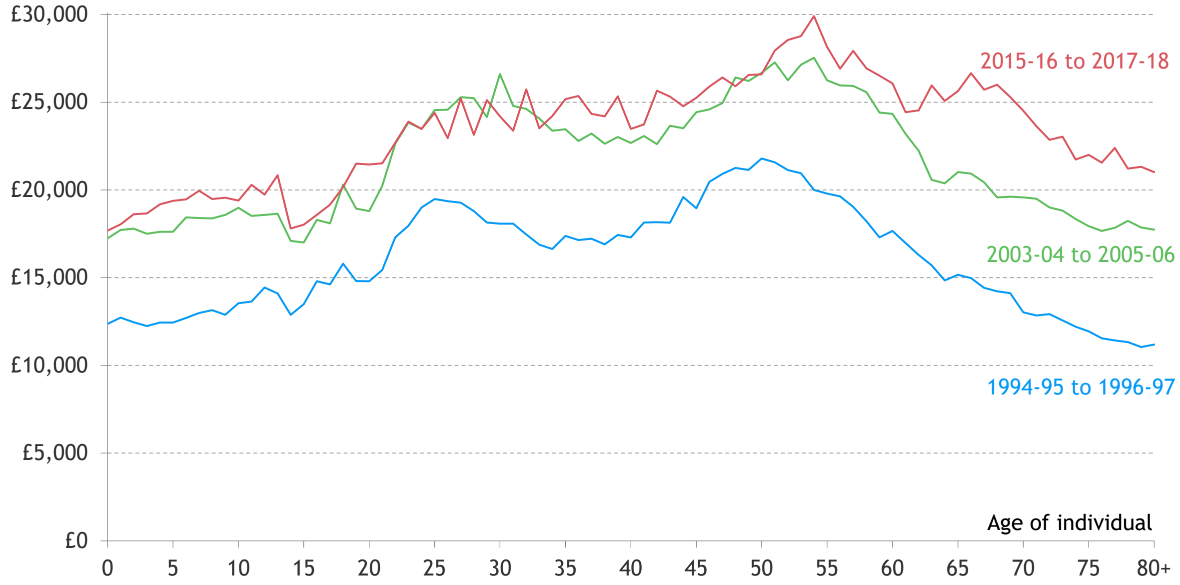
The previous section looked at overall averages, but income levels and growth have of course varied across society over the period of interest. One notable feature of the past 15 years in particular is that growth has been particularly weak for children and adults below pension age, leading to a convergence between typical pensioner and non-pensioner living standards. There are differences by housing tenure too, with the highest-income group – mortgagors - having benefited from large falls in interest costs over the past decade in a way that renters haven't. There is some good news in relation to inequalities around geography and ethnicity, with some convergence of incomes occurring over the longer term. In many cases however, very large income gaps remain.

Pensioner incomes have grown particularly strongly

As recently as the mid-1990s, older people typically had the lowest incomes of any age group. As Figure 4 shows, back then the typical equivalised household income recorded among adults at age 75 was around £12,000 a year in today's money. That was only a little more than half the equivalised household income of the typical 50 year old (£22,000), and slightly less than that of young children (around £12,500). But a significant improvement in the incomes and housing status of pensioners has changed this pattern, as the red line – which averages over the three years to 2017-18 - shows. Indeed, between 1994-95 and 2017-18 the typical real income of a 75 year old grew by 103 per cent: far faster than for younger age groups. As a result, although the 70-plus group remains typically poorer than ages 25-70, it is children (and, by implication, their parents) that now comprise the poorest group.

Figure 4: Children (and parents) are typically poorer than other age groups, while those in their 50s are richest

Real (CPI-adjusted, 2018-19 terms) median equivalised disposable household income (after housing costs), by age



Notes: The OECD equivalisation scale assumes children over 13 have higher needs than those under 13. UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income*

Although all age groups are better off than in the mid-1990s, it is also notable how little growth there has been since the mid-2000s. Only in the older part of the age scale did incomes increase in any meaningful way between the three years to 2005-06 and the three years to 2017-18.

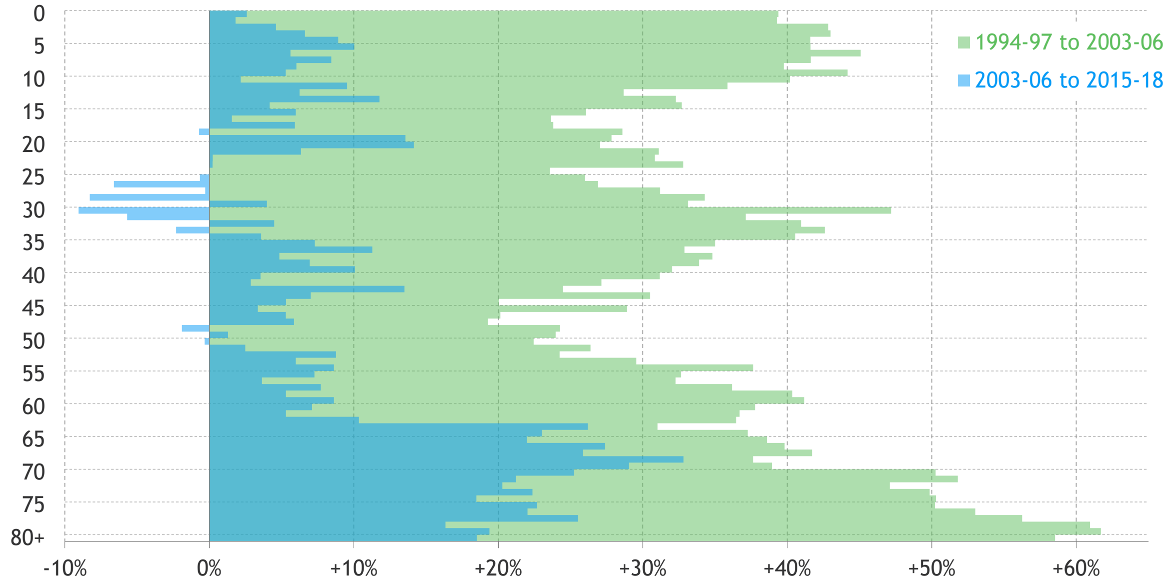
Figure 5 illustrates just how little equivalised household income growth there has been for children and working-age adults over the last 12 years, particularly compared to pensioners. It also shows how weak growth over these years has been more generally, by comparing it with that recorded in the shorter nine year spell surrounding the millennium.

Indeed, typical incomes for ages 25 to 31 have actually *fallen* in the main since the mid-2000s, relative to growth of around 30 per cent over the course of the preceding nine years. And this chimes with separate statistics on consumption which show that typical real non-housing spending for 18-29 year olds remained lower in 2017-18 than in 2001-02.[13] Likewise, income growth of under 5 per cent for children under three in the last 12 years compares with an increase of around 40 per cent between the mid-1990s and mid-2000s.

[13] L Gardiner et al., *An intergenerational audit for the UK*, Resolution Foundation, June 2019

Figure 5: Old-age incomes have grown much faster than those of children and working-age adults over the past 12 years

Total growth in real (CPI-adjusted) median equivalised disposable household income (after housing costs), by single year of age



Notes: UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income*

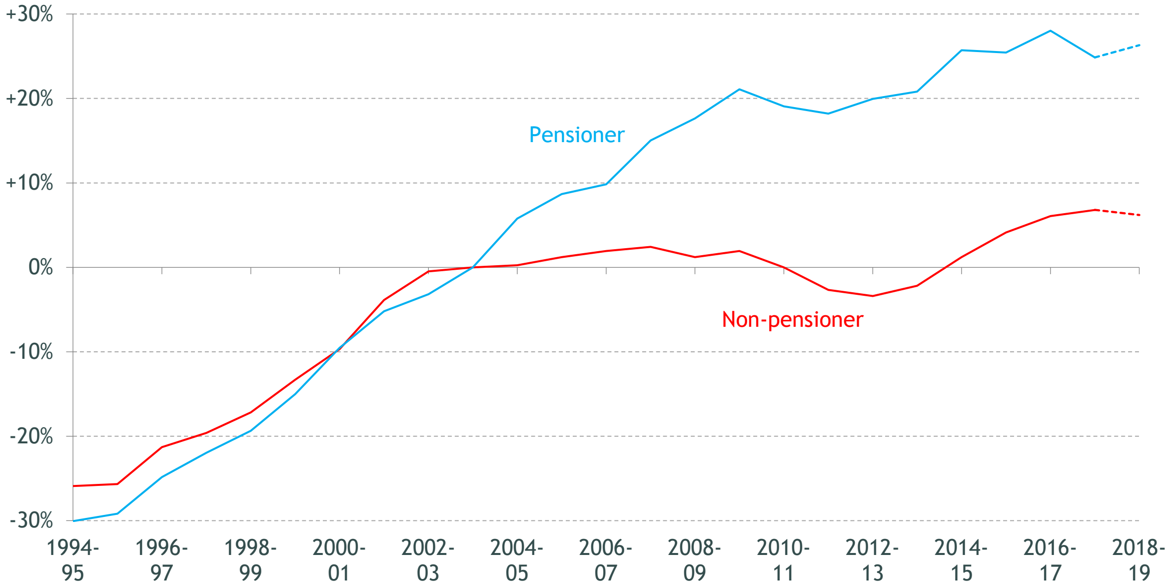
One working-age group that slightly bucks the trend is 19-20 year olds, with income growth of around 14 per cent since the mid-2000s. However, it is important to note that student loans that pay for tuition fees (as well as living costs) are counted as disposable income in this survey.[14] It is likely that income figures for this age group have therefore been distorted by the rise in tuition fees since September 2012.[15]

The much stronger performance of pensioner incomes relative to non-pensioner incomes since the early 2000s is also shown in Figure 6. The typical pensioner income grew by 25 per cent between 2003-04 and 2017-18 (averaging 1.9 per cent a year), compared to 7 per cent for non-pensioners (0.5 per cent a year). In absolute terms however, the result of this is that typical pensioner and non-pensioner incomes are now essentially identical at around £23,000. Looking at the most recent year, our nowcast suggests non-pensioner income growth continued to be poor in 2018-19 (with a fall of 0.6 per cent) while the typical pensioner income grew modestly (though this is particularly hard to predict).

[14] A Corlett, *Did raising tuition fees flatter measurements of young people's incomes?*, Resolution Foundation blog, October 2017
[15] Students living in halls of residence are also not included in the survey, creating additional compositional distortions when looking at this age group over time.

Figure 6: Pensioner incomes had a much stronger decade after 2003-04 than non-pensioner incomes

Cumulative growth in real (CPI-adjusted) median equivalised disposable household income (after housing costs) relative to 2003-04



Notes: 2018-19 values are nowcasts. UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income;* and RF nowcast

While pensioner incomes have grown steadily since the mid-1990s, there appears to have been an absence of growth since 2014-15 and a sharp decline in 2017-18. There are, however, good reasons for questioning how genuine this short-term change is, given changes both in the way that pension income is received and in the way that it is recorded. A range of possible explanations is explored in Box 1, but only time and further data will tell.

i Box 1: Why has pensioner income growth been weak recently?

Despite very impressive income growth overall since 1994-95, Figure 6 shows that the typical pensioner income was apparently lower in 2017-18 than in 2014-15. Indeed, median pensioner income apparently fell 2.5 per cent in 2017-18 (with similar falls being apparent across the pensioner income distribution). The proportion of pensioners in poverty has also been rising since 2012-13, up from 13 per cent to 17 per cent.

There are a number of potential reasons for these findings, and it is likely that several have contributed.

First, there are actual economic pressures. Inflation (excluding housing costs) in 2017-18 was 3.1 per cent – faster than increases in benefits and private pensions – leading to at least a temporary income fall for many. Pensioners are also not entirely immune from recent benefit cuts, and a particularly large rise in poverty among pensioners who rent may relate in part to housing benefit cuts.[16] In addition, some long-term positive trends such as a rise in home ownership and more generous private pensions may now have levelled off.[17]

Second, there is the prospect that some of this is just noise. Because pensioners form a relatively small part of the population, survey sample sizes can be an issue – with some of the changes depicted likely to lack statistical significance.

Third, there is the issue of benefit income under-reporting in the survey data. We have highlighted this phenomenon before,[18] with the consequence that the income levels of those most reliant on benefit income – including pensioners of course - are under-estimated. However, it does not appear that this problem has overall got worse over the last few years.

A fourth hypothesis relates to the way in which 'pensioners' are defined. In this report and in the DWP's *Households Below Average* Income publication, pensioner incomes refer to family units where at least one person is over state pension age. However, this means that many non-retired people are included in this category. In 2009-10, a fifth of pensioner family units had at least one person in work – e.g. a 61 year old couple where the man was still in work but the woman was above state pension age.[19] But as the female state pension age has risen from 60 to 65, equalising with the male age, so employment among 'pensioner' family units has fallen. This compositional change is a part of the story of the boom and fall of 'pensioner' incomes.

Fifth, for 2017-18 in particular, there is a data issue with widows' pensions. The number of people with widows' employee pensions fell from 1.1 million in 2016-17 (similar to the previous four years) to 0.7 million in 2017-18; and the amount of income from these fell by a third from £7.0 billion to £4.7 billion. But, in all likelihood, this merely reflects changes to the relevant survey question made in 2017-18, rather than a real change.

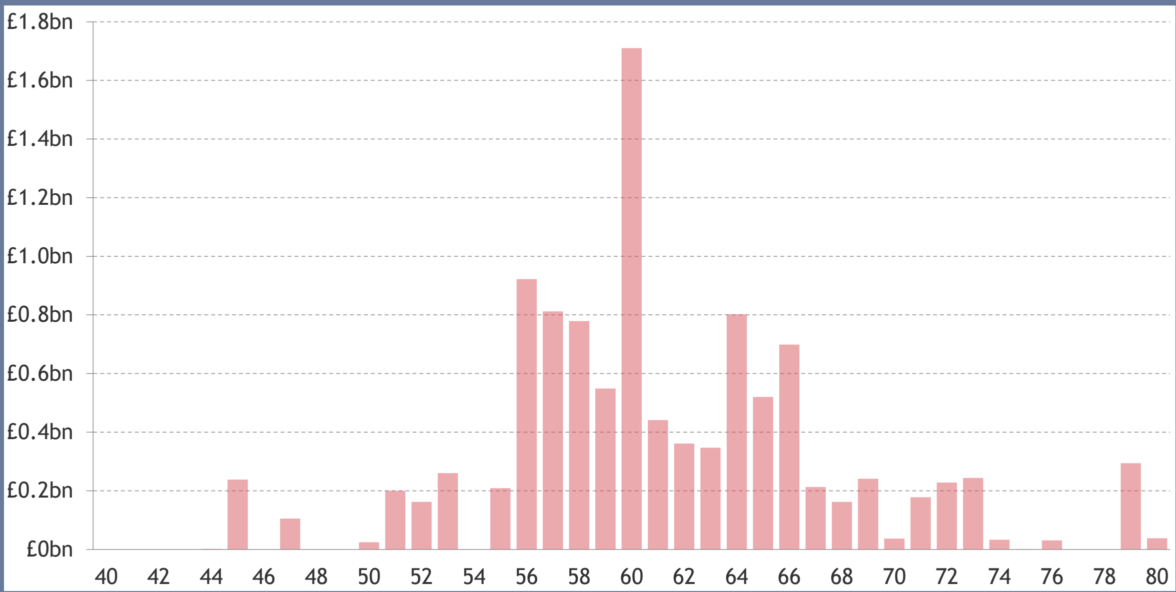
Finally, a broader problem with the measurement – and definition – of pensioner incomes has become more important in the recent period. While it is clear how much annuities and previous-salary-linked pensions contribute to pensioners' 'incomes' each year, the correct treatment of lump sums and other one-off wealth drawdowns is less straightforward. Indeed, one-off lump sums have not previously counted towards the income stats at all. This is despite the original pension contributions when young also not counting as disposable income, meaning this 'income' never appears in the data. With the rise of defined-contribution pensions and the introduction of 'pension freedoms' in 2015 – allowing people to withdraw from these pension pots as desired from age 55 (though with tax implications) – this has become a more pressing issue.

[16] H Barnard et al., UK Poverty 2018, Joseph Rowntree Foundation, December 2018
[17] See for example https://www.resolutionfoundation.org/data/housing/
[18] A Corlett, S Clarke, C D'Arcy & J Wood, The Living Standards Audit 2018, Resolution Foundation, July 2018
[19] A Corlett, As time goes by: shifting incomes and inequality between and within generations, Resolution Foundation, February 2017

Figure 7 shows that lump sum payments in the survey totalled £11 billion in 2017-18, clustered around age 60, with none of this counting as 'income'. It is unclear at this point how much the changing form of pensions has affected income trends, but further work and clarification from government statisticians is urgently needed.

Figure 7: There was a total of £11 billion of pension withdrawals in the 2017-18 survey, not counted as income

Total pension lump sums/withdrawals by age (last 12 months, 2017-18 survey)



Notes: UK.
Source: RF analysis of DWP, *Family Resources Survey*

The impressive catch-up of pensioner incomes relative to non-pensioner incomes over recent decades is welcome in the extent to which it reflects strong growth at older ages. But it also owes much to wretched levels of income growth for children and working-age adults.

Within the working-age population, large gaps between family types remain

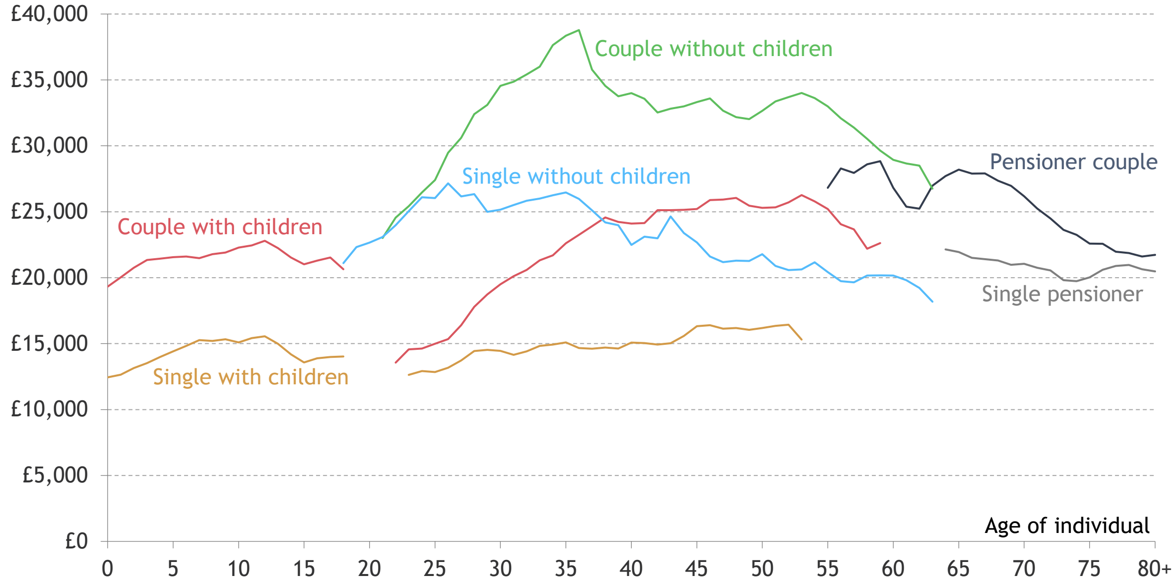
Of course, it is not just age that determines household incomes. As Figure 8 makes clear, the presence of a partner and of children have large effects on living standards.[20] The gap in typical living standards between non-pensioner family units with children and

[20] We use the OECD 'companion' scale to equivalise incomes after housing costs. This standard scale implies, for example, that a couple only needs 172 per cent of the income (after housing costs) of a single adult to provide the same standard of living, due to economies of scale, while a child under 14 requires 34 per cent of what the first adult needs.

those without is around £9,000 a year; while the gap between singles and couples (with or without children) is around £8,000.[21] Single parents and their children therefore have the lowest typical disposable incomes, at every age.

Figure 8: Being single and/or having children tends to mean lower equivalised household incomes relative to couples and the childless

Real (CPI-adjusted, 2018-19 terms) median equivalised disposable household income (after housing costs), by age and family type, 2015-16 to 2017-18



Notes: UK. There may be multiple family units (e.g. single adults) in a household. Sample sizes of under 50 excluded. Rolling three-year-of-age average.
Source: RF analysis of DWP, *Households Below Average Income*

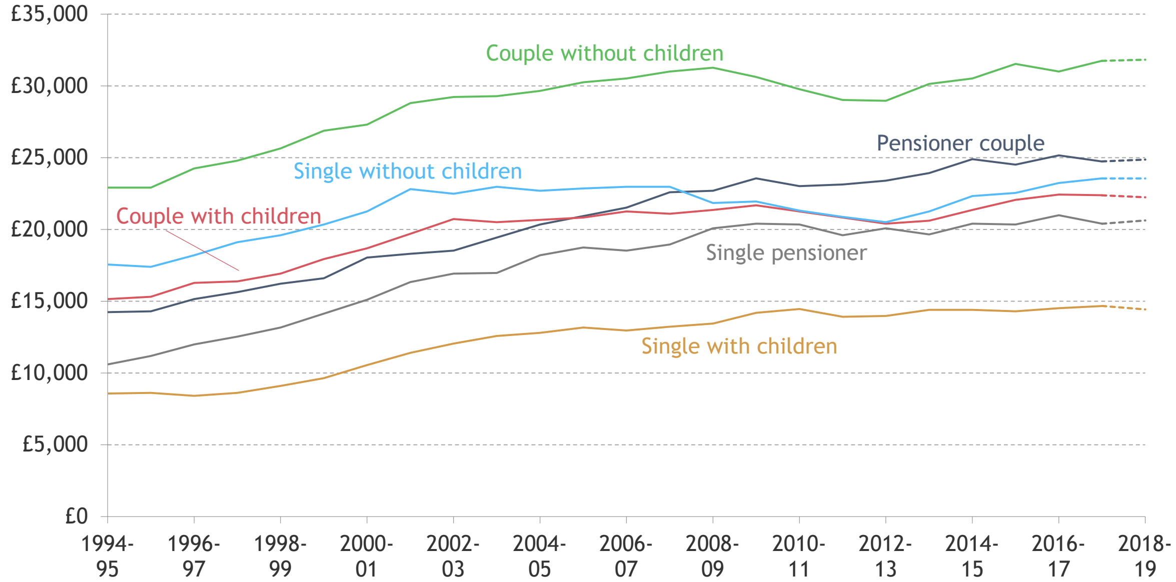
Looking across the full age range, the typical single parent income is under £15,000. That's less than half that of couples without children (around £32,000). But, while single parent households have the lowest incomes, they have experienced faster growth over the past decade and a half than any other non-pensioner group (though still slower than pensioners). Figure 9 shows that equivalised household incomes have risen by around 17 per cent for single parent families since 2003-04. This is compared to growth of 9 per cent for couples with children, and just 3 per cent for single adults without children.

The reasons for this relatively strong growth are explored further in Section 5, but a key part is the changing employment status of single parents. Between 1996 and 2018, the single parent employment rate grew from just 43 per cent to around 67 per cent, boosting incomes while also changing the composition of the in-work group.[22] Indeed, if we look at the typical real income of just those single parents in working households (therefore crudely controlling for employment change), this is lower than in 2003-04 – highlighting the importance of employment changes to the overall figures for the group.

[21] 'Family units' (also known as 'benefit units') are single adults or couples, plus any dependent children living in the same household. A household may contain multiple family units, e.g. several single adults flat-sharing.
[22] RF analysis of ONS, *Labour Force Survey*

Figure 9: Single parents and their children have the lowest household incomes, but have experienced faster growth than other working-age family types

Real (CPI-adjusted, 2018-19 prices) median equivalised disposable household income (after housing costs), by family type

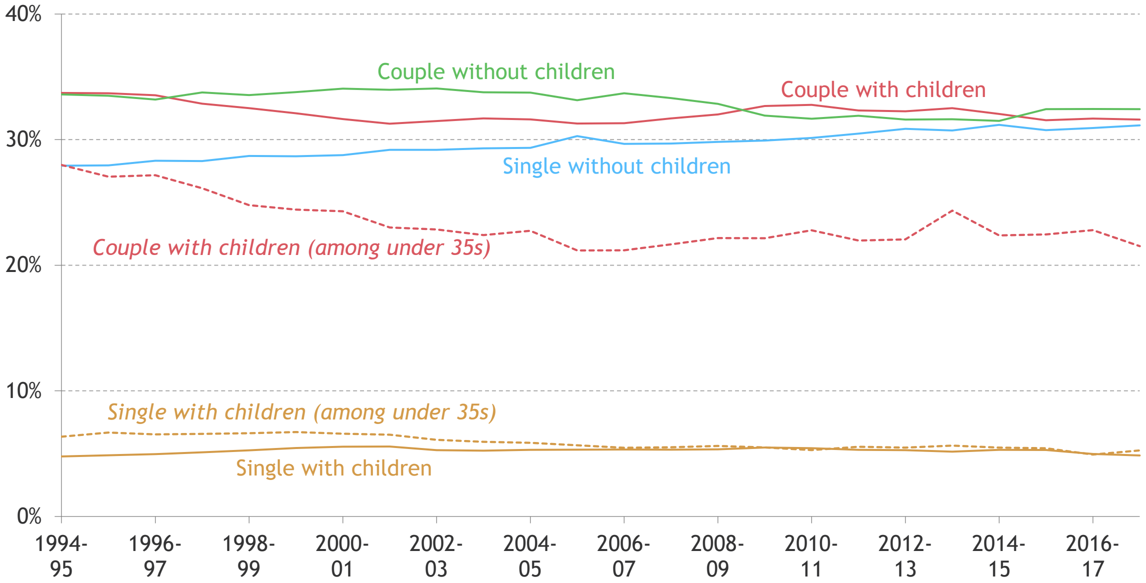


Notes: 2018-19 values are nowcasts. UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income*; and RF nowcast

Given the importance of family make-up for incomes, it should be noted that the composition of the non-pensioner population has not changed radically since 1994-95, as Figure 10 shows. Single parents now make up a lower share of working-age adults than at any time since 1995-96 – and the downward trend is even more apparent for under 35s. In contrast, single adults without children now make up a larger share. As a result, childless couples, couples with kids and childless singles each now make up just over 30 per cent of working-age adults, with single parents making up the remaining 5 per cent. The movements are relatively modest though.

Figure 10: Single parents now make up a lower share of working-age adults than at any time since the mid-1990s, but single adults without children are at a near-record high

Family types of non-pensioner adults



Notes: UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income*

There is a living standards divide between home owners and renters

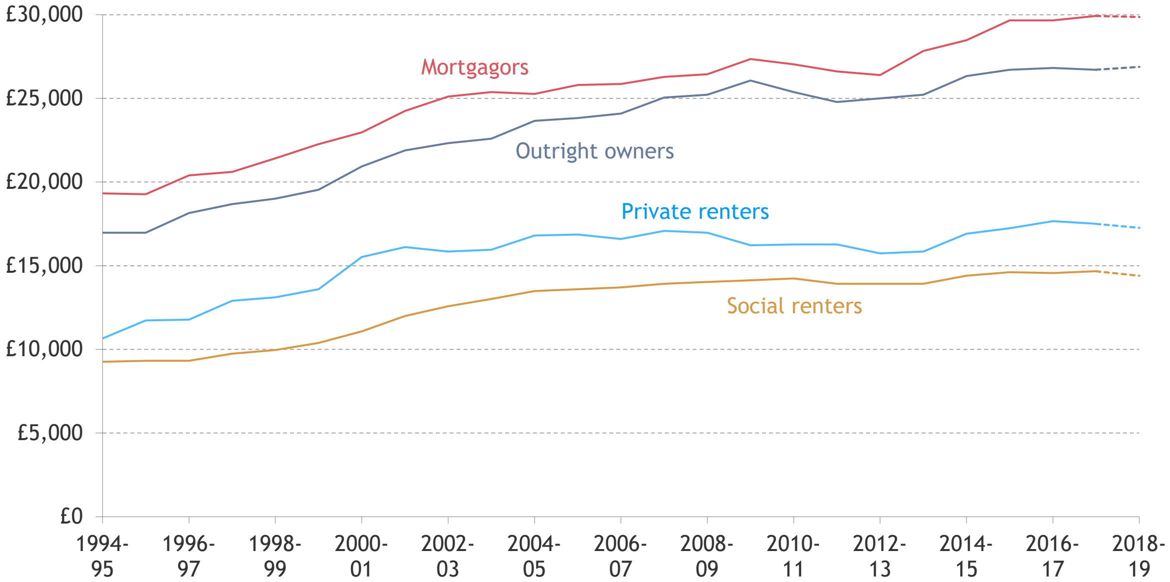
Housing tenure can be both a cause, and a reflection, of disposable household income differences. As Figure 11 shows, this results in a clear income divide between renters and home owners.[23] Indeed, the typical disposable income of a mortgagor in 2017-18 (£30,000) was twice that of a typical social renter (£15,000).

Mortgagors have fared particularly well over recent years, contributing to the tenure living standards divide (though note we do not include capital repayments as housing costs). This has been particularly driven by low interest rates in the period after the financial crisis.

[23] Though note that we follow the Households Below Average Income approach of treating mortgage capital repayments (and deposits) as saving rather than a loss of disposable income.

Figure 11: The typical mortgagor has twice the disposable income of the typical social renter

Real (CPI-adjusted, 2018-19 terms) median equivalised disposable household income (after housing costs), by housing tenure

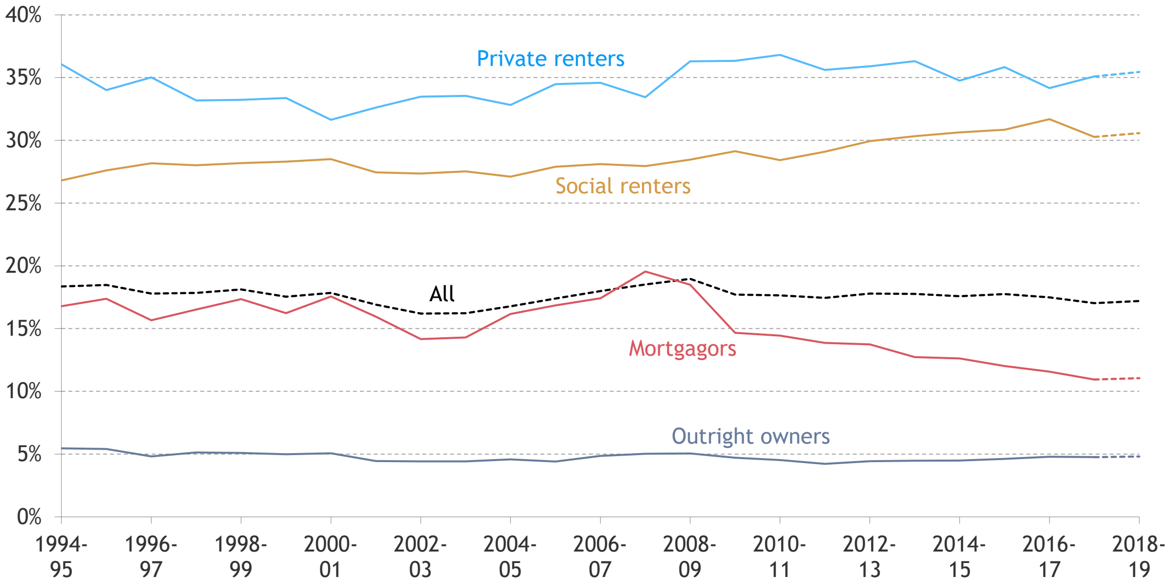


Notes: 2018-19 values are nowcasts. UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income;* and RF nowcast

Figure 12, which shows the path of average housing cost-to-income ratios by tenure since 1994-95, highlights the downward shift in relative housing costs for mortgagors.

Figure 12: Housing cost to income ratios for mortgagors have fallen considerably

Average ratio of housing costs to disposable income (before housing costs)



Notes: 2018-19 values are nowcasts. Mortgage costs here exclude capital repayments. Costs and incomes include housing benefit. UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income*; and RF nowcast

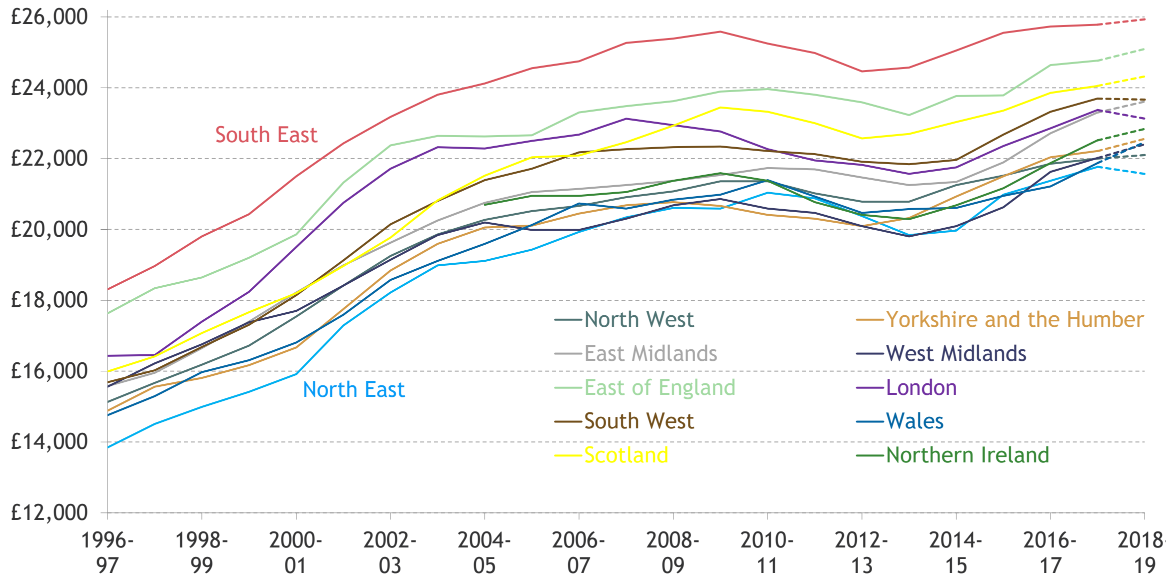
From a high of 20 per cent of income in 2007-08, mortgagor housing cost-to-income ratios fell to 11 per cent in 2017-18. In contrast, the average proportion of income private renters spend on housing costs remained steady over the period at around 35 per cent (far higher than before the 1990s).[24]

Trends have generally been similarly felt across regions

Although income levels differ hugely across the country, the pattern of income trends since the mid-1990s has been largely similar across the regions and nations of the UK, as can be seen in Figure 13. Typical incomes grew relatively swiftly in the sub-periods from 1994-95 to 1998-99 and 1998-99 to 2003-04 for all areas, before slowing across the country, then falling in the crisis and slowly recovering since. Throughout, the South East has had the highest typical income (after housing costs), with the North East of England most commonly having the lowest.

Figure 13: Income growth has slowed across all parts of the country in recent years

Three-year average of real (CPI-adjusted, 2018-19 terms) median equivalised disposable household income (after housing costs), by region



Notes: 2018-19 values are nowcasts.
Source: RF analysis of DWP, *Households Below Average Income;* and RF nowcast

The absolute income gap between the richest and poorest parts of the country has remained steady over time at around £4,000-6,000 a year. However in relative terms this does represent a convergence between regions, and this trend is also visible for incomes before housing costs. So, at least at this broad level of 12 regions and nations, geographic inequality is still far too high, but not rising.[25]

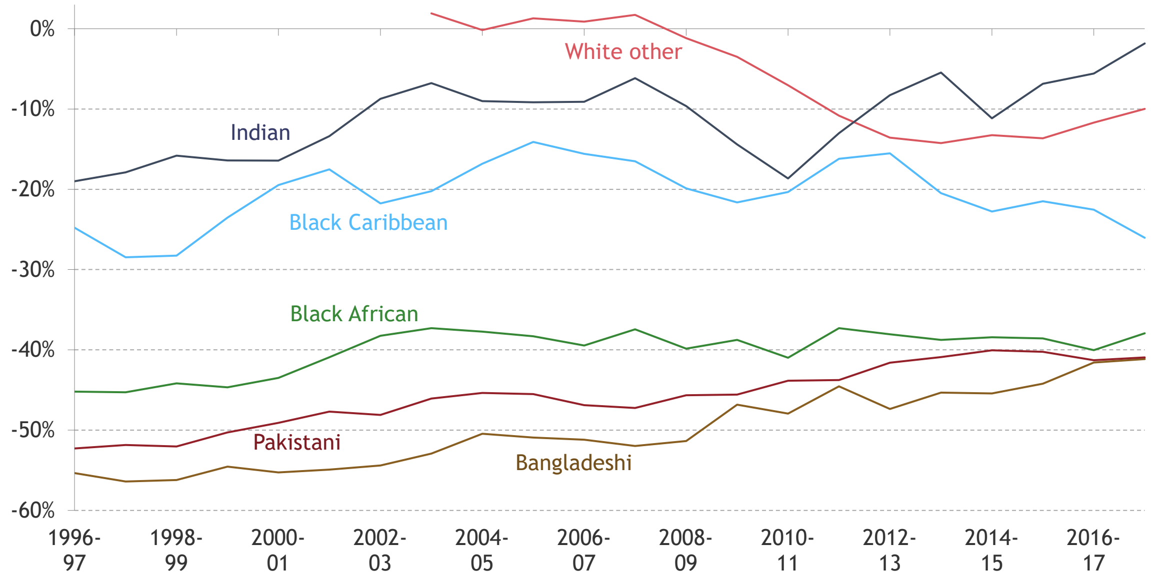
[24] A Corlett & L Judge, *Home affront: housing across the generations*, Resolution Foundation, September 2017
[25] See S Clarke, *Mapping gaps: Geographic inequality in productivity and living standards*, Resolution Foundation, July 2019 for a fuller discussion of changes in regional inequality.

Large household income differences by ethnicity remain

Just as with regions, the relative gaps in typical incomes between different ethnicities have narrowed slightly over time. But, again as with regions, the divide remains very sizeable, as Figure 14 shows. For instance, typical incomes (after housing costs) for Bangladeshi, Pakistani and Black African households are all around 40 per cent lower than for those of White British ethnicity.[26] This is despite a reduction in the income gap of 14 percentage points for Bangladeshis and 11 percentage points for Pakistanis since the mid-1990s.

Figure 14: Large household income differences by ethnicity remain

Proportional difference in three-year average of real (CPI-adjusted, 2018-19 terms) median equivalised disposable household income (after housing costs), relative to White British households



Notes: UK from 2002-03, GB before.
Source: RF analysis of DWP, *Households Below Average Income*

This convergence is down to large increases in the median incomes of these two groups, with incomes almost doubling for Bangladeshis (from £7,300 to £14,300) since the mid-1990s.

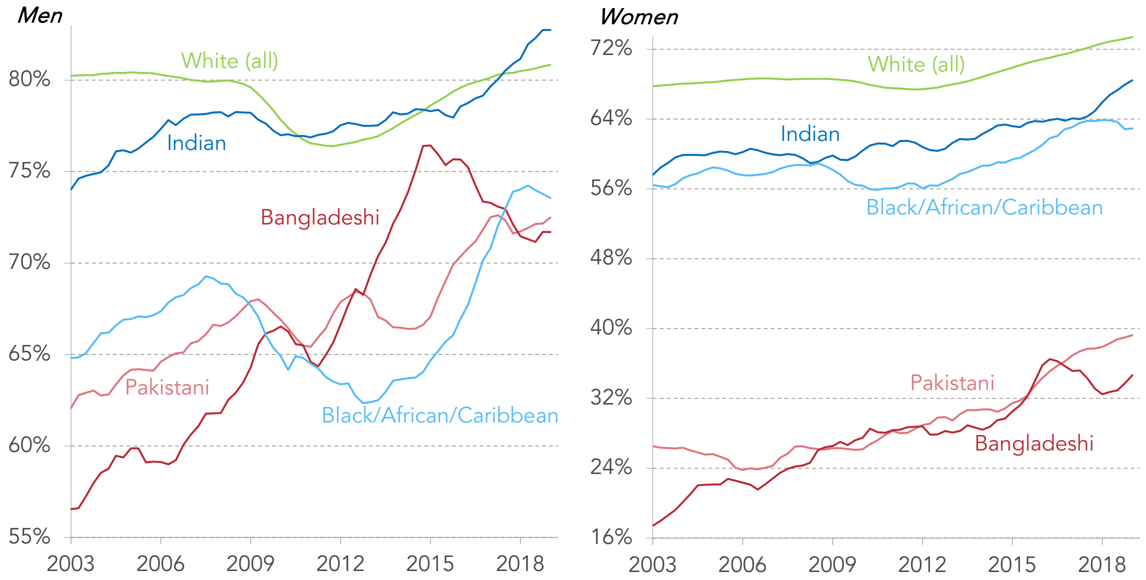
As Figure 15 shows, some of this progress can be put down to significant increases in employment rates (from a low base), for both men and women.[27] Male employment rate differences by ethnicity have shrunk particularly markedly, though the employment rate among Black, Pakistani and Bangladeshi men remains lower than the White male rate was even in the depths of the crisis. There has also been significant qualifications growth

[26] Ethnicity is based on the head of household and is self-reported based on a list of options. Small sample sizes make the reporting of meaningful results impossible for some groups so our analysis is limited here to the most common categories.
[27] Also see A Corlett, Diverse outcomes: living standards by ethnicity, Resolution Foundation, August 2017

for minority groups over recent years, partly as the balance of some populations has shifted away from first generation migrants, born abroad, to second and third generation migrants, born in the UK.[28]

Figure 15: Differences in employment rates by ethnicity have narrowed – particularly for men

16-64 employment rate (average of last eight quarters)



Notes: UK.
Source: ONS, *Labour Market Statistics*

Despite long-term progress, however, the country remains a long way from closing some of these gaps. For example, were the income gap for Bangladeshis to continue to narrow at the same pace, then it would still take until the 2070s to close. And, as Figure 14 showed, the gap for Black Caribbean households was essentially no smaller in the three years to 2017-18 than in the mid-1990s.

Of course, income differences between specific groups are related to – as well as a determinant of – broader inequalities in income. In the next section we look at how income inequality, poverty and the distribution of growth have changed over time.

[28] K Henehan & H Rose, *Opportunities knocked? Exploring pay penalties among the UK's ethnic minorities*, Resolution Foundation, July 2018

Section 4

Living standards across the distribution

The previous section highlighted numerous differences in both the levels of, and growth in, the typical incomes of households of different ages, family types, housing tenures, regions and ethnicities. We switch in this section to look instead at the inequality that exists between lower- and higher- income households. Here we look at how inequality, child poverty and the broader distribution of income growth have changed. We look at income differences in both relative (per cent) and absolute (£) terms.

After housing costs income inequality has drifted upwards over the past two decades, though not on all measures

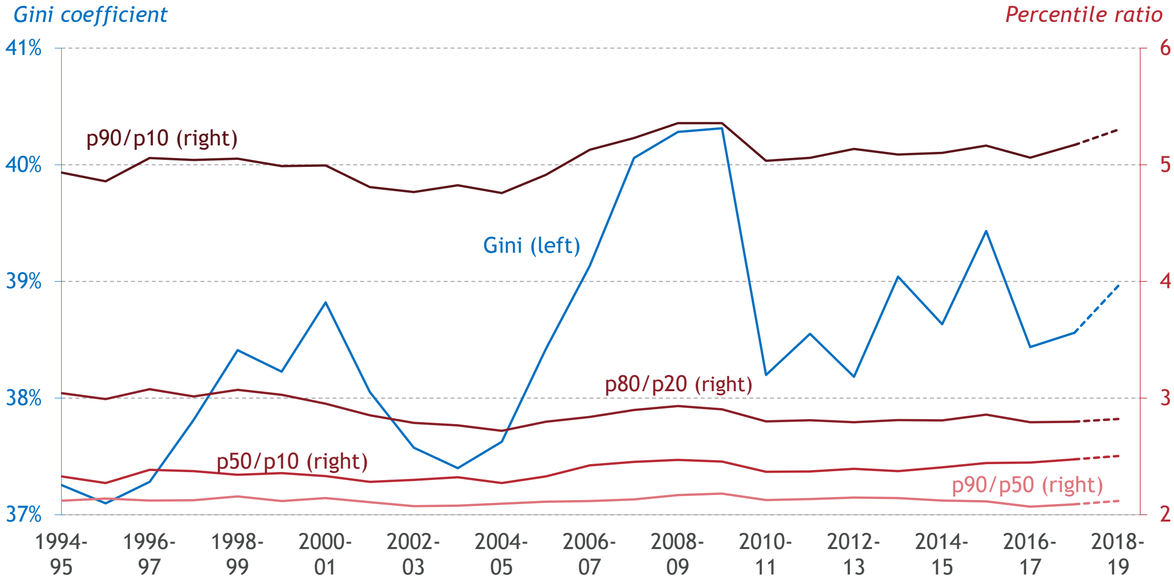
There are many ways to measure inequality. We might look at the gap between the very poorest and the rest of society, the concentration of income in the hands of those at the top, or even assess the whole income distribution at once. Gaps may be measured in relative or absolute terms. And the precise definition of income – such as the choice of how to treat housing costs – matters too.

Figure 16 shows some standard relative inequality measures, using incomes after housing costs. It shows that the main Gini coefficient measure of inequality drifted upwards over the period – rising from 37 per cent in 1994-95 to 39 per cent in 2017-18. And our nowcast points to a further increase in 2018-19.

That overall drift appears to be the product of two separate trends at the very top and bottom of the distribution. The share of income flowing to the top one per cent of the population increased from 6.8 per cent in 1994-95 to 9.6 per cent in 2008-09, before falling back to 8.7 per cent by 2017-18. On the other hand, the share of income going to the bottom tenth fell from 1.8 per cent in 1994-95 to 1.2 per cent in 2008-09, and although it rose following the crisis it has since fallen again.

Figure 16: The Gini measure of relative income inequality has increased modestly since 1994-95

Measures of (relative) inequality for equivalised disposable household income (after housing costs)



Notes: UK from 2002-03, GB (adjusted to UK levels) before. 2018-19 values are nowcasts.
Source: RF analysis of DWP, *Households Below Average Income*; and RF nowcast

With the poorest households (p10) having fallen behind relative to the middle (p50) recently, the p50/10 ratio has reached a record high of 2.5. In contrast, outside of the movements at the top and bottom, inequality trends were broadly flat between 1994-95 and 2017-18 – with the p80/p20 having fallen slightly from 3.0 to 2.8.

Changes in inequality have been far from consistent over time though. As already noted for example, the Gini coefficient fell sharply after the financial crisis before ticking up again more recently. Earlier sub-periods too were marked by different movements, with the Gini rising in the 1990s low-inflation recovery and falling in the strong, shared growth sub-period. The pre-crisis spike in inequality particularly stands out, and future improvements in the measurement of top incomes may revise up this increase over the 2003-04 to 2007-08 sub-period still further (see Box 2). The drivers of these changes are explored further in Section 5.

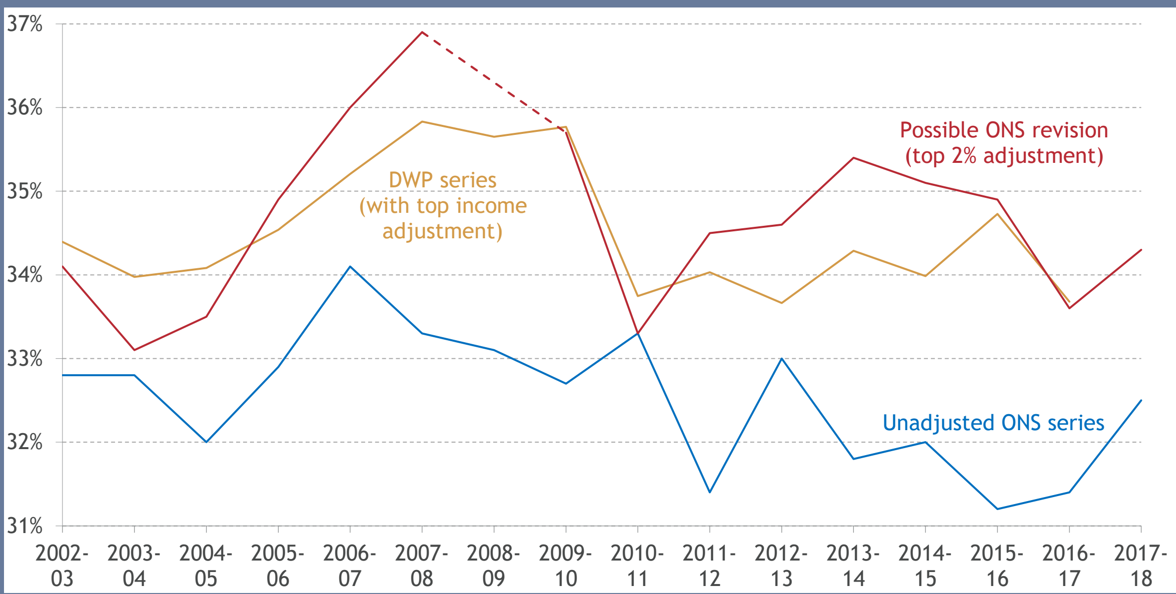
i Box 2: Improving the measurement of top incomes and benefit incomes

In this report we largely take the DWP's *Households Below Average Income* (HBAI) data as read. However, there are some known inaccuracies in this (and other) survey data that might be reparable in future. As well as the pensioner income problems discussed in Box 1, two key problems are the measurement of top incomes and the recording of benefit incomes.

The incomes of the richest are known to be underestimated in survey data. To get around this, HBAI already replaces these incomes with others deduced from Income Tax records. However, this currently relies on nowcasting – which would ideally be later revised – and could also be improved by covering a broader range of incomes.[29] Such improvements are likely to be implemented in the separate ONS household income publications within the next year. As Figure 17 shows, these top income corrections make important differences to inequality levels and trends, and so such figures may change in future.

Figure 17: Official methodological changes may lead to future revisions in top incomes, and therefore overall inequality

(Relative) Gini coefficient for equivalised disposable household income (before housing costs)



Notes: UK.
Source: DWP, *Households Below Average Income*; ONS, *Using tax data to better capture top earners in household income inequality statistics*

In the longer term, it is expected that administrative tax data can be used directly – allowing top incomes to be measured with precision. And ideally this top income adjustment would also move beyond looking only at income liable for Income Tax (which excludes some important sources) towards a more general definition of income (perhaps even including capital gains and inheritances).

In addition to this pipeline of likely revisions to top incomes, there is a known problem of benefit underreporting. By comparing the amount spent on benefits in 2017-18 to the amount recorded in HBAI, we can see that £40 billion is 'missing'. This is at least partly a result of survey respondents

[29] A Corlett, Unequal results: improving and reconciling the UK's household income statistics, Resolution Foundation, December 2017

simply forgetting all of their sources of income or underestimating values. Not only is this a problem for our understanding of income levels, but the significance of these errors has also changed over time. As we have shown in previous work, correcting for this might significantly revise income and poverty levels and trends.[30]

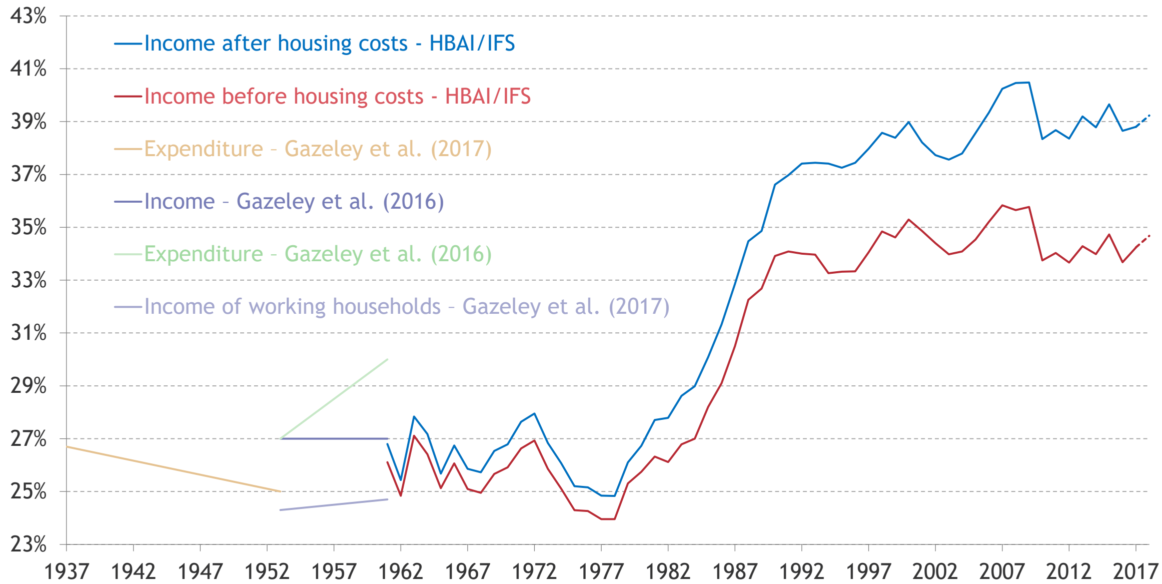
DWP and ONS are working to improve their data by linking to administrative benefit records.[31] But it will likely be several years until we see the impact of these improvements.

The bigger picture on UK income inequality is that it is high – relative both to what came before and to international peers

Stepping back from the trends of the past two decades, it is worth remembering just how high inequality in the UK is. As Figure 18 shows, the UK's Gini coefficient (this time measured on a before housing costs basis too) rose sharply over the course of the 1980s. Even with the limited historic data available prior to 1961, it seems safe to say that relative income inequality in 2017-18 was significantly higher than was ever reached in the five decades from 1937 to 1987.

Figure 18: The UK is much more unequal today than it was prior to the 1980s

(Relative) Gini coefficient for household income/expenditure



Notes: 2018-19 values are nowcasts. UK from 2002-03, GB before.
Source: IFS, *Living Standards, Inequality and Poverty*; I Gazeley et al., *The poor and the poorest, 50 years on: evidence from British Household Expenditure surveys of the 1950s and 1960s*, 2016; I Gazeley et al., *What Really Happened to British Inequality in the Early 20th Century? Evidence from National Household Expenditure Surveys 1890–1961*, 2017; and RF nowcast

[30] A Corlett, S Clarke, C D'Arcy & J Wood, The Living Standards Audit 2018, Resolution Foundation, July 2018
[31] DWP "have developed a high level 3-year work programme" to realise the benefits of administrative data for the FRS and related outputs (see D Burke & P Matejic, Family Resources Survey and related series – update and developments, DWP, June 2018). ONS, Transformation of ONS household financial statistics: ONS statistical outputs workplan, 2018 to 2019, June 2018, states that "[after] the development of an adjustment for the income of high earners […] research into coverage and values reported at the lower end of the income distribution will be prioritised".

We can also compare levels of inequality internationally (while noting the likelihood of methodological and definitional differences), using OECD statistics. These again highlight the relatively high level of income inequality in the UK. The UK's Gini coefficient of 35 per cent – by their measure - is lower than the US (39 per cent) but higher than Canada (31 per cent) and the vast majority of EU nations, including Ireland (30 per cent), Germany (29 per cent), Sweden (28 per cent) and Denmark (26 per cent).[32]

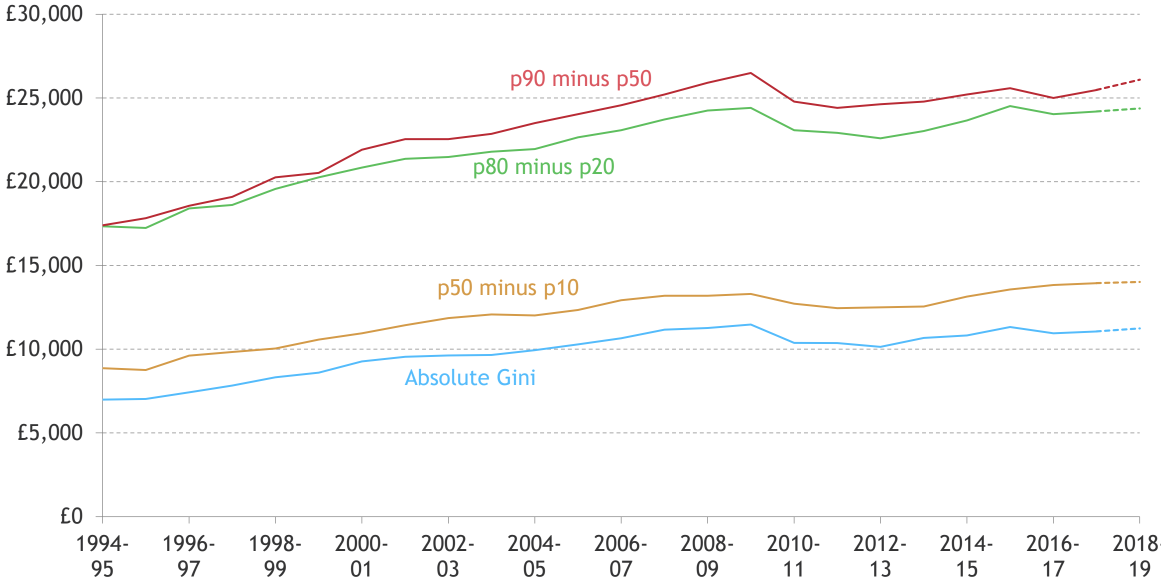
Absolute gaps between income groups have grown

The above might be deemed measures of 'relative' inequality. Such measures mean that a £1,000 income rise for a family on £10,000 and a £10,000 rise for one on £100,000 – both 10 per cent increases – leave 'inequality' between the two unchanged. While this view is useful in separating out the distribution of 'the pie' from its size (and removing the need to account for price changes), it is also useful to consider the 'absolute' gap between income groups. In that example, the absolute income gap between the two families rises from £90,000 to £99,000.

Figure 19 shows how the real gaps between different points in the income distribution have changed over time, as well as a more abstract measure called the Absolute Gini.[33] For example, the gap between the median (p50) and p10 has grown from £8,900 in 1994-95 to a record high of £13,900 in 2017-18: a growing volume of goods and services that a middle-income family can afford and a lower-income family cannot.

Figure 19: Absolute gaps between income groups have grown

Absolute inequality in real (CPI-adjusted, 2018-19 terms) equivalised household income (after housing costs)



Notes: 2018-19 values are nowcasts. UK from 2002-03, GB before.
Source: RF analysis of DWP, Households Below Average Income; and RF nowcast

[32] https://data.oecd.org/inequality/income-inequality.htm
[33] This is equivalent to the (Relative) Gini multiplied by mean income.

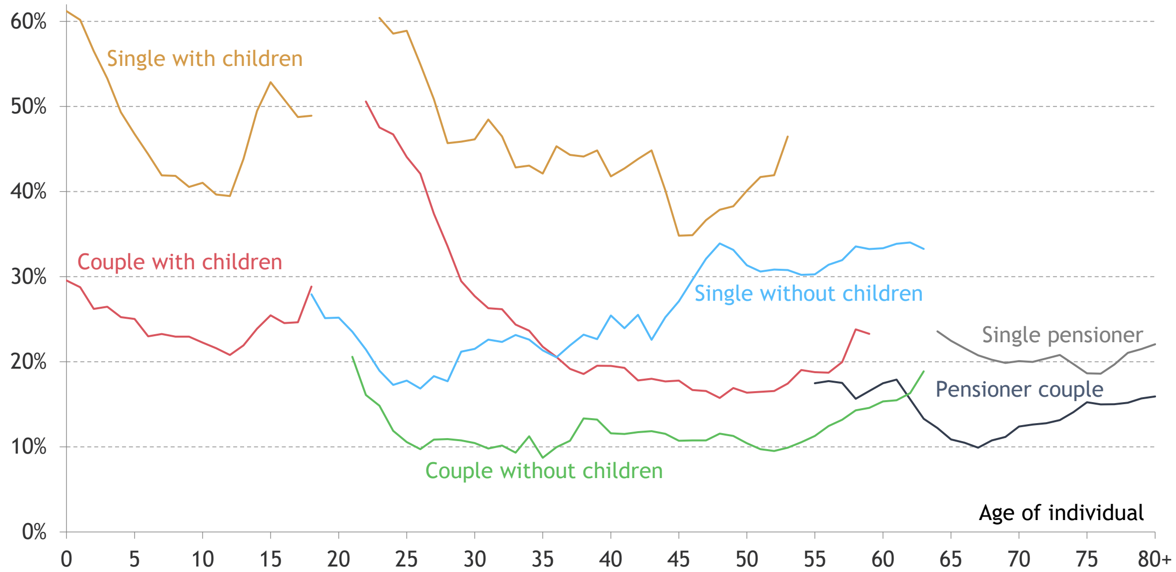
Clearly there are enormous differences in trends depending on whether inequality measures are relative or absolute. Many (by omission) put no weight on the absolute view, while others see the relative approach as potentially misleading.[34] But neither is 'wrong' and it is useful to consider both.

Child poverty rates fell between 1998-99 and 2010-11, but that progress now appears to be unwinding

In addition to broader measures of inequality across the income distribution, levels of poverty deserve particular attention. Overall, 22 per cent of people live in households in relative poverty (with incomes below 60 per cent of the median). But, as Figure 20 shows, there are good reasons to focus especially on child (and by implication, parent) poverty.

Figure 20: Poverty is highest among children and parents, and single adults are more at risk than couples

Proportion of individuals living in relative poverty (after housing costs), by age and family unit type, 2015-16 to 2017-18



Notes: UK. Sample sizes of under 50 excluded. Rolling three-year-of-age average. The OECD equivalisation scale assumes children over 13 have higher needs than those under 13.
Source: RF analysis of DWP, *Households Below Average Income*

Comparing recent relative poverty rates by age and family type, it is clear that children and parents face considerably higher odds of poverty than pensioners and families without kids.[35] This is the same pattern that is seen with typical incomes, as shown

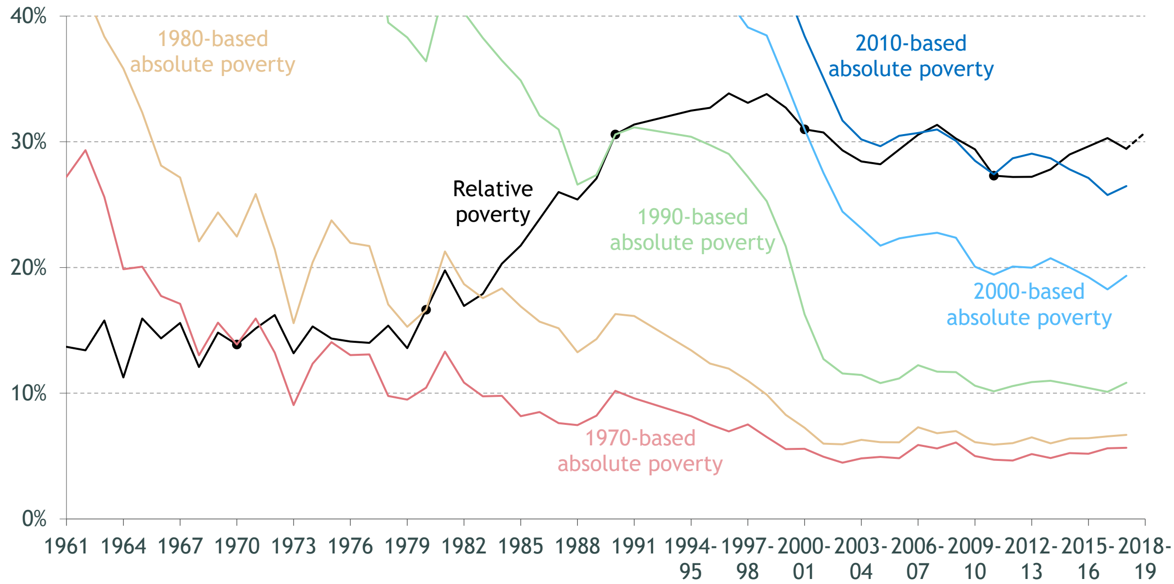
[34] e.g. J Hickel, *How not to measure inequality*, Jason Hickel blog, May 2019
[35] Work by the Social Metrics Commission suggest that accounting for mortgage capital repayments and childcare costs further widens the poverty gap between parents and others. *A new measure of poverty for the UK: the final report of the Social Metrics Commission*, September 2018

earlier in Figure 4. Notably, over half of pre-primary children living with only one parent are in poverty. And even among couples, parents up to (and including) the age of 35 are more likely to be living in poverty than a single pensioner age 80 or over.

Figure 21 focuses on child poverty, setting out trends over the past 57 years. In relation to the standard relative poverty measure, we can see a similar pattern to that displayed for inequality: namely a sharp rise over the course of the 1980s, such that levels today are much higher than they were in earlier decades. Focusing instead on measures of *absolute* poverty (the proportion living below a fixed poverty line, adjusted only for inflation) we see clear declines over time. Few children now live in poverty by the standards of 1970 or 1980, for example.[36]

Figure 21: Absolute child poverty has declined over time, but levels of relative child poverty remain high by historical standards

Proportion of children living in poverty (after housing costs), for different definitions of poverty



Notes: UK from 2002-03 and before 1994-95, GB in-between. 2018-19 value is a nowcast. 1992 and 1993 values are interpolated due to missing data. Dots indicate where the relative poverty threshold and a specific absolute threshold are identical.
Source: RF analysis of DWP, *Households Below Average Income*; IFS, *Households Below Average Income 1961-1991*; and RF nowcast

But it is worth digging into some of the trends on display for both relative and absolute child poverty from the mid-1990s onwards. There were particularly large declines from 1998-99 to 2003-04, with a fall of 5 percentage points in the relative poverty measure (and, as described in Box 2, this may well be an underestimate). There was then little progress ahead of the financial crisis, but relative and absolute child poverty declined again between 2007-08 and 2010-11.

Worryingly, there are clear signs of a reversal of some of the previous relative poverty progress since 2012-13. No further rise was recorded in 2017-18: in fact there was a fall,

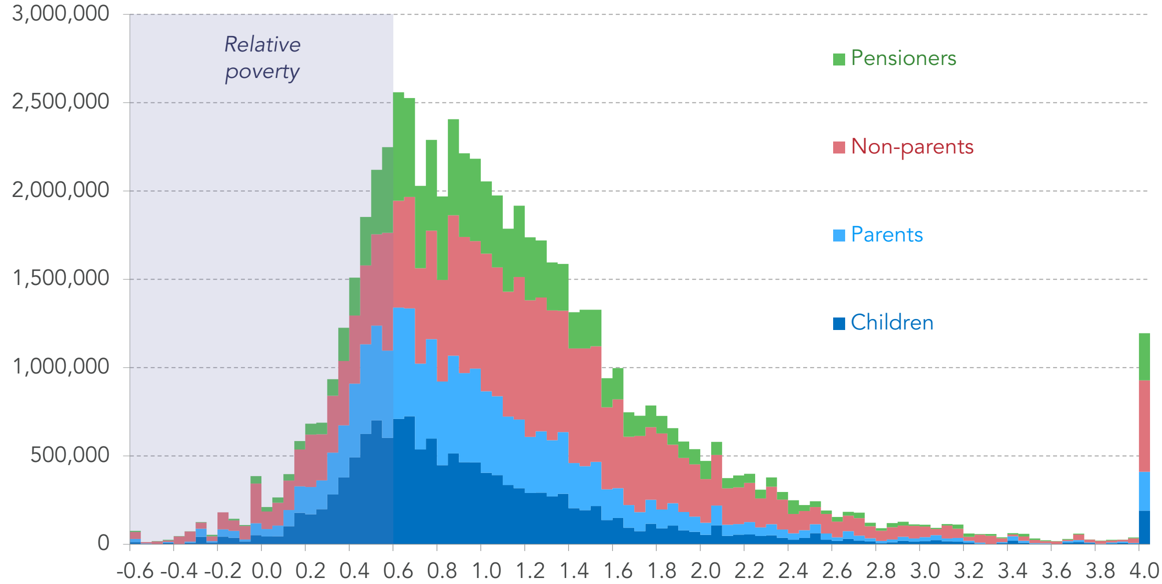
[36] And the few that are recorded as such might be due to unreliable data.

though this was not statistically significant. But our nowcast points to an increase in 2018-19, and further rises have been projected for future years as social security cuts such as the benefit freeze (up to 2019-20), two-child limit and family element abolition weigh on family incomes.[37]

Figure 22 makes clear that there are a large number of children and parents just above the relative poverty line (with 1.3 million sitting between 60 per cent and 65 per cent of the median, for example), and therefore at risk of falling below the threshold and into poverty in this narrowly-defined sense.[38] Equally, however, a large number currently fall just below the threshold.

Figure 22: A large proportion of children and parents have incomes near the relative poverty line

Population distribution of equivalised disposable household income (after housing costs), relative to the median, 2017-18



Notes: UK. Median income is 1.0 here, and the relative poverty line is 60 per cent of the median. Some households in the data have negative incomes after housing costs.
Source: RF analysis of DWP, *Households Below Average Income*

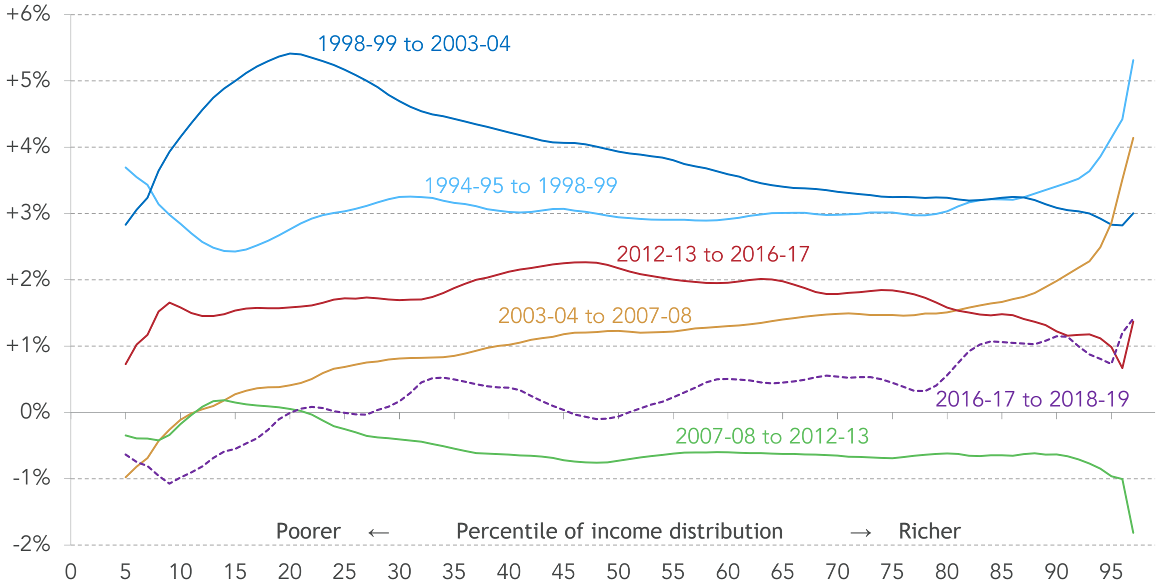
Both the overall strength and the distribution of growth have varied between sub-periods

As well as looking at specific measures of inequality, we can also assess the shape – and the strength – of income growth right across the income distribution. Figure 23 does this, setting out average annual growth in income for each percentile of the distribution across each of our six sub-periods. (Box 3 provides a brief overview of the way in which living standards evolved in earlier decades).

[37] A Corlett, *The Living Standards Outlook 2019*, Resolution Foundation, February 2019
[38] This clustering does however make the child poverty rate particularly hard to predict, with small movements in the poverty line and/or family incomes (or in the quality of measurement) having potentially large effects.

Figure 23: Both the strength and distribution of growth have varied between sub-periods

Average annual relative growth in real (CPI-adjusted) equivalised disposable household income (after housing costs)



Notes: 2018-19 values are nowcasts. UK from 2002-03, GB (adjusted to UK) before. Smoothed using a five-percentile rolling average.
Source: RF analysis of DWP, *Households Below Average Income*; and RF nowcast

It highlights a number of important differences in the lived experience of growth and inequality in each timeframe. At the top of the chart, the 1994-95 to 1998-99 and 1998-99 to 2003-04 sub-periods stand out as phases of relatively strong income growth. That growth was shared fairly evenly across the distribution (with a clear spike at the top) in the former sub-period, but growth in the latter sub-period was weighted more towards lower-income households.

Income growth for most then slowed markedly pre-crisis, with the bottom half of the distribution especially affected. The post-crisis squeeze hit the entire distribution, though top incomes fell fastest. But, following a relatively evenly-felt but muted recovery between 2012-13 and 2016-17, the Article 50 sub-period has included particularly weak (or negative) growth towards the bottom of the distribution.

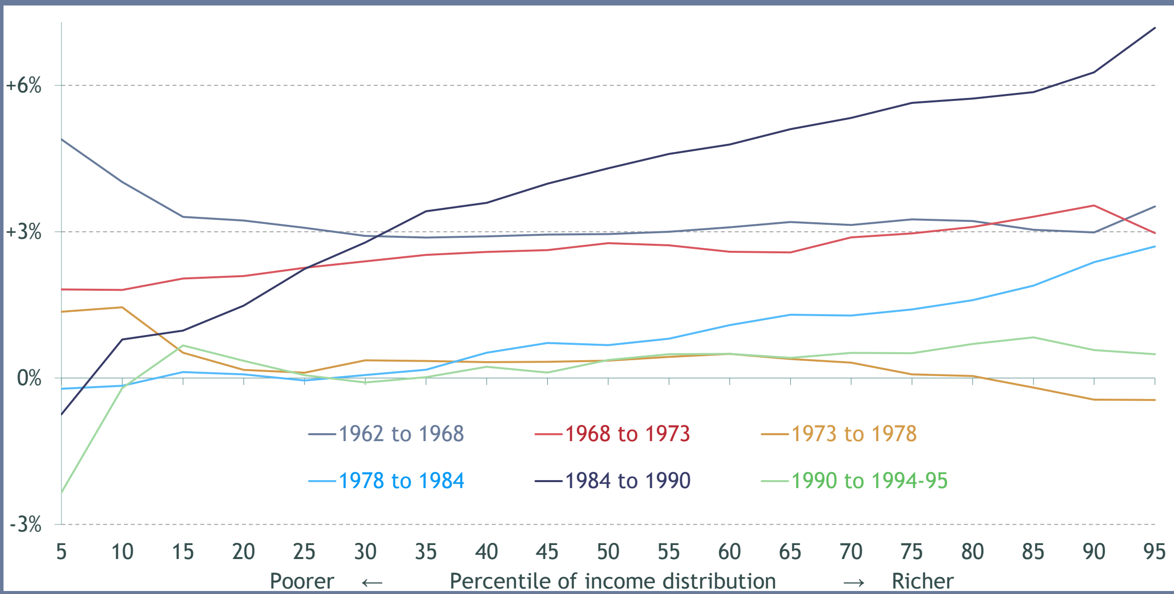
i Box 3: Income growth across the distribution in earlier periods

In this paper our analysis focuses on the period since 1994-95, the point at which the large and standardised Family Resources Survey began.[39] But survey data exists for earlier years too, and it is worth using this data to briefly consider how income growth evolved across six sub-periods leading up to the mid-1990s – as set out in Figure 24.

[39] The survey was run in 1993-94 but its data is not considered reliable.

Figure 24: The 1980s stand out as a time of rising inequality

Average annual relative growth in real (CPI-adjusted) equivalised disposable household income (after housing costs)



Notes: GB.
Source: RF analysis of IFS, *Living Standards, Inequality and Poverty*

Drawing on previous work, we can roughly describe and explain changes in the level and distribution of incomes over these six sub-periods as follows:

1962 to 1968: Strong, shared growth with typical income growing by 3.0 per cent a year on average and little overall change in the employment rate, Gini coefficient or relative poverty rate.

1968 to 1973: Average growth of 2.8 per cent a year, aided by rising female employment,[40] but slight increases in inequality. This can be attributed to growing earnings inequality as occupational pay rates diverged.[41]

1973 to 1978: The 1973 oil crisis, coming on top of the effective end of the Bretton Woods system, a significant stock market crash and the time of the three-day week, led to a sharp fall in real incomes and the 1976 'IMF crisis'. CPI inflation (ex. housing) averaged 24 per cent in 1975, and the Bank Rate went as high as 15 per cent in 1976. Mean income fell and median income grew by only 0.4 per cent a year. However, higher-income households were harder hit and – aided by increases in pensioner and child benefits especially, together with tax rises – inequality declined.

1978 to 1984: With another recession in the early 1980s, this was also a relatively weak sub-period for typical incomes, growing by 0.7 per cent a year overall. Inflation averaged 16 per cent in 1980, and the Bank Rate was raised to an all-time high of 17 per

[40] M Brewer & L Wren-Lewis, *Why did Britain's households get richer? Decomposing UK household income growth between 1968 and 2008–09*, IFS analysis for the Resolution Foundation, December 2011
[41] M Brewer, A Muriel & L Wren-Lewis, *Accounting for changes in inequality since 1968: decomposition analyses for Great Britain*, IFS, December 2009

cent in 1979. There was a large rise in (male) unemployment and economic inactivity, and a step change in the number of workless households.[42] Earnings inequality also increased, partly due to an increase in part-time work and changes in the nature of self-employment, as well as inequality between occupations.[43] Tax rates were cut in 1979, with the highest rate falling from 83 per cent to 60 per cent and the basic rate also cut. In addition, there were large changes in housing policy: with a shift from social housing to home ownership but also an end to the contraction of the private-rented sector, and the beginning of a rocketing of housing costs relative to incomes.[44] All of this meant a significant rise in inequality and poverty levels.

1984 to 1990: With inflation relatively low, this was a sub-period of very strong income growth overall. Median income rose by 4.3 per cent a year on average, and mean income even more. But this was not equally felt, with inequality and relative poverty increasing enormously. This was not just about earnings inequality increasing, with tax and benefit changes also playing their part.[45] Real-terms freezes in benefits meant their value fell relative to earnings, while income tax rates were cut to 40 per cent and 25 per cent in 1988 and the poll tax was introduced in 1989/1990.[46]

1990 to 1994-95: The recession of the early 1990s reduced employment and further increased the number of workless households. Median income grew by only 0.4 per cent a year on average. But there was little further change in overall inequality or (high) poverty, partly due to the replacement of the poll tax by council tax.[47] Rents again grew rapidly relative to earnings as a result of policy changes.[48]

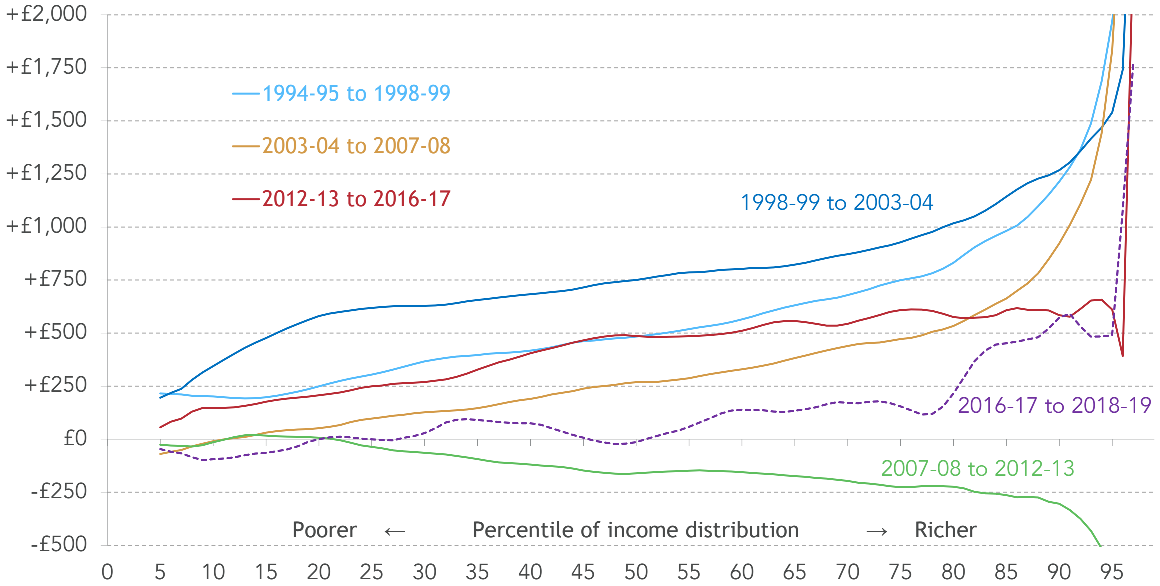
Overall then, the relatively modest movement in inequality recorded over the past 15 years or so has come against a backdrop of very weak growth for all. That low growth is likely to have sharpened the lived experience of existing high levels of inequality for low to middle income households.

Figure 25 helps illustrate this point by focusing on absolute (£ terms) income growth over the same sub-periods. The average annual growth across all incomes and all sub-periods comes in at just over £400 a year, but (outside of the immediate post-crisis sub-period) incomes have grown consistently faster for higher-income households than for lower-income ones (indeed, the rises of the very richest are beyond the scale of the chart).

[42] M Brewer & L Wren-Lewis, *Why did Britain's households get richer? Decomposing UK household income growth between 1968 and 2008–09*, IFS analysis for the Resolution Foundation, December 2011
[43] M Brewer, A Muriel & L Wren-Lewis, *Accounting for changes in inequality since 1968: decomposition analyses for Great Britain*, IFS, December 2009
[44] A Corlett & L Judge, *Home affront: housing across the generations*, Resolution Foundation, September 2017
[45] M Brewer, A Muriel & L Wren-Lewis, *Accounting for changes in inequality since 1968: decomposition analyses for Great Britain*, IFS, December 2009
[46] ONS, *The effects of taxes and benefits on income inequality: 1977 to financial year ending 2015*, April 2016
[47] ONS, *The effects of taxes and benefits on income inequality: 1977 to financial year ending 2015*, April 2016
[48] A Corlett & L Judge, *Home affront: housing across the generations*, Resolution Foundation, September 2017

Figure 25: In absolute terms, it has been usual for the incomes of richer households to rise fastest of all

Average annual absolute growth in real (CPI-adjusted, 2018-19 prices) equivalised disposable household income (after housing costs)



Notes: 2018-19 values are nowcasts. UK from 2002-03, GB (adjusted to UK) before. Y-axis has been cut off. Smoothed using a five-percentile rolling average.
Source: RF analysis of DWP, *Households Below Average Income*; and RF nowcast

Another way of viewing this is that the top 10 per cent of the population received around a third of the total increase in (equivalised) household income between 1994-95 and 2018-19. The top 1 per cent received 13 per cent, while the bottom 30 per cent received 10 per cent. Such figures are consistent with only small rises in *relative* inequality, shown earlier, but are nonetheless a useful supplementary way of viewing growth.

Most importantly, these charts highlight that there has been zero or even negative growth towards the bottom of the distribution in three of the four more recent sub-periods, creating a pressing need for sustained income increases in future.

Having shown how disposable incomes have risen and fallen over the past 25 years, we look in Section 5 at what different *components* of income – such as wages or benefits – have contributed overall and in each sub-period.

Section 5

The changing drivers of living standards improvements

Previous sections have shown how incomes have changed over time. But what has driven those changes? To answer that question in this section we track trends in the various components of household income, exploring the relative importance of changes in employment rates, working patterns, hourly pay, returns on investments, benefits, taxes and housing costs.

Employment income dominates, with the shifting balance of work between men and women altering just how this plays out in households. As of 2017-18, just over half the gross average household income came from male employment income and a further third came from female employment. But, while male earnings continue to dominate income *levels*, income *growth* in the period since 1994-95 has been driven broadly equally by male and female employment income. This reflects both rapid growth in female employment and pay, and a decline in the average hours worked by men. The rise in female employment has been particularly important among parents (especially those with children under 5), with a large rise in single parent employment and a rise in the proportion of dual-earning couple parents.

Male employment income is the biggest element of working-age income, but remains below pre-crisis levels

So far we have analysed how household incomes and inequality have evolved over the past two decades without much concern for what has driven these changes. This section rectifies that, taking a closer look at the various elements that make up household income and building on previous work that analysed these components between 1968 and 2008-09.[49] We focus on working-age family units.

A household's disposable income depends on their gross income (from employment, from investments and from social security) and their outgoings (in the form of taxes, housing costs and other deductions). Changes in disposable income can therefore be the product of movements in both economic conditions and government policy – issues we turn to in

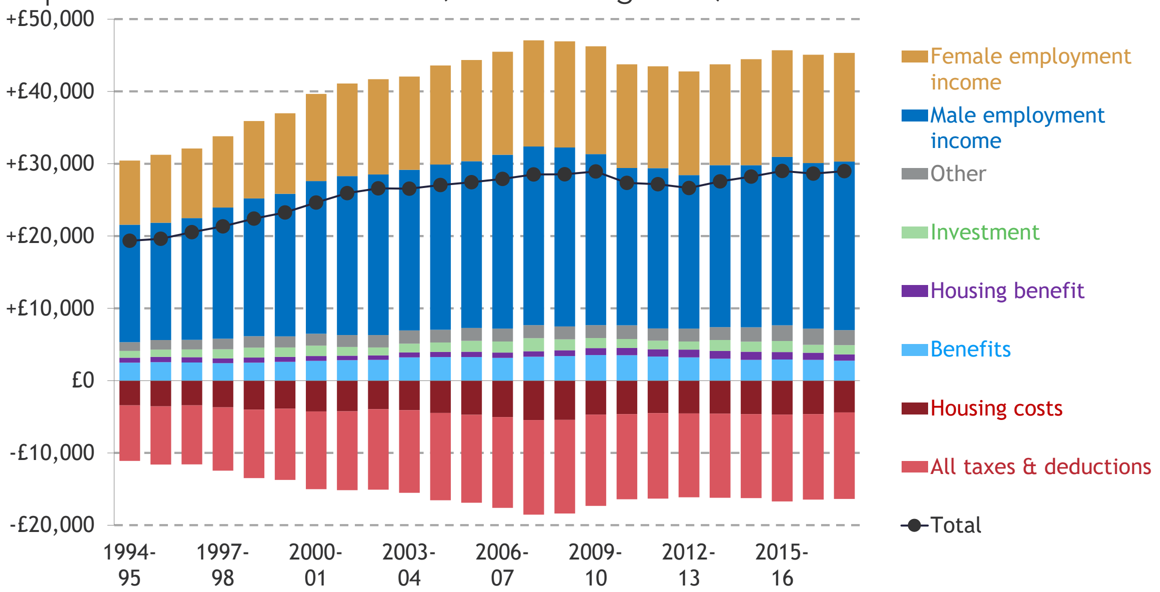
[49] M Brewer & L Wren-Lewis, *Why did Britain's households get richer? Decomposing UK household income growth between 1968 and 2008–09*, Resolution Foundation, December 2011

the next section. But societal shifts can matter too, for instance changes in the division of labour between men and women. How important changes in these different components are is the focus of this section.

Figure 26 sets out the split in every year between 1994-95 and 2017-18.[50] It shows that male employment income constituted 51 per cent of gross income in 2017-18 – making it the single largest component.[51] Female employment income accounted for a further 33 per cent, meaning total income from employment dwarfed all other sources of income on average. Benefit income (including housing benefit) was the next largest component, contributing 6 per cent of gross income. On the other side of the ledger, the most significant costs for households overall are taxes and deductions associated with employment (including Income Tax, National Insurance and pension contributions): these amounted to the equivalent of 21 per cent of gross income in 2017-18. But housing costs are also significant, reducing average household income by £4,400, or 10 per cent of gross income in 2017-18.

Figure 26: Male earnings constitute the largest component of household income

Components of real (CPI-adjusted, 2018-19 terms) working-age equivalised disposable household income (after housing costs)



Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

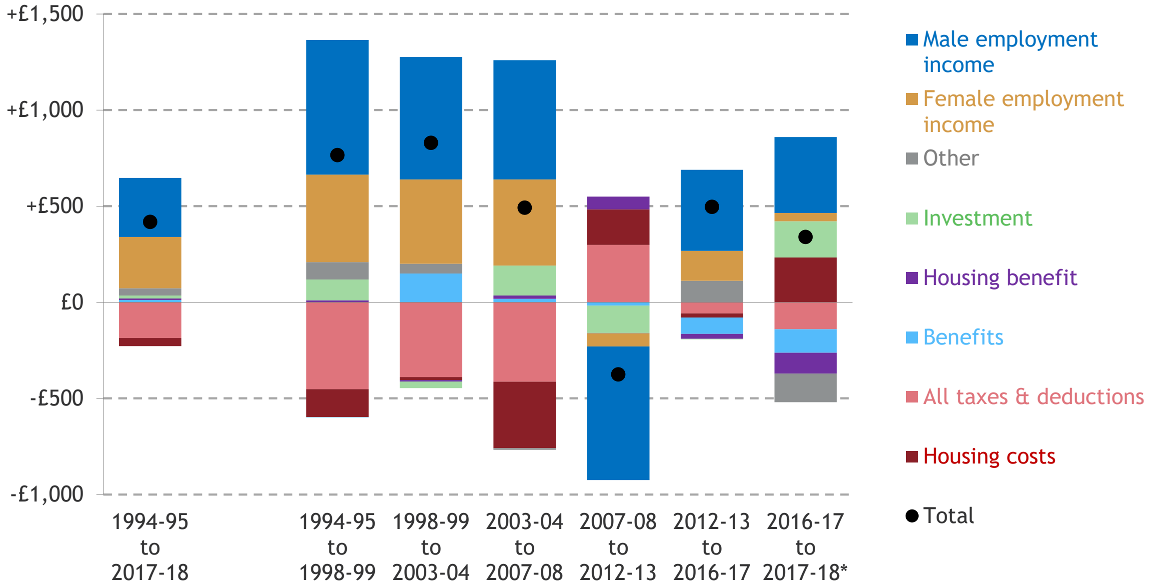
Although male employment income is the biggest component of household income, it remained lower in 2017-18 than it had been in 2009-10 – reflecting the scale of the earnings squeeze endured over this period. Female employment income was also hit by the crisis, but had just about surpassed its 2009-10 level by 2017-18.

[50] This section analyses mean rather than median income. This is because aggregate analysis can only be carried out using means, however it does mean that the figures are skewed by higher-income households.
[51] 'Employment income' in this section is meant in the broad sense – i.e. including self-employed earnings.

Over the longer term, female employment income has grown much more rapidly than male employment income. Figure 27 shows that the former increased by £6,100 (or 70 per cent) between 1994-95 and 2017-18, while the latter increased by £7,100 (or 44 per cent). As a result, female and male employment income have contributed broadly equally to the overall growth in household income recorded over the period.

Figure 27: Male and female earnings have contributed equally to the overall rise in income since 1994-95

Contribution to average annual change in real (CPI-adjusted, 2018-19 terms) working-age equivalised disposable household income (after housing costs)



Notes: GB. *Growth figures for 2017-18 relate to only a single year and are therefore less robust.
Source: RF analysis of DWP, *Households Below Average Income*

Figure 27 further splits the years since 1994-95 into the same six periods used throughout this report. We can see that employment income is consistently the largest contributor to household income growth (both positive and negative), but other incomings and outgoings have pushed and pulled in different directions.[52]

For example, in the 2003-04 to 2007-08 period, the drag from housing costs is clearly visible, offsetting a large chunk of employment income growth. Conversely, falling housing costs supported household income during the downturn (though it is worth emphasizing that this boost was not felt equally across tenure types, as discussed in Section 3). Interestingly, housing costs and employment income both pushed up working-age household income in 2017-18, in a way not observed in any earlier periods. We should of course remember that year-on-year changes can be noisy, but this effect is likely to

[52] We use equivalised incomes. Changes in household size can potentially contribute to equivalised household income growth, but in fact there has been relatively little relevant change since 1994-95. We tested this formally by carrying out a shift-share analysis in which we decomposed changes in household income into that which has been the result of changes in the share of households in different groups (single, couples, with children, pensioners, etc.) and that which has been the result of changes in the incomes of these different groups. Our analysis suggested that less than 1 per cent of the change in income since 1994-95 is the result of shifts between different groups. It is also worth noting that over this period there has been little change in the distribution of equivalisation factors, which are used to adjust household income to take account of different household sizes, further reinforcing the point that familial sizes have been relatively stable since the mid-1990s.

reflect the combination of a cut in interest rates in the aftermath of the EU Referendum alongside continued strong employment growth.

The importance of benefit income has waxed and waned. It was an important contributor to household income growth in the late 1990s and early 2000s, but cuts to working-age benefits, as well as employment growth (which reduced benefit entitlements), reduced their contribution to household incomes from 2012-13 onwards. The result is that over the full 24-year period, benefit income made only a very small contribution to growth in the mean household income.

The changing gender balance of employment income has been a big feature of the living standards improvements recorded since the mid-1990s

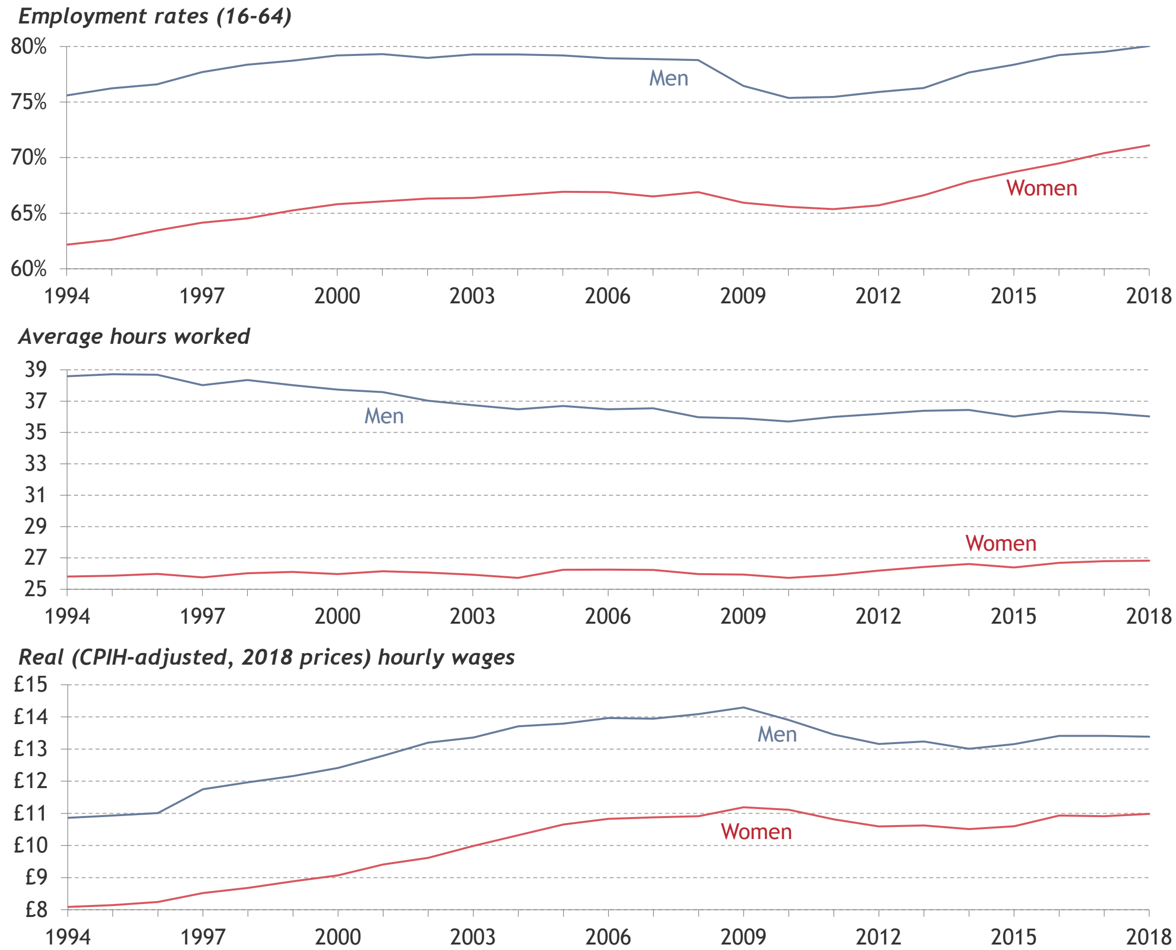
Given the overwhelming importance of employment income to overall household incomes, it is worth digging into this element in some more detail.

At a household level, employment income is determined by the earnings of its constituent members, which itself is a product of decisions taken about who works (and who engages in unpaid work), and for how long. The level of an individual's employment earnings is in turn determined by three things: whether or not they have a job, how many hours they work, and what their effective hourly wage is.[53] It is therefore worth briefly recapping how these things have changed at an individual level since the early 1990s.

Figure 28 shows how employment rates, wages and hours worked have changed for men and women since 1994. In all cases women have pulled closer to men. In 1994, women's average hourly earnings were 74 per cent of men's; by 2018, this had risen to 82 per cent (£11 for women versus £13.38 for men). Over the same period female employment rates have risen from 62 per cent to 71 per cent, while men's have increased from 76 to 80 per cent. Perhaps most dramatic though has been the decline in average hours worked for men, dropping from 38.6 a week in 1994 to 36 a week in 2018, while over the same period women's average hours have held relatively steady.

[53] We distinguish between these different concepts throughout this section by using 'employment income' (or 'earnings') to refer to the total income derived from work, and using 'wages', 'employment' and 'hours' to refer to the component parts of those earnings.

Figure 28: Women have been pulling closer to men in terms of employment, hours and hourly pay



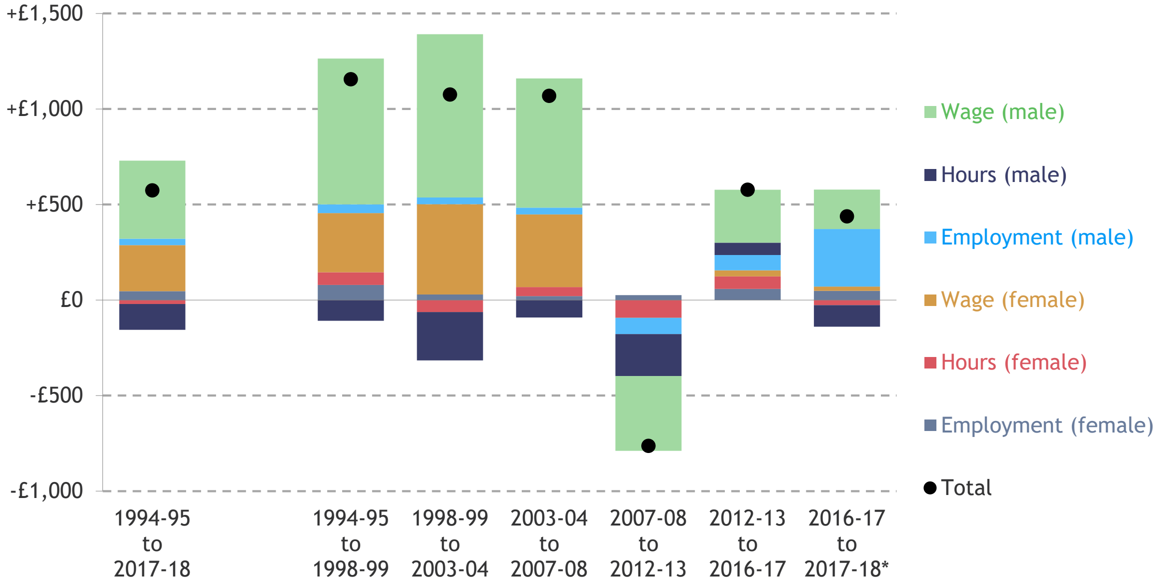
Notes: Hourly wages are excluding overtime. Average actual hours worked per week. All figures relate to the UK.
Source: RF analysis of ONS, *Annual Survey of Hours and Earnings* and ONS, *Labour Force Survey*

Given this backdrop, Figure 29 decomposes changes in mean gross employment income into its constituent parts – wages, hours and employment. Since 1994-95, hourly wage growth has accounted for the vast majority of the increase in employment income, while changes in male and female employment accounted for 14 per cent. This is in line with previous studies.[54]

[54] Earlier work showed that, between the late 1960s and 2009-09, wage growth for men and women accounted for the vast majority of the increase in employment income; increases in female employment and hours worked contributed 14 per cent; while changes in male employment and hours weighed on incomes. See M Brewer & L Wren-Lewis, *Why did Britain's households get richer? Decomposing UK household income growth between 1968 and 2008–09*, Resolution Foundation, December 2011.

Figure 29: Since 1994-95 male wage growth has been the biggest contributor to the increase in employment income

Contribution to average annual change in real (CPI-adjusted, 2018-19 terms) working-age employment income



Notes: GB. *Growth figures for 2017-18 relate to only a single year and are therefore less robust.
Source: RF analysis of DWP, Households Below Average Income

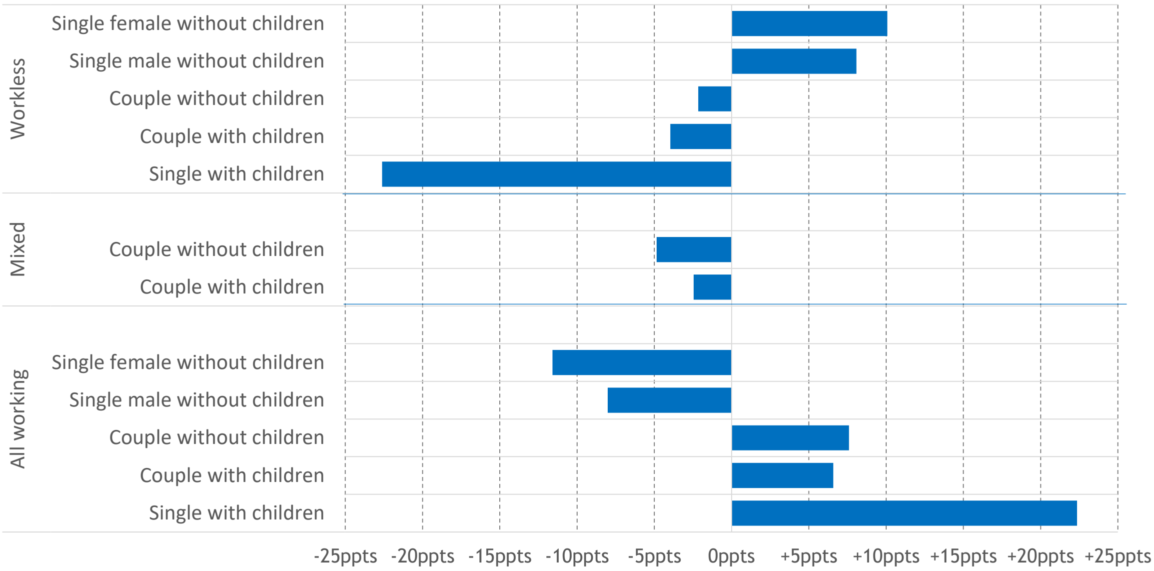
Looking at the six different sub-periods, we can see that this finding broadly held through each of the three pre-crisis phases. Post-crisis however, the picture has changed somewhat. Wage growth (or, more precisely, male wage growth) made a very large negative contribution in the period from 2007-08 to 2012-13, driving the drop in employment income recorded in this phase. A more familiar – but weaker – picture was restored from 2012-13 to 2016-17, but the latest year was characterised by a further weakening of the wage contribution and the dominance instead of increased (primarily male) employment.

Figure 29 suggests that male and female hourly wage rates have driven the vast majority of employment income growth over the past two decades, and a rise in female employment has also boosted the average, while a fall in the average hours worked by men in employment has weighed on incomes.

One of the big shifts over the period has been a rise in the proportion of dual-earning couples and a decline in the proportion of households in which no one is in employment. Figure 30 shows that the proportion of dual-earning couples with and without children has risen by over 5 percentage points and the share of households with children in which no one works has declined by over 20 percentage points for single parent families and by 2 to 4 percentage points for couples.

Figure 30: There has been a pronounced rise in the share of dual-earning couples and a fall in households in which no one works

Change in proportion of families: 1996-97 – 2017-18

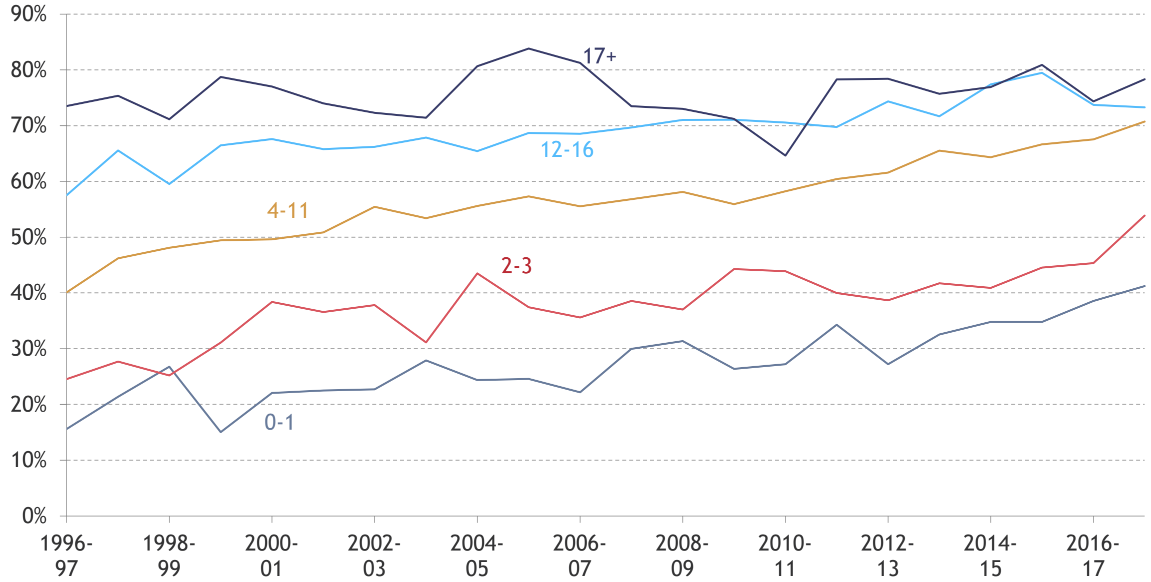


Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

Figure 31 looks at the rise in working among single parents in more detail. It shows that the biggest rises have been for those with younger children. Back in 1996-97, just over 10 per cent of single parents with children up to one year of age were in employment; but by 2017-18 the figure was 41 per cent (which will include parents on parental leave from work). Among those single parents with children aged 2 and 3, the proportion in work jumped from 25 per cent to 53 per cent. The employment rate of single parents with children in primary school (4-11) increased by 30 percentage points over the period, and there has also been an increase for those with secondary school-aged children.

Figure 31: Single parents with young children are increasingly likely to be in work

Employment rate of single parents, by age of youngest child



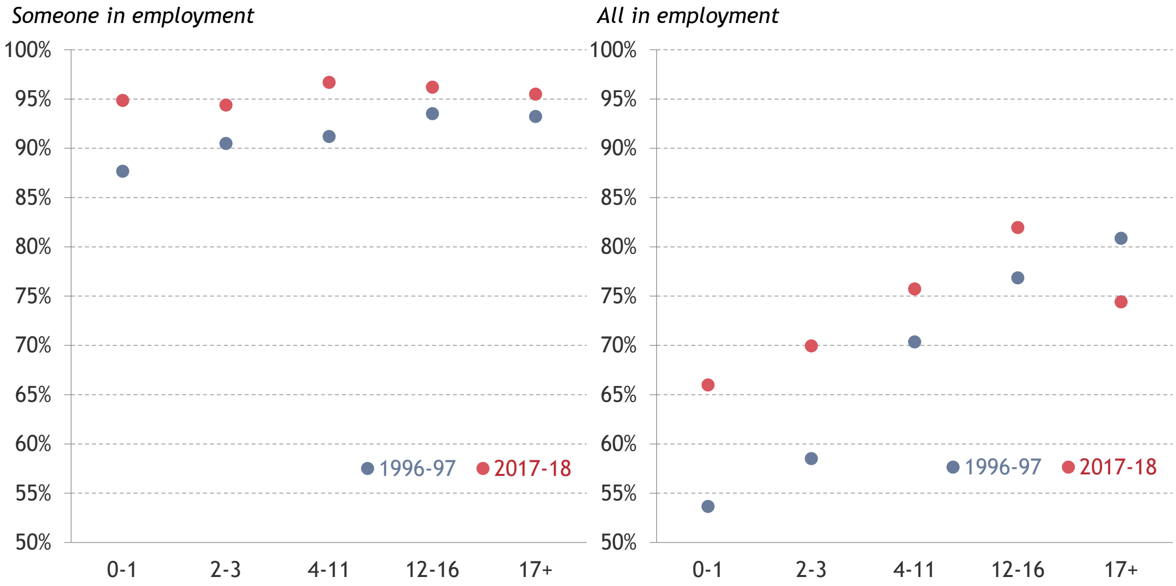
Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

Turning to couples with children, there is also clear evidence of an increase in employment – and particularly an increase in the share of families in which both adults work. Figure 32 shows the proportion of families in which at least one person is in employment and those in which all adults are in employment, and the change between 1996-97 and 2017-18. There has been a marked decline in the proportion of couples with children where no-one is in work. And although it remains common for just one person to be in work, particularly among those with children under 4, the increase in dual-earning families has also been pronounced.

The employment rises in Figure 31 and Figure 32 might be put down to two forces. First, there have been significant policy efforts, with changes in maternity leave and pay, an expansion of free or subsidised childcare and changes in the benefit system to encourage and support employment – especially among single parents. And, second, the post-crisis earnings shock may have encouraged a rise in second earners to supplement household income.

Figure 32: There has been a significant rise in the proportion of households with young children in which everyone works

Proportion of couples (by age of youngest child)



Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

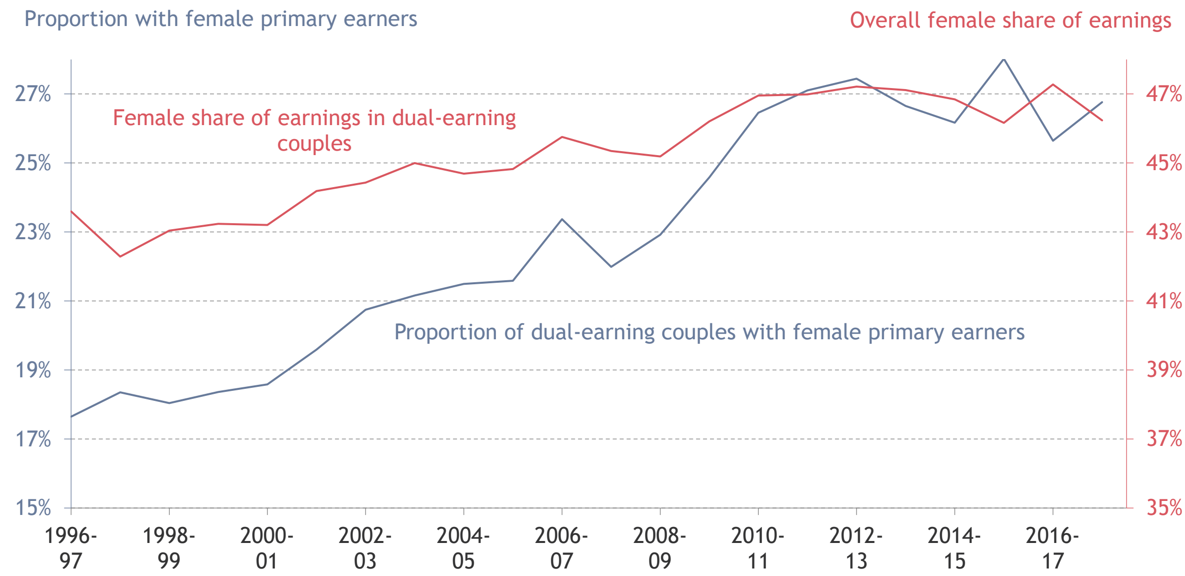
The rise in female employment income has not just been the result of higher employment rates though. Looking again at dual earning couples, there has been a marked increase in both the proportion where the woman is the primary earner and in the share of employment income (in dual earning couples) accounted for by women.

Figure 33 shows that the woman is now the highest earner in a quarter (27 per cent) of dual earning couples, up from 18 per cent in 1996-97. Over the same period the share of employment income in dual earning households accounted for by women has risen from 43 per cent to 46 per cent. Furthermore the rise in households in which the women is the highest earner has been most pronounced for families in the bottom half of the income distribution, with the share of couples in which the woman earns the most rising from 15 per cent to 25 per cent.

There has been a noticeable slow-down in both series since 2010 however, flowing from two factors. The first is compositional. As discussed above, there has been a noticeable rise in dual earning couples since 2012, with the proportion of couples in which both adults work increasing from 56 per cent to 61 per cent. This has brought couples where previously the lower earner (usually the woman) did not work into the population of interest, thereby slowing the increase in the proportion of in which the woman is the primary earner. The second factor reflects a genuine slowdown in the rate at which female earnings have been catching up with male earnings. Between 2002 and 2010 the ratio of average female to male earnings increased by 9.7 per cent, yet between 2010 and 2018 the increase was just 2.7 per cent.

Figure 33: There has been an increase in the share of households in which the woman is the primary earner

Dual earning couples where female is primary earner and female share of earnings



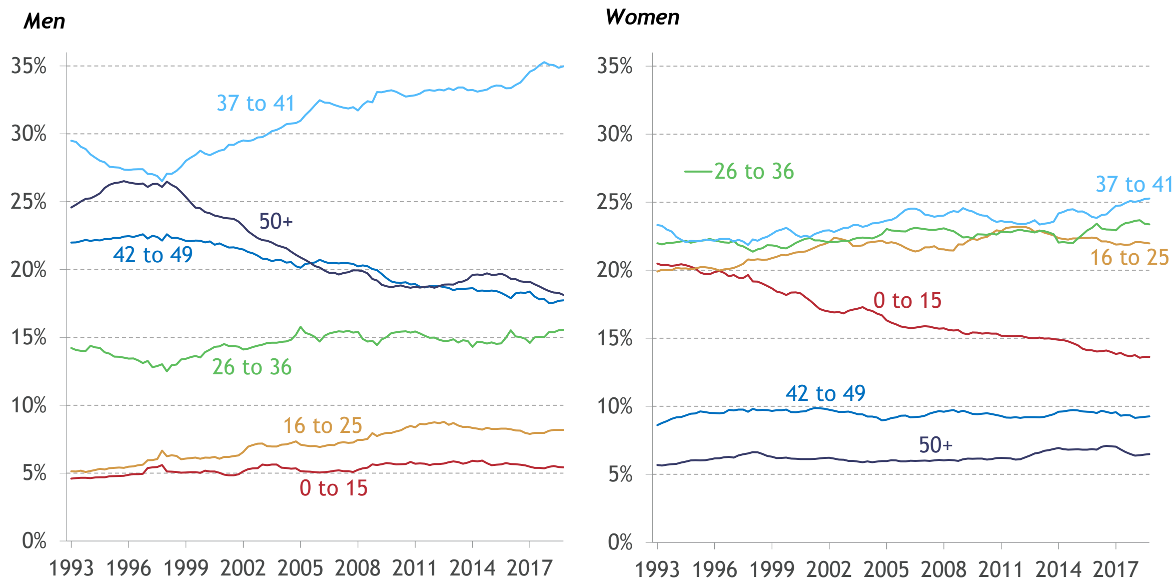
Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

Finally we mentioned above the impact that a decline in hours worked by men has had on household incomes. This is clearly evident in Figure 34, the proportion of men working over 41 hours a week has fallen notably since the early 1990s. Overall average male full-time hours have fallen by around 1 hour. On the other hand the proportion of women working fewer than 16 hours a week has gone from 20 per cent to 14 per cent.

Changes in the role played by both men and women in the UK labour market therefore appear to have had a big effect on household incomes over the past two decades. Incomes have been boosted by both a rise in female employment and the narrowing of the gender pay gap, this has been somewhat offset by a decline in hours worked by men.

Figure 34: The proportion of men working over 41 hours a week, and the proportion of women working under 16 hours, has fallen significantly

Proportion of workers by hours worked



Notes: UK.
Source: RF analysis of ONS, *Labour Force Survey*

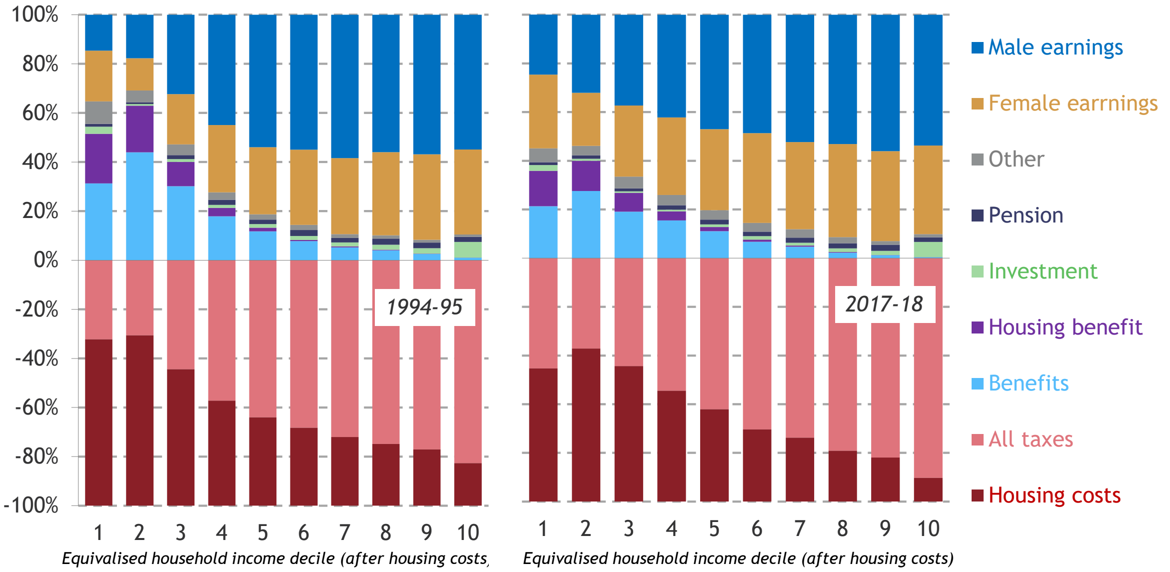
For the bottom half of the income distribution, a broader range of sources of income are important

It should be stressed that the analysis above is based on mean income, and is therefore weighted towards higher-income households rather than being representative of all households. We turn now to analyse the different sources of income across the distribution. Figure 35 shows the share of total income and outgoings accounted for by each individual source, from the poorest to the richest income decile, and comparing 1994-95 with 2017-18.

It shows that the sources of income are much more diverse towards the bottom end of the income distribution than at the top – and compared to the mean figures shown earlier.

Figure 35: Looking at the whole income distribution, benefits and housing costs are particularly important for the bottom half

Various income sources as a proportion of total working-age income, and expenses as a proportion of total outgoings: 1994-95 & 2017-18



Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

Benefits (including housing benefit and tax credits) constitute approximately 35 per cent to 40 per cent of income in the bottom two deciles, and still around 20 per cent in the fourth decile. By contrast, market earnings (of men and women) constitute over 90 per cent of income in the top three deciles. The contribution of male employment income alters especially noticeably, accounting for 28 per cent of gross income in the bottom decile and 54 per cent in the top decile. Interestingly the bottom decile is the only one in which female earnings accounted for a larger share of gross income than male earnings. Additionally, investment income is only a noticeable component of income in the top decile (and even here it only constitutes 6 per cent of gross income).

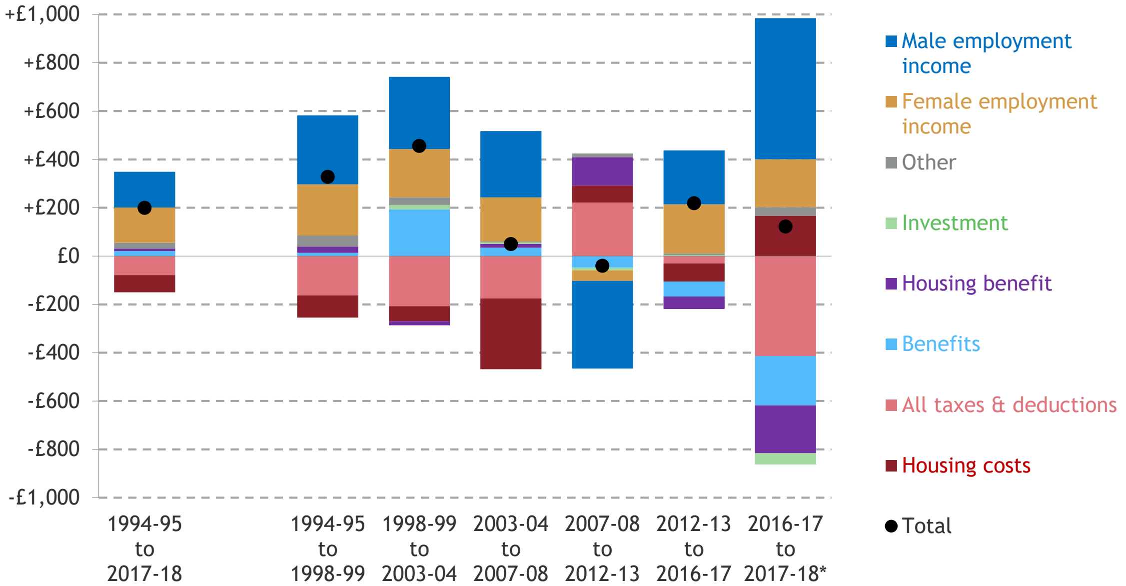
In terms of outgoings, housing costs account for a much larger share in the bottom half of the distribution – being more important than taxes in fact – than they do at the top. For example housing costs accounted for 55 per cent of all outgoings in the bottom decile of the income distribution in 2017-18, falling to 10 per cent in the top decile.

Figure 35 also highlights how the relative importance of most of the sources of income and outgoings have remained broadly constant over the past two decades. There are some important differences though. For example, there has been a rise in the share of income accounted for by female earnings across the distribution: so much so that, from the fourth decile up, male earnings have decreased as a share of income. However, the proportion of income accounted for by male earnings has increased by 9 percentage points in the bottom decile and by more modest amounts in deciles 2 and 3, reflecting rising employment. The overall increase in employment income has also meant that benefits have become a smaller part of households' gross income.

Figure 36 focuses on what has driven income growth in the bottom half of the distribution over the period. It shows that the biggest factor has been male and female employment income, both adding £150 each a year to the bottom half average. Growth in benefit income added £20 more a year, making only a modest difference to the total. Increases in both taxes and housing costs dragged on income growth in the bottom half to broadly similar degrees (amounting to £80 and £70 a year respectively). But it is worth noting that – in relative terms – this housing cost effect is much bigger than the one recorded for all working-age households.

Figure 36: Employment income has been the biggest driver of income growth for households in the bottom half of the income distribution

Contribution to average annual change in real (CPI-adjusted, 2018-19 terms) equivalised disposable household income (after housing costs) for households in the bottom half the income distribution and of working-age



Notes: GB. Growth figures for 2017-18 relate to only a single year and are therefore less robust.
Source: RF analysis of DWP, *Households Below Average Income*

Earnings and housing costs have increased inequality, while increases in employment have pulled in the opposite direction

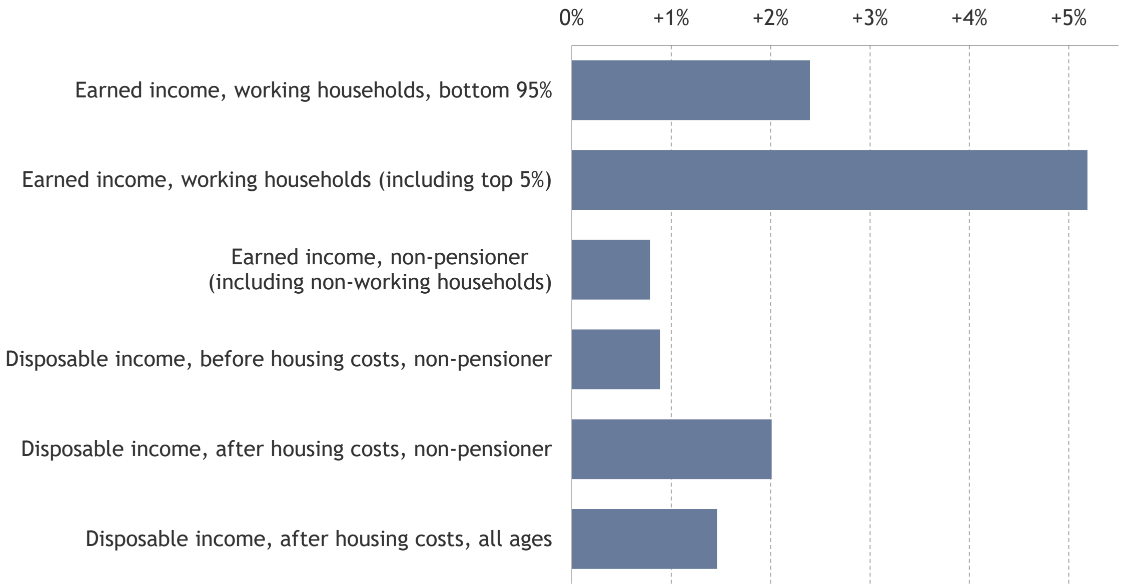
As explored in Section 4, overall income inequality has increased only relatively modestly over the last couple of decades (leaving the UK more unequal than many other advanced economies). There has, however, been a marked rise in *earnings* inequality among working households.

This sometimes give rise to the perception that market income inequality has risen, with the tax and benefit system having to work harder in order to increase redistribution and hold net income inequality more steady. But this is not the case. Instead, rising earnings inequality among working households has been offset by a drop in the proportion of households in which no one works: that is, rising employment has pushed back against the divergence in pay.

Figure 37 navigates this process. It shows that the Gini coefficient of earnings for working households (excluding the top 5 per cent) rose by over 2 percentage points between 1994-95 and 2017-18. Adding in the top 5 per cent then lifts the increase in inequality to over 5 percentage points. Crucially however, once we include non-working (i.e. non-earning) working-age households in our calculation, earnings inequality appears essentially flat (rising by less than 1 percentage point). Moving beyond this stage, we see that housing costs pushed up inequality (on which more below), contributing to the overall 2 percentage point rise in non-pensioner income inequality after housing costs. But the convergence between pensioner and non-pensioner incomes acted in the opposite direction.

Figure 37: Earnings inequality among working households has risen, but the overall inequality rise has been more muted

Rise in selected Gini coefficients between 1994-95 and 2017-18

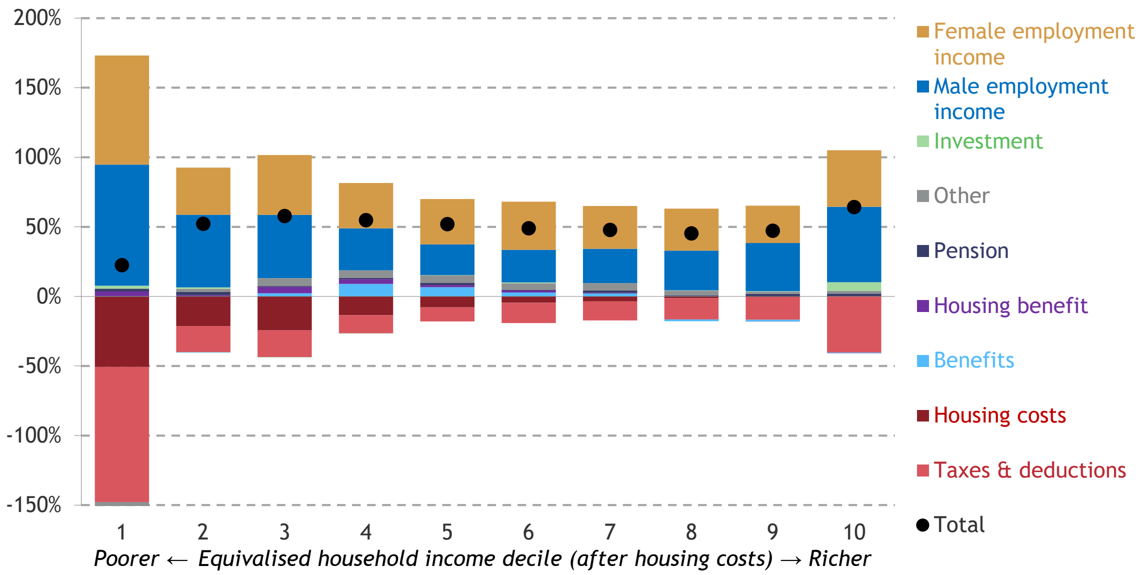


Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

To dig further into these trends, Figure 38 describes the contribution made by each component of income to overall income growth between 1994-95 and 2017-18 across the distribution. It shows that real net household income grew by 64 per cent in the top decile of the income distribution (a larger relative rise than was recorded in any other decile), with 54 percentage points of this being the result of an increase in male earnings and 41 percentage points stemming from a rise in female earnings. Overall income growth was weakest in the bottom decile, amounting to just 21 per cent over the period. The decomposition set out in the chart makes clear that this underperformance came about despite substantial increases in the contributions made by male and female earnings in this part of the distribution. These gains were in large part offset by significant increases in housing costs among the bottom three deciles especially.

Figure 38: Housing costs have weighed upon income growth for the poorest

Contribution to growth in real working-age equivalised household income (after housing costs): 1994-95 – 2017-18

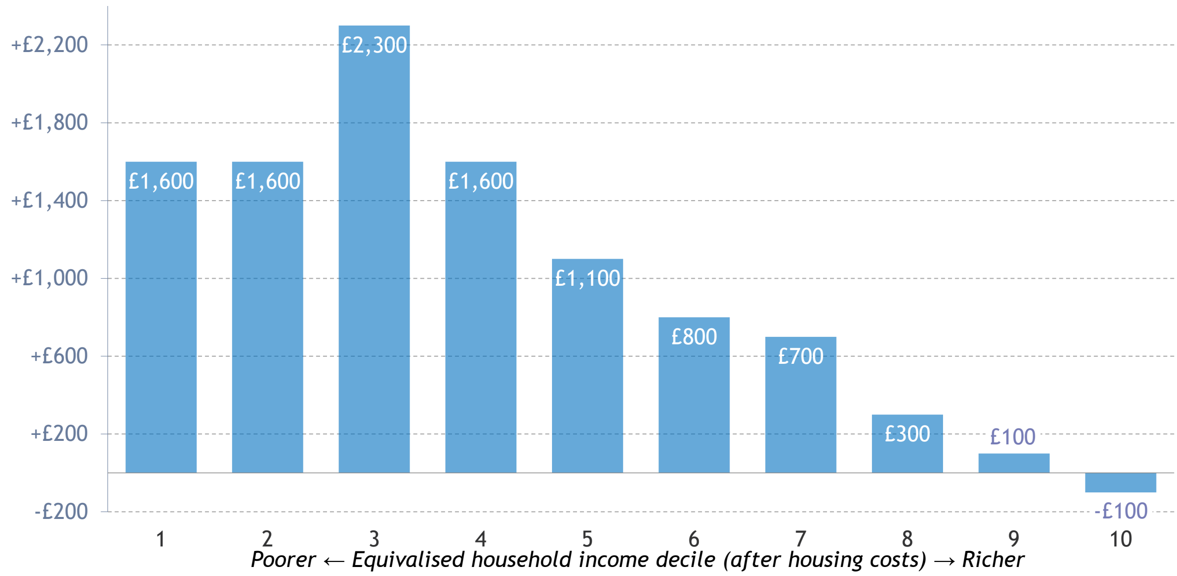


Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

Figure 39 further sets out the real-terms housing cost increases recorded in each income decile over the period from 1994-95 to 2017-18, and highlights the extent to which such increases have been most pronounced in the bottom half of the distribution. Conversely, housing costs barely changed over the period for households towards the top of the distribution (indeed, they fell in the top decile).

Figure 39: Housing costs have increased the most for households in the bottom half of the income distribution

Change in real (CPI-adjusted, 2018-19 terms) housing costs: 1994-95 – 2017-18



Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

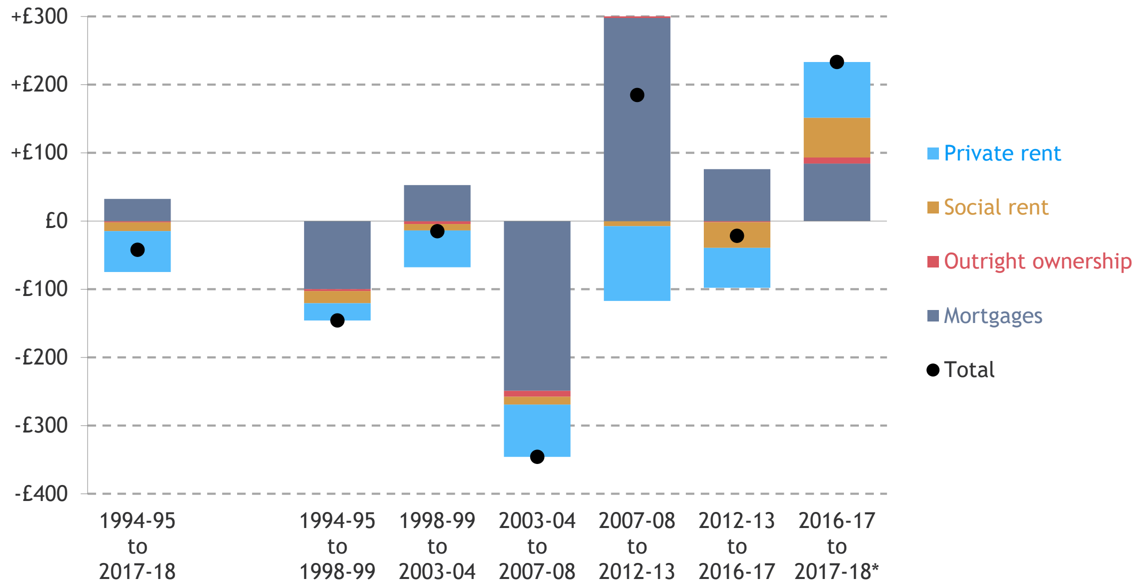
As well as playing out differently across the income distribution, housing costs have also contributed to inequality because costs have evolved differently across tenures. Figure 40 shows how housing costs for the four broad forms of tenure have contributed to the overall change in housing costs over the six periods. Each tenure's contribution is of course affected by direct changes in housing costs (for instance, changes in rents in the private rented sector), but it is also a product of the prevalence of the tenure (and any change in this, as private renting has replaced ownership for instance).

Taking the period as whole, we again see that housing costs dragged on income growth to the tune of £42 a year on average (reflecting the findings shown in Figure 36). That overall effect breaks down into drags of £60 and £13 associated with private renting and social renting respectively, along with a boost of £32 associated with mortgage costs.

But these long-run figures mask some quite different movements across our six sub-periods. That's particularly true of mortgage costs. These exerted a drag of £250 a year in the immediate pre-crisis period (2003-04 to 2007-08) as house prices rocketed, but then provided a boost of £300 a year in the crisis itself (the 2007-08 to 2012-13 period) as interest rates were slashed. This boost was not replicated for renters however. Instead, the costs associated with private renting were relatively consistent, dragging on income growth in all phases except the final (single year) one. The same pattern held for rents in the social sector.

Figure 40: GB falling mortgage costs have boosted household incomes for home owners since the crisis

Contribution of housing costs to the average annual change in real (adjusted to 2018-19 prices) equivalised working-age household income



Notes: Growth figures for 2017-18 relate to only a single year and are therefore less robust.
Source: RF analysis of DWP, *Households Below Average Income*

We have seen then that changes in housing costs have been a big component of the living standards story over the past two decades. But household experiences have varied greatly by tenure and (relatedly) by income, with the housing headwind blowing hardest for renters and those on low to middle incomes.

Real income growth has been buffeted by inflation shocks

As well as changes in housing costs, it is important to take into account how inflation in general has affected living standards. Consider for example that the real-terms wages figures set out above are of course influenced by developments in nominal pay, but they are also a product of movements in consumer prices.

Importantly, nominal earnings appear to be less sensitive to changes in cost pressures than they once were. Indeed, there is no observable relationship between nominal wages and consumer price inflation since the late 1990s.[55] In this period, wages have not responded to imported inflation shocks (of which there have been several). For instance, the significant squeeze on real wages that occurred between 2009 and 2014 was a product of nominal wage growth failing to keep pace with the rise in inflation (climbing above 4 per cent in both 2008 and 2011) that was prompted by the large crisis-related sterling depreciation. Sterling depreciated and inflation rose again in the aftermath of the EU

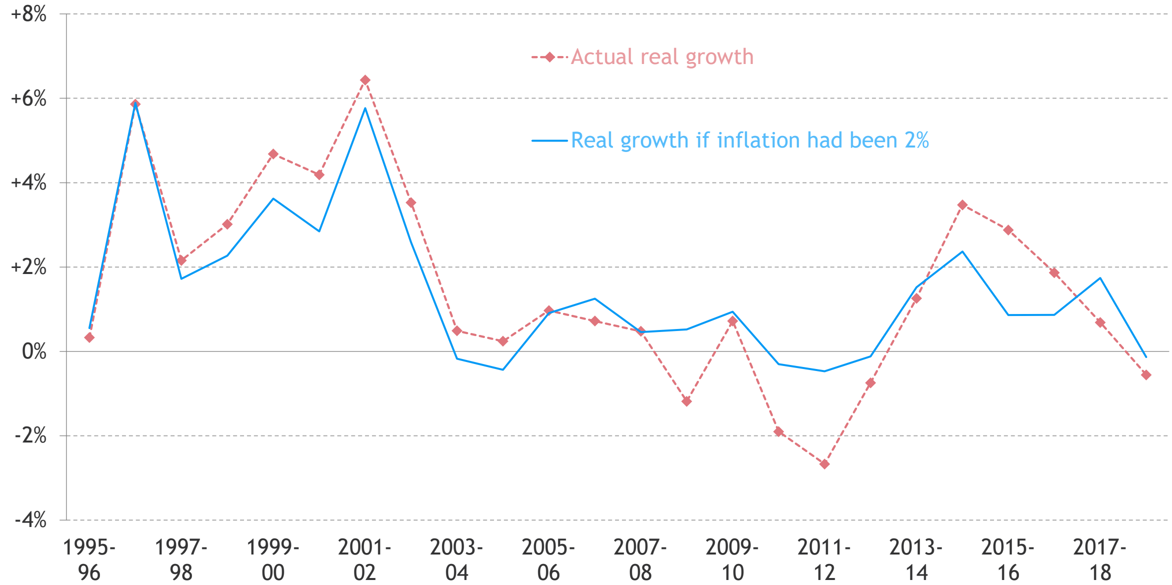
[55] S Clarke & P Gregg, *Count the pennies: Explaining a decade of lost pay growth*, Resolution Foundation, October 2018

referendum, with nominal wages again failing to respond – meaning real wages fell once more. Conversely the period between late 2014 and mid-2016 was one in which inflation was well-below 2 per cent, boosting living standards as nominal pay growth remained steady.

The impact that oscillating inflation has had on living standards is apparent in Figure 41. It shows growth in real household income and the impact of inflation. The blue line shows what non-pensioner household income growth would have been if inflation had been 2 per cent in each year, while the red line shows what actual income growth was. The post-crisis and post-referendum periods of high inflation are both apparent: the first reducing real income growth between 2008-09 and 2013-14, the second reducing growth in 2017-18 and 2018-19. Also apparent are the period of below-target inflation which boosted incomes between 2014-15 and 2016-17 and an income boost around the millennium.

Figure 41: An inflation rollercoaster has been a key part of the last decade's living standards story

Real growth in median non-pensioner equivalised household disposable income (after housing costs)



Notes: GB. We use a modified version of CPI which excludes rents, maintenance repairs and water charges. This is to avoid double counting when using household incomes 'after housing costs'. The Bank's target is for 2% CPI inflation.
Source: RF analysis of DWP, *Households Below Average Income*

While the various sources of income discussed in this chapter are key determinants of living standards, we can't ignore the fact that for much of the last decade at least swings in prices have been just as important. This makes it increasingly important to properly estimate inflation, something we discuss in more detail in Box 4.

i Box 4: Measuring inflation

Because we need to accurately capture price changes in any measure of real income, choosing which measure of inflation to use is obviously important. In this paper we have deflated nominal income using a variant of the consumer price index (CPI) which excludes rents, maintenance repairs and water charges (CPI excluding housing costs), our focus is on incomes after housing costs (i.e. where housing is already accounted for).

However this is not the only measures of inflation we could use. Traditionally consumer price inflation was captured by the retail price index (RPI), which includes mortgage interest payments but excludes high income households (those in the top 4 per cent of the income distribution) and pensioner households. RPI is also constructed using a different formula to CPI, and it is debated how much it over- or understates inflation, particularly for certain goods.[56] The ONS has ruled that the RPI is no longer a National Statistic, but is still produced because of its use in pre-existing gilts and long-term contracts.

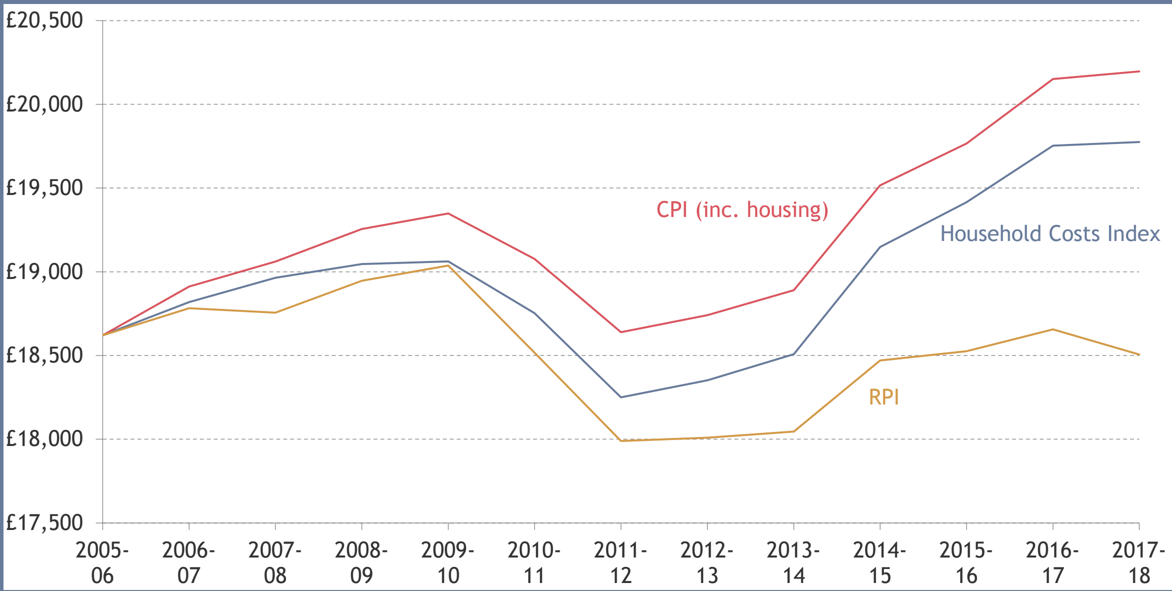
The ONS has accepted that while the CPI and CPIH (a measure of CPI that includes owner-occupied housing) may be good measures of consumer price inflation at the macro-level, they have some shortcomings when it comes to measuring changes in the costs and prices of the outgoings faced by households. Therefore the ONS is currently developing the Household Costs Indices (HCIs). These include mortgage interest payments (and potentially capital repayments), gross expenditure on insurance premiums, credit card debt interest costs and student loan repayments (rather than the price of tuition fees). They are also weighted so that spending by each household is weighted equally rather than weighting the spending of households based on the amount they spend (which gives more weight to higher-spending households). The ONS plans to produce these on a quarterly basis soon and seek National Statistics status for them in future.[57]

Figure 42 shows how different measures of inflation might affect our understanding of how real household income has evolved since 2005-06. Deflating nominal income (before housing costs, for comparability) by CPI including housing costs suggests that household income has grown by 8 per cent since 2005-06, whereas using the new HCI suggests incomes have grown by just 6 per cent. The biggest difference though arises when using the RPI; deflating household income by this measures suggests that incomes are still below the level of 2005-06.

[56] House of Lords Economic Affairs Committee, ***The use of the retail price index (RPI)*, January 2019**
[57] John Pullinger, '*National Statistician's statement on the future of the Household Costs Indices*', 28 June 2019

Figure 42: The trajectory of household income growth is highly sensitive to the choice of deflator

Equivalised typical household income (before housing costs) deflated with three different measures of inflation (2005-06 terms)



Notes: GB
Source: RF analysis of DWP, *Households Below Average Income*; and ONS, *Consumer Price Inflation and Household Costs Indices*

So which measure is better? There is not space here to go into the long-running debates about the relative merits of RPI compared to the CPI and its variants. But given that the RPI has been stripped of its National Statistic status, and so has not been updated or improved in some time, it is better to concentrate on the difference between CPI including housing costs and the HCI (particularly as the ONS has suggested that it sees the HCI as possible replacements for the RPI). Some characteristics of the HCI may mean it is more suitable for deflating household incomes, such as its expanded basket and the fact that it gives equal weight to each household. On the other hand there are still methodological issues to be resolved with the HCI, and our analysis already deals directly with mortgage interest costs and student loan repayments by deducting these from income.

This section has provided a forensic description of what has driven changes in household income – at the average and across the distribution - since the early 1990s. Over the period as a whole, hourly wage growth has been by far the most important factor. But other components have come to the fore in different sub-periods. For example, housing costs weighed especially on incomes in the early- and mid-2000s, while the contribution made by benefits to household incomes peaked in the early 2000s.

Since the financial crisis we have observed further shifts. Benefit income has fallen, while for home owners falling mortgage costs have supported living standards. And the decades-long norm of wage growth being the dominant force in driving improvements in living standards has been at least temporarily broken, with employment growth and some hours increases taking the strain. However, it will be difficult to drive further income gains in the coming years unless faster wage growth can be restored – though the most recent statistics (beyond the period we analyse here) have been more encouraging. We turn to what the future may hold in Section 6.

Section 6

Fixing the future by learning the lessons of the past

The preceding sections have looked at what has driven income changes over time for different groups. In this final substantive section we consider the prospects for each different potential driver of income growth over the coming years. We reflect both on what is in line to happen given current economic and political expectations, and on what could be achieved if these circumstances were to alter. Crucially, as the UK enters a period of further political change, we also delve into what households themselves expect and want on the living standards front.

Political change provides an opportunity to reflect on how Britain can rise to its ongoing living standards challenge

Brexit has dominated the political landscape over the last three years, and even now it remains unclear just what form the UK's exit from the EU will take. This uncertainty has already had a clear impact on growth and on living standards, but the longer-term consequences are yet to be determined – resting as they do to a large extent on the nature of our future trading arrangements with the rest of the world.

But Britain is undergoing additional political change too, with a new Prime Minister who will inevitably have a new approach not just to Brexit but also the domestic policy agenda. The era of austerity, while still casting a sizeable shadow over the country's public services and its approach to welfare, looks largely to have run its course: the debate around the Autumn Budget and Spending Review will focus more on where additional government resources should be allocated rather than on where they should be cut back. And there is at least some possibility that a general election may be called later this year, with the possibility of an entirely new government taking power.

Given this background, it is worth reflecting on how policy makers could and should approach the country's sizeable ongoing living standards challenge. What lessons can we learn from what has come before? And how do our findings sit with the attitudes and expectations of UK households themselves? Is it enough to focus on more of the same in the coming years, or must we explore alternative approaches to boosting living standards?

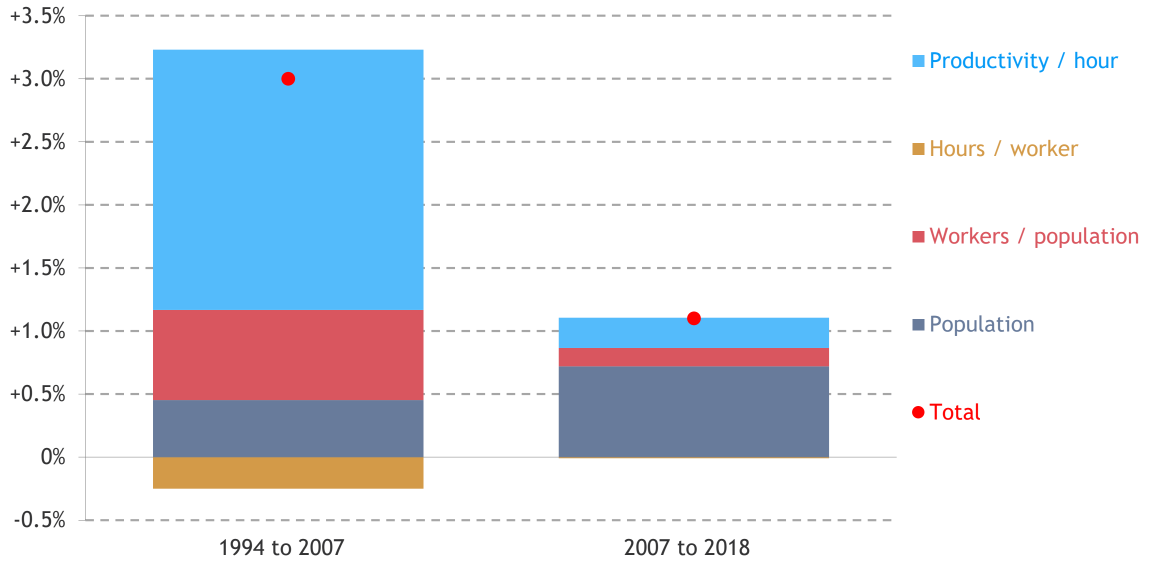
Both the scale and the nature of economic growth and living standards improvements have shifted in the post-crisis era

Throughout this report we have focused on six sub-periods covering the years since 1994-95, highlighting several important differences across these phases. But it is clear that the financial crisis marks the biggest single living standards moment over the last quarter century. Reflecting on how our economy has altered pre- and post-crisis, and at what has changed in relation to household incomes more specifically, therefore provides us with an important way into considering the prospects for the coming years.

Figure 43 provides this reflection by decomposing overall GDP growth into its constituent parts in both the pre- and post-crisis years. It highlights the slowdown in average annual growth over the past decade, relative to the pre-crisis norms. Average annual growth fell from 3 per cent a year between 1994 and 2007 to just 1.1 per cent a year between 2007 and 2018. But it highlights also the very different composition of overall growth in the post-crisis period.

Figure 43: Post-crisis growth has been characterised by working harder rather than working smarter

Contribution to average annual growth in real GDP



Notes: UK.
Source: RF analysis of ONS, *National Accounts*

Pre-crisis, economic growth was driven overwhelmingly by rising productivity. Increases in output per hour accounted for more than two-thirds (69 per cent) of aggregate GDP growth, with a rising employment rate accounting for a further 24 per cent and overall population growth contributing 15 per cent. At the same time, declines in average hours provided a modest offset: more people worked, but they worked shorter weeks and generated more output every hour.

In direct contrast, between 2007 and 2018 aggregate growth was instead overwhelmingly driven by population growth. This accounted for two-thirds (65 per cent) of output growth in the period, with productivity now only contributing 22 per cent. A rising employment rate again made a positive contribution (13 per cent), but falls in average hours no longer provided any meaningful drag to growth. In this era, the country got richer (more slowly than pre-crisis) primarily by working more.[58]

The implication is that the slowdown recorded in the growth of overall GDP after the financial crisis was even more marked when focusing on GDP per capita instead. That is, the living standards impact was especially pronounced.

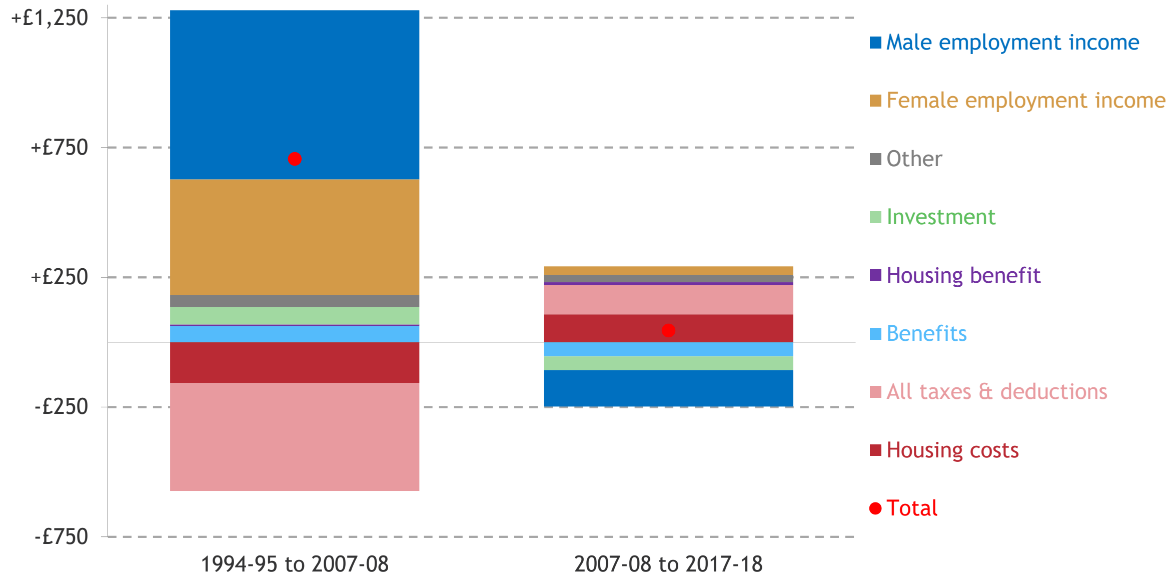
We see that when turning next to household income growth, with Figure 44 compressing the analysis set out in Figure 27 into the broader pre- and post-crisis periods. It brings out both the very sharp post-crisis slowdown in household income growth and the overwhelming importance of lost employment income in this equation. Average annual real-terms growth across all households fell from £710 pre-crisis to £40 post-crisis, with the male employment income component alone dropping from £650 a year to a *decline* of £140 a year. Female employment income continued to make a positive contribution post-crisis, but this fell from £450 a year between 1994-95 and 2007-08 to just £30 a year between 2007-08 and 2017-18.

Other components contributed much smaller amounts in both periods, but shifted direction pre- and post-crisis. For example, benefits (including housing benefit) went from a positive contribution of £70 a year to a negative contribution of £40 a year. Housing costs on the other hand went from being a drag of £160 a year to a boost of £110 a year. As explored in the previous Section, falling mortgage interest costs were the key driver of this. In fact the decline in rates together with a reduction in the number of mortgagors means the drag on working-age incomes from mortgage interest has fallen by an average of £190 each year – totalling £1,900 in 2017-18 relative to 2007-08.

[58] See also estimates of the contribution of labour input in total output growth: ONS, *Multi-factor productivity estimates: Experimental estimates to October to December 2018*, April 2019

Figure 44: Male employment income has been a drag on mean working-age living standards over the past decade

Contribution to average annual change in real (CPI-adjusted, 2018-19 terms) working-age equivalised disposable household income (after housing costs)



Notes: GB.
Source: RF analysis of ONS, *National Accounts*

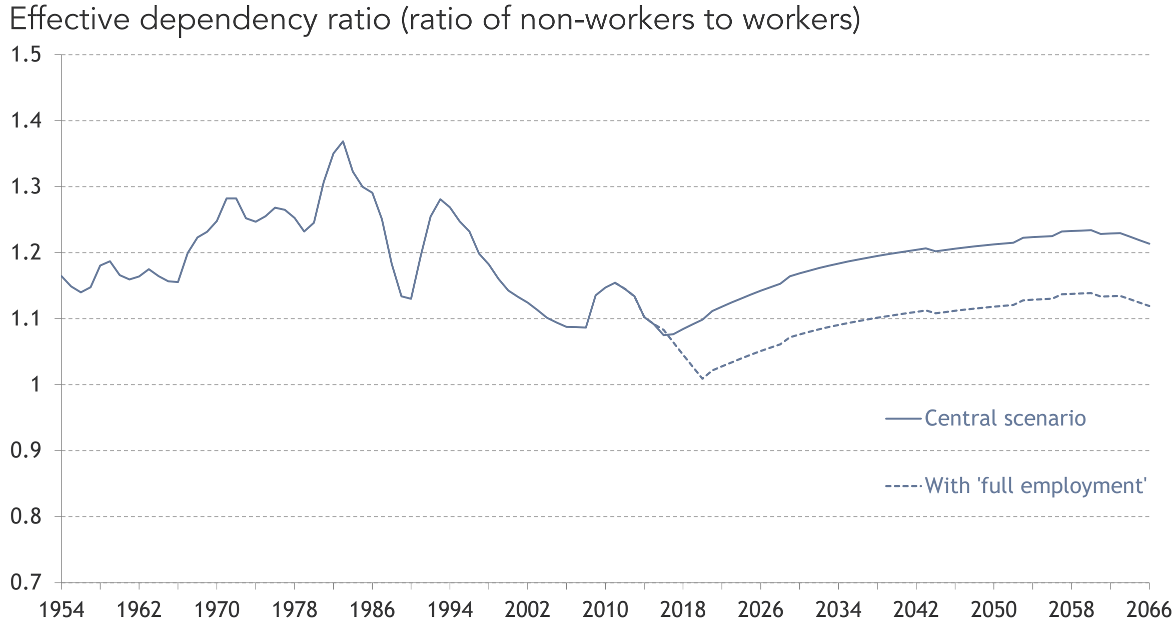
Sweating everything other than productivity cannot sustain strong income growth

Worryingly, even the weak levels of output and household income growth recorded in the post-crisis period might now be under threat. There is much to suggest that the drivers of growth over the last decade - higher levels of international migration, a rising state pension age[59] and increases in employment for typically disadvantaged groups[60] – are starting to run out of road. With productivity growth plummeting, we have instead sweated everything else – but that approach is not sustainable.

On population for example, Figure 45 shows the effect that ageing is likely to have on economic activity in the coming years. Large increases in the state pension age – particularly for women – have helped to lower the UK's effective dependency ratio (the ratio of non-workers to workers) in recent years, and further increases will continue to have a positive effect in the years to come. But it remains the case that we can expect the effective dependency ratio to rise over the coming years. That means any given increase in overall population growth is likely to feed into slower economic growth than has been the case over the past decade.

[59] A Corlett, *The Living Standards Outlook 2019*, Resolution Foundation, February 2019
[60] S Clarke & N Cominetti, *Setting the record straight: How record employment has changed the UK*, Resolution Foundation, January 2019

Figure 45: The UK's effective dependency ratio is set to rise over the coming years

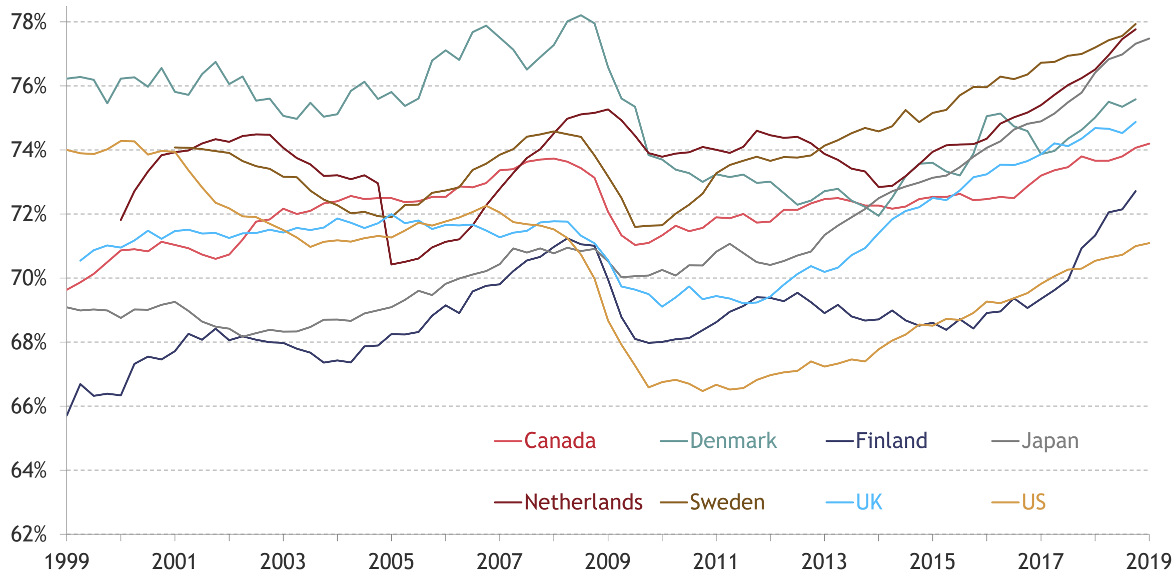


Notes: UK. Estimates do not take account of the impact of Brexit on employment levels or the population. Any large-scale impact on employment levels is likely to be temporary and this analysis looks to highlight long-term trends.
Source: Resolution Foundation analysis using: Bank of England, Three centuries of macroeconomic data; ONS, 2014-based mid-year population estimates; ONS, 2014-based population projections; OBR, *Economic and Fiscal Outlook*, March 2016; OBR, *Fiscal Sustainability Review*, June 2015

As Figure 45 shows, the effective dependency ratio could be driven lower in the near-term if the country can push towards 'full employment'. And certainly there is still room for more employment. But further significant gains are likely to be harder to achieve than they have been. At 76.1 per cent the employment rate is already at a record high and Figure 46 highlights just how far the UK has come over recent years. The UK's employment rate gap relative to Denmark, for example, has dropped from 5.5 percentage points in 2007 to just 0.7 percentage points in 2018 (or 2.8 percentage points relative to Sweden - the new leader).

Figure 46: The UK has narrowed its employment rate gap relative to the best international performers

Employment rates across selected OECD countries: % of working-age population



Source: RF analysis of OECD, *OECD employment rates*

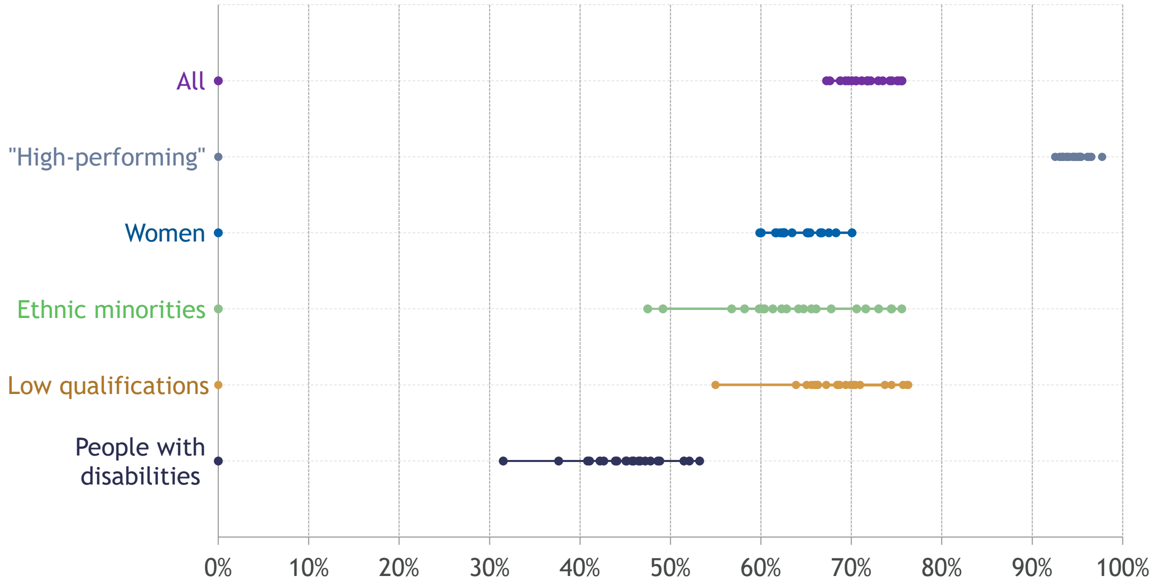
We can undoubtedly go further, with a particular need to focus on narrowing employment gaps for disadvantaged groups and across different parts of the country. Figure 47 makes this clear. It shows the employment rates recorded across different groups and in different regions and nations of the UK. Focusing on white, male, prime-aged and highly educated adults – who are 'high-performing' in terms of labour market outcomes – we can see that employment rates vary little across the country – sitting in the range of 93 per cent to 98 per cent in 2018. But employment rates drop significantly – and vary much more markedly by place – when we focus instead on black, Asian and ethnic minority groups, or on those with disabilities.

These gaps have narrowed a lot over recent decades. As we have shown previously, it is those on low incomes and furthest from the labour market who have benefited most from increases in employment in recent years.[61] But clearly there is further to go – with implications for how much more growth the country can generate from rising employment. Our estimate of what is possible if we move to true full employment is that we could increase the number of people in work by 2 million,[62] lifting our employment rate to 78 per cent and taking us to the top of the international leader board.

[61] S Clarke & N Cominetti, *Setting the record straight: How record employment has changed the UK*, Resolution Foundation, January 2019
[62] P Gregg & L Gardiner, *The road to full employment: what the journey looks like and how to make progress*, Resolution Foundation, March 2016

Figure 47: Large employment gaps remain in place across the UK

Employment rates across 20 UK sub-regions, by group: 2018



Source: RF modelling using ONS, *Labour Force Survey*

This is an ambition the next Prime Minister should undoubtedly pursue, but the strong progress of recent years inevitably limits just how far overall living standards can be boosted by further employment growth.

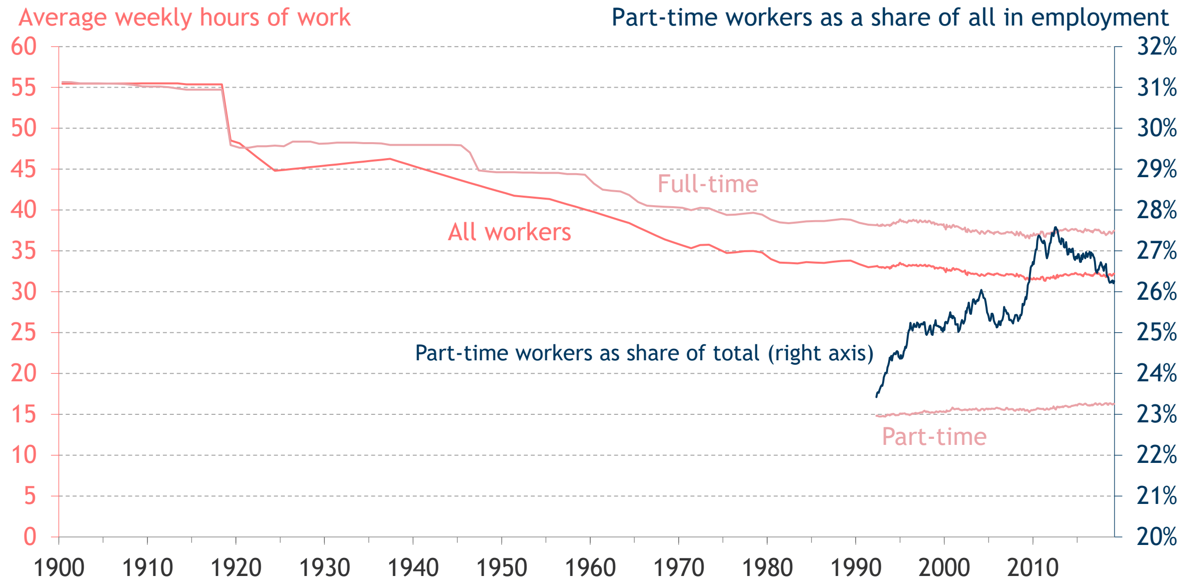
What about the extra hours being worked by those who are already in work? Figure 48 makes clear just how unusual the pattern recorded over the past decade has been in the context of the longer run. Average hours worked fell consistently from more than 55 a week at the start of the 20th century to just over 31 a week at the start of 2011 – driven by both a rise in part-time working and by a decline in the average hours worked by full-time workers. But that long downward drift subsequently went into reverse as the post-crisis employment recovery took hold, with the average rising back above 32 hours a week and staying there ever since (despite repeated forecasts for it to start falling again).[63]

This new trend is likely in part the product of the income shock faced by households in the post-crisis period, with individuals wanting to work more in order to support incomes hit by the pay squeeze and – in some instances – by cuts to working-age benefits.

[63] See for example, OBR, *Economic and Fiscal Outlook*, various.

Figure 48: Average working hours have declined over the longer term, but that fall has paused post-crisis

Average working hours and part-time workers as a share of total

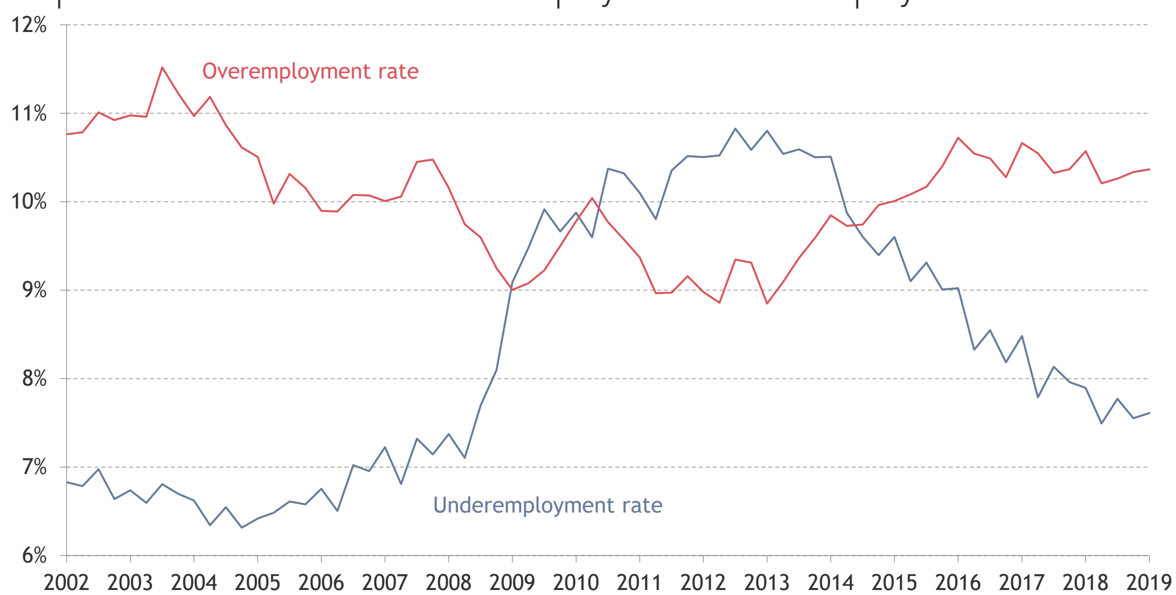


Source: ONS, *Labour Force Survey*; Bank of England, *Millennium of data*

Figure 49 sets out trends in self-reported under- and overemployment rates. It shows that underemployment remains elevated relative to levels just ahead of the financial crisis (and overemployment remains a little down on past highs). There is therefore some more progress that could be made in tightening the labour market.

Figure 49: Underemployment is heading back towards 2008 levels

Proportion of workers who are overemployed and underemployed

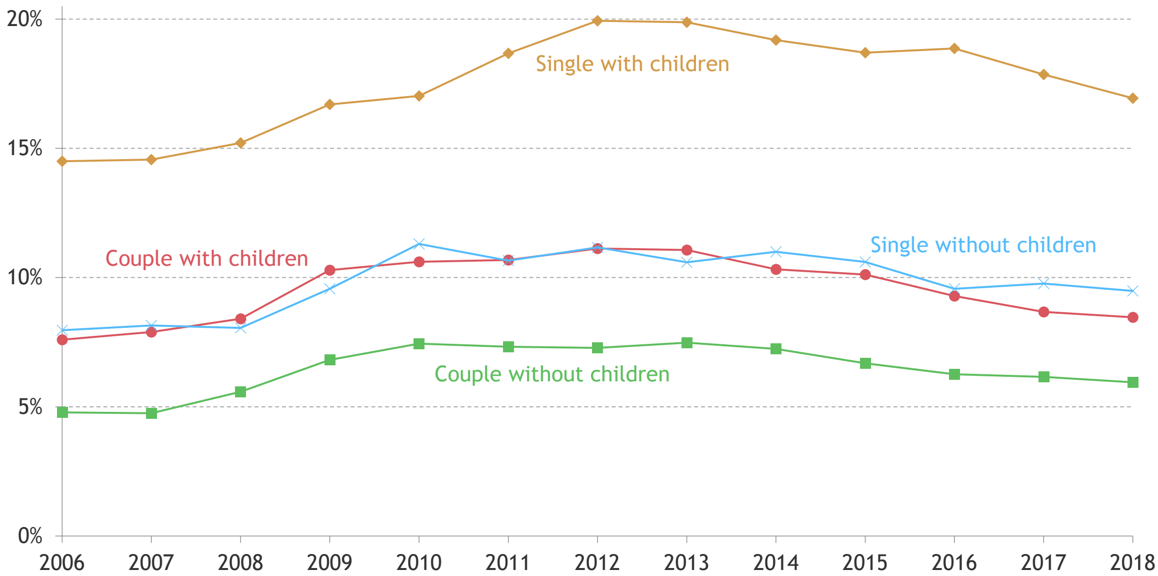


Notes: UK.
Source: RF analysis of ONS, *Labour Force Survey*

It is worth noting that the level of underemployment is more marked for some groups. Figure 50 illustrated this by comparing trends in underemployment across different family types. It shows that rates are always highest among single parents and lowest among couples without children. Rates for all groups remain slightly elevated relative to 2006, but the fact that one in six working single parents would like more hours shows that there is some potential for policy to make a difference.

Figure 50: Underemployment remains elevated among single parents

Proportion of workers who are underemployed, by family type



Notes: UK. Excludes adults living with non-dependent children.
Source: RF analysis of ONS, *Labour Force Survey*

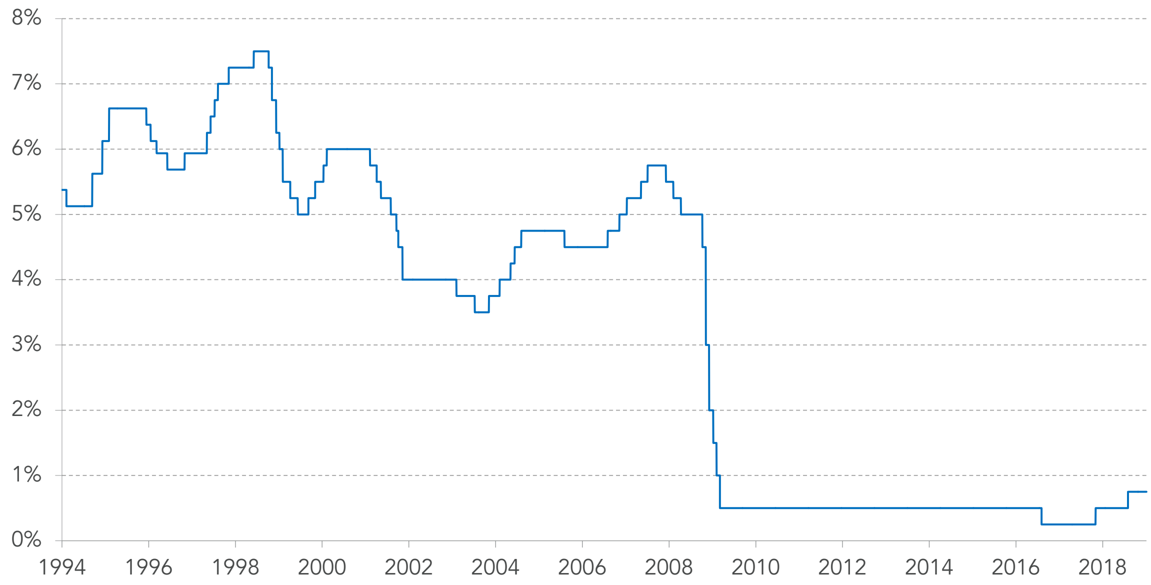
Nevertheless, while pockets of underemployment point to the scope for further increases in average hours for some groups, the bigger picture is one in which it is hard to envisage significant living standards gains over the coming years coming from any increase in average hours worked at the aggregate level. At most, hours might again be kept from falling.

Finally, the substantial boost to household income growth that has come from falling mortgage interest rates is clearly a temporary one. Average payments are now rising and market expectations are for a gradual increase in Bank Rate from its current level of 0.75 per cent.[64] In any case, the dramatic rate cuts of 2008, visible in Figure 51 cannot be repeated.

[64] OBR, Economic and Fiscal Outlook, March 2019

Figure 51: The fall in Bank Rate which gradually fed through to lower mortgage interest costs cannot now be repeated

UK Bank Rate



Source: Bank of England

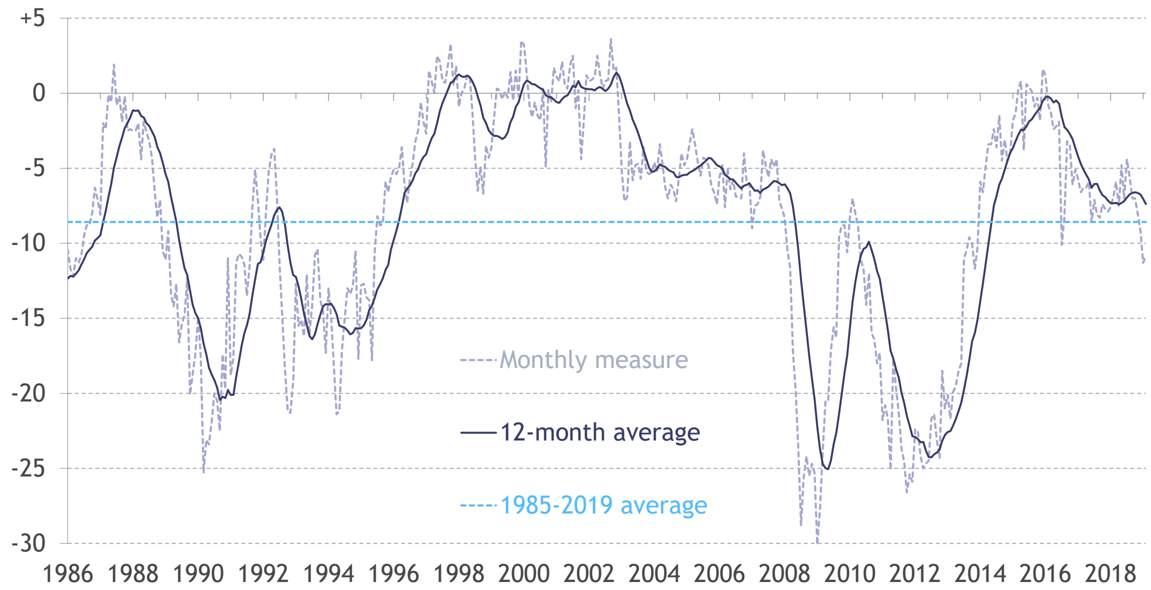
And households themselves are pessimistic about the prospects for the future

The sense of having limited room for persisting with the model of the past ten years of working ever-harder is reinforced by the pessimism households themselves display in relation to the country's economic fortunes and prospects.

Figure 52 sets out trends in the GfK consumer confidence index through to early-2019. The index is a composite of four separate measures that ask respondents to make backward and forward looking assessments of both the overall state of the economy and their own financial circumstances. The net balance of positive and negative responses is recorded for each question, with the overall index averaging across these balances. Consumer confidence has been in negative territory for the vast majority of the period covered by the survey, but it has declined notably over the last three years. At –7.4, it is not currently as negative as in the aftermath of the financial crisis (when it fell as low as -25), but the weak sentiment and direction of travel implies that households do not feel confident about what is around the corner.

Figure 52: Overall consumer confidence has fallen over the last three years

Overall GfK consumer confidence index



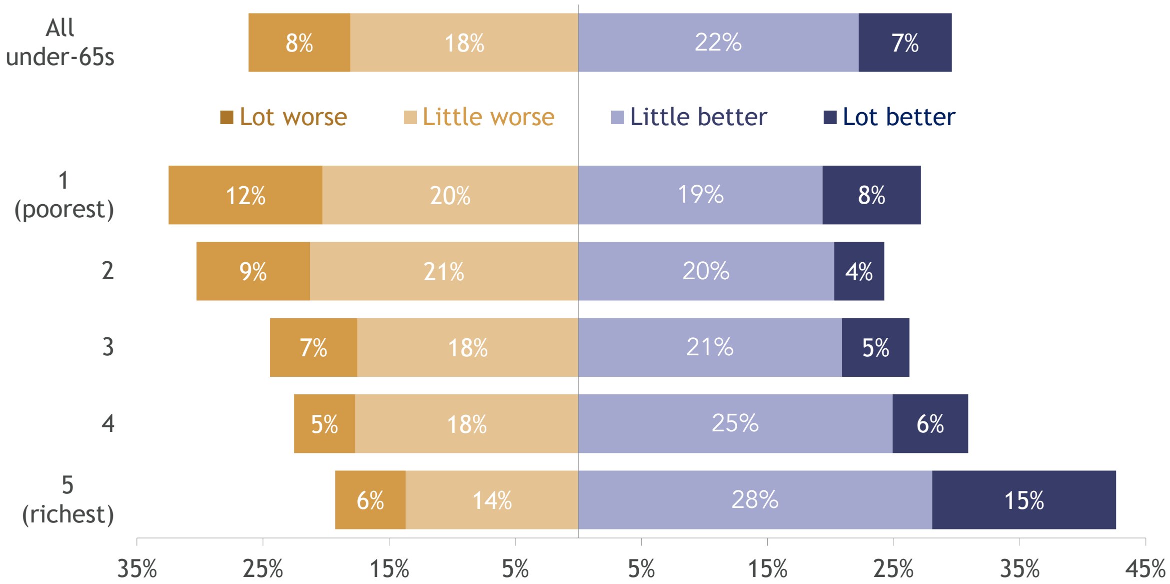
Notes: UK. The overall confidence index is the average of the net balances of respondents reporting that: their financial situation has got better over the past 12 months; their financial situation is expected to get better over the next 12 months; the general economic situation is expected to get better over the next 12 months; and now is the right time to make major purchases. Both the general economic situation question and the personal financial situation one asks respondents to say whether they expect things to get "a lot better", "a little better", "stay the same", "a little worse" or "a lot worse" over the coming 12 months. The major purchase question asks respondents to say whether they think the next 12 months represent "the right time", "neither right nor wrong time" or "the wrong time" to be making major purchases such as furniture or electrical goods.
Source: Research carried out by GfK on behalf of the European Commission

When asked instead to consider their own prospects for the coming year, households are generally a little more sanguine – but pessimism is still prevalent, with sizeable variation across the income distribution.

Figure 53 details the responses recorded across equivalised working-age household income quintiles. It shows that a net balance of working-age households are pessimistic about their own prospects in both the bottom fifth of the income distribution (a net balance of 5 per cent) and in the next fifth (a net balance of 6 per cent). The balance switches to positive (2 per cent) in the middle quintile, before climbing as high as +23 per cent among the richest fifth of working-age households.

Figure 53: Lower-income working-age households are more pessimistic than others about their financial prospects in the coming year

Expected change in household financial situation in coming 12 months, by equivalised working-age household income quintile: September 2018



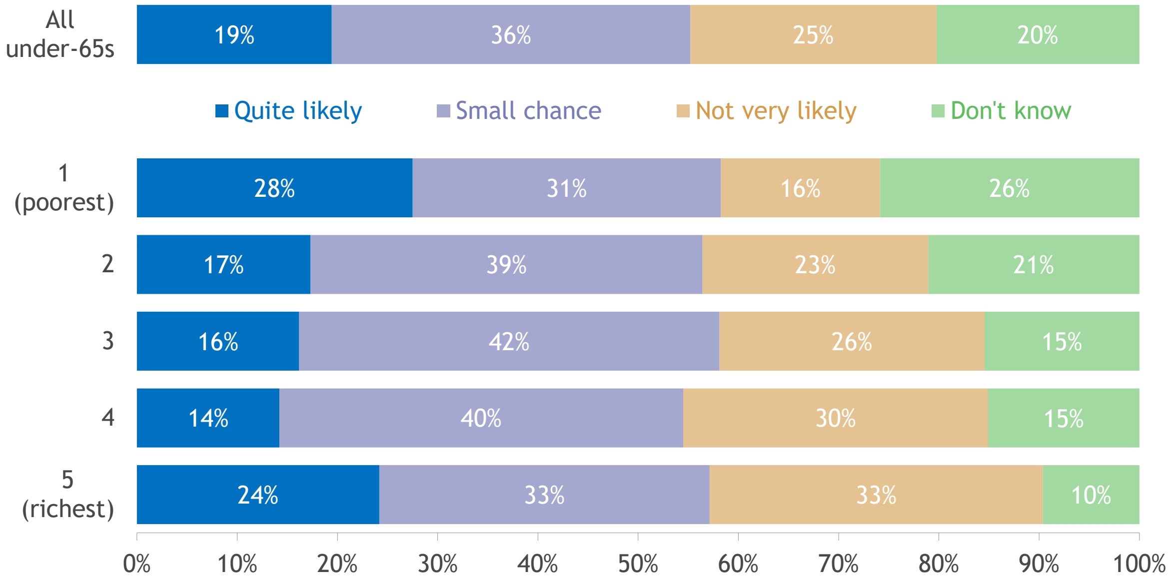
Notes: GB.
Source: RF analysis of Bank of England, *NMG Survey*

Perhaps most worryingly, a sizeable minority of households believe they are at risk of a very significant financial correction, as Figure 54 shows. Across all working-age households, 19 per cent said they were “quite likely” to suffer a “sharp drop” in income in the 12 months following the survey. But that figure climbed to 28 per cent among the poorest fifth of working-age households.

Interestingly, this concern is also more elevated among the top fifth of households, with 24 per cent describing their chance of a sharp drop as “quite likely”. The implication is that households across the income distribution view further living standards growth as somewhat precarious.

Figure 54: More than one-in-four lower-income working-age households believe they are "quite likely" to suffer a "sharp drop" in income

Perceived likelihood among working-age households of suffering a sharp drop in income in the coming 12 months, by equivalised household income quintile: September 2018



Notes: GB.
Source: RF analysis of Bank of England, *NMG Survey*

Altering the near-term gloomy outlook for living standards requires the next government to build on the lessons of the past

Absent a change in the UK's economic underpinnings or policy backdrop, household pessimism is likely to prove well-founded. Applying central projections for the coming years and layering on known policy positions, our last annual *Living Standards Outlook* painted a rather gloomy picture for household income growth in the near-term.[65] It pointed to further weak growth for working-age households in the coming years - with a particular emphasis on families with children - reflecting the combination of further sluggish wage growth and significant welfare cuts. The resulting projected outcome of rising inequality driven by flat income growth at the bottom of the distribution represented an unprecedented and unwanted combination.

But that is not to say that change can't be affected that alters the future. The political change facing the UK provides policy makers with a fresh opportunity for focusing on improving the living standards outlook. In doing so, they would do well to learn the lessons of past economic phases to understand what might sit behind sustainable growth in household incomes across the distribution.

[65] A Corlett, *The Living Standards Outlook 2019*, Resolution Foundation, February 2019

Most fundamentally, that means restarting the productivity growth engine that has historically supported the dominant contribution pay growth has made to overall improvements in household incomes. Output per hour is currently 28 per cent down on where it would have been had the long pre-crisis average rate of growth been maintained over the past decade, meaning there is considerable scope for progress.

There is of course no silver bullet for boosting productivity growth – the productivity 'puzzle' of the post-crisis period is well-named. But we do know that subdued business investment is playing a key role in holding productivity growth back, with political and economic uncertainty causing firms to at best delay investment decisions and at worst look elsewhere. It is imperative therefore that the country moves beyond the current period of insecurity. Maintaining a tight labour market over the coming months should also boost productivity growth, causing firms to increasingly need to focus on investment and innovation as a means of driving their businesses forward.

From a distributional perspective, the 'end of austerity' provides the opportunity for rethinking the programme of benefit cuts currently in place and instead providing additional support for those on low to middle incomes. Indeed, as we considered in the *Living Standards Outlook*, the government could link growth and redistribution together by recycling the fiscal benefits of stronger productivity and pay growth into increased benefit generosity. By shifting the support available to households with children, such an approach would also build on the importance we have recorded in past periods of boosting employment within families and among women in particular.

The continued roll-out of Universal Credit makes these questions particularly pressing. For example, the new benefit system does not have the same incentives that lead some to work precisely 16 hours per week, but whether this leads to people working *more* hours than that or *fewer* will depend on the design of the system. The current design also risks disincentivising second earners and this could be remedied.

The other area any new government could choose to focus on is housing policy. As we have articulated through this report, rising housing costs for many have acted as a major living standards headwind over recent decades. While mortgagors have benefited since the crisis, costs remain too high for many – especially those on low to middle incomes. Tackling these costs can take several forms, from boosting housing supply[66] to rebalancing housing demand and changing our approach to the tax treatment of property wealth.[67]

The way forward should also reflect what really matters to households themselves

The other great lesson of the last 25 years, is that living standards are affected not just by general economic growth and policy approaches, but also by wider changes in society. With that in mind, it is important that policy makers understand and work with

[66] L Judge, *Social renting: a working hypothesis*, Resolution Foundation, April 2019
[67] See for instance, Resolution Foundation, *A new generational contract: The final report of the Intergenerational Commission*, May 2018

household attitudes to living standards. This is especially true for low to middle income families, where the pressures of juggling work, caring commitments and managing the household finances can be particularly acute.

It is against this backdrop that we undertook two focus group discussions with low to middle income participants in June 2019: a Sheffield group that contained 10 participants and mixed parents and non-parents; and a Birmingham group that again contained 10 participants, but this time included only parents.

The groups served as a reminder that not everything that matters for living standards is measured by household income. Most obviously, there is health, happiness, the state of the environment, beauty, relationships, non-pecuniary services, public services, and the quality of job. Such groups also reflect the fact that the realities of living on very low incomes make it difficult to think about where future living standards growth might come from. But we know that well-being is strongly associated with household income, and that income is also a proxy for employment and home ownership that are also drivers of well-being.[68] We also know that improvements in household income matter more for the well-being of those with the lowest incomes.

The sentiments of the Sheffield and Birmingham groups certainly backed up these findings. But participants also raised the additional complexities associated with trading-off work against hassle: of wanting to find more hours, but facing difficulties with finding childcare, and of wanting to progress at work, but struggling to find time for training and up-skilling.

For instance, parents in the groups told us they might work more hours if the benefit system and childcare supported them to do so:

> *"If there were more childcare hours available, I think for me and quite a few of my friends I could work more hours." – Respondent 4*

> *"I want to stick to the hours I do as it affects your benefits. It doesn't pay to do any more than 16 hours. It fits around the children." – Respondent 5*

But we heard also about the importance of the work-life balance for parents of young children.

> *"I went part-time after my first child. When she turned three I went term-time only. So my pay is cut a lot. Now I have three kids. As much as work wants me to go back full-time I am refusing to. I want that work life balance with the kids. I would like the money [though]." – Respondent 6*

The group members focused too on the need for refreshing our approach to social security and government spending. One discussion appeared to support the findings of the 2018 British Social Attitudes survey, which found that an increasing share of people (61 per

[68] G Bangham, *Happy now?: Lessons for economic policy makers from a focus on subjective well-being*, Resolution Foundation, February 2019

cent) "would be prepared to accept" tax rises in order to increase spending elsewhere, and that 58 per cent and 70 per cent respectively support wage top ups for couples with children and single parents:[69]

> *"I would accept a higher tax on my National Insurance to invest in the NHS. That's always one that I have been banging on about." – Respondent 1*

> *"But you aren't on a big wage are you? Why do you want to be taxed more when there are others who earn more money?" – Respondent 2*

> *"It treats us all: I don't mind paying another contribution on top of what I do. You can't keep increasing the population like we are without needing a lot more money for things like the NHS." – Respondent 1*

> *"People with higher incomes should maybe be taxed more." – Respondent 3*

One of the other big issues participants wanted to talk about was housing. Here some respondents noted that they were happy not to own, with renting being seen as a long-term tenure:

> *"I think a lot of people are fixated on owning a property for security and achievement... Renting through housing associations you get the security ... a lot of people put themselves into debt to go and get the dream house and don't think about the costs." – Respondent 8*

But there was dissatisfaction with the rented sector too, and a clear sense that social housing was preferable to renting privately:

> *"I don't want the pressure of a house... I have council renting, it's cheap, it's affordable. I haven't got that as a cost – heating etc. A house doesn't seem like something I want it's a lot of pressure I don't need." – Respondent 7*

Overall, the focus groups provided much to support the findings of our quantitative analysis of living standards drivers – namely the importance of supporting people into work, with a particular emphasis on parents, and of dealing with the housing costs that for some can be a major barrier to greater disposable incomes and security.

Taken together with the bigger picture of the past decade, the findings provide a clear route map for the next Prime Minister as they attempt to reinvigorate living standards improvements across the country – something we turn to in the conclusion.

[69] D Phillips, J Curtice, M Phillips & J Perry, *British Social Attitudes 35*, *NatCen*, *2018*

Section 7

Conclusion

Living standards are affected by a wide range of factors, and it is only by learning the lessons of what drove improvements in the past that we can hope to restart growth and so fix the future. In this report we have looked in considerable detail at what has pushed growth forward – in aggregate and for different groups – over the past quarter of a century, and at what has pulled it back. What lessons then can we offer to the new Prime Minister?

First and foremost, there is a need to restore the productivity growth that was the engine of improvements in the pre-crisis decades – ensuring that we can start working smarter once again, rather than working ever-harder. This is by no means an easy task, but there is much to be gained by providing businesses and consumers with a clearer sense of what is coming down the road – creating more certainty and so boosting confidence and, crucially, investment in the future.

Second, while recognising that there is a finite amount of additional jobs growth to be achieved, the new Prime Minister must also build on the successes established pre-crisis in relation to parental (and especially maternal) employment rates. Working with societal change and preferences, that means focusing on childcare and social care provision and, with some urgency, on rethinking the government's approach to social security. Welfare cuts have hit parents and their children especially hard in recent years, with the prospect of a sharp rise in child poverty in the years to come. The leadership election focus on tax cuts for higher-income households rather than support for lower-income ones through welfare policy is one which risks doing more harm than good to both the overall pace of income growth and its distribution.

Finally, there remains a clear need to recognise the importance of housing costs to the living standards of the country. Political interest in housing too often starts and ends with home ownership, yet it is clear that renting is now a long-term destination for millions of households. And it is one that has dragged on living standards growth in a major way in certain periods over the past 25 years – adding to income inequality along the way. If and when interest rates start to rise again in the coming years, mortgagor households may come under increased financial pressure – but unaffordable housing is already a reality for too many.

Absent such changes, the living standards outlook appears gloomy. If the next Prime Minister wants to enjoy anything but the briefest of honeymoon periods then they would do well to dwell on what they can learn from the successes and failures of their predecessors

Annex 1: Low to middle income families in 2017-18

The Resolution Foundation's research is focused on those with 'low to middle incomes'. As set out in earlier Audits, we define this by focusing on those in:

- non-pensioner family units – excluding those containing at least one pensioner, as older households face different sets of challenges;
- the bottom half of the non-pensioner equivalised income distribution (before housing costs) – i.e. below a disposable income of around £27,000 for a couple in 2017-18; and
- family units in which at least one person is in (at least part-time) work.

As Table 1 shows, this divides the UK population into four groups: pensioner family units, those in non-working family units, those in higher-income family units, and those with low to middle incomes. That final group makes up 30 per cent of the population and 52 per cent of children.

Table 1: In 2017-18, there were 8 million 'low to middle income' family units, covering 20 million people

Numbers and proportions of people in our four income categories, 2017-18

	Non-pensioner						Pensioner	
	Non-working	(%)	Low to middle income	(%)	Higher-income	(%)		(%)
Total population	***6,220,000***	***10%***	***19,700,000***	***30%***	***25,710,000***	***40%***	***13,000,000***	***20%***
Adults	4,630,000	*9%*	12,600,000	*25%*	20,760,000	*41%*	12,930,000	*25%*
Children	1,590,000	*12%*	7,110,000	*52%*	4,950,000	*36%*	70,000	*1%*
Total number of families	***4,010,000***	***12%***	***8,280,000***	***24%***	***13,540,000***	***39%***	***8,740,000***	***25%***
Couple with children	250,000	*4%*	2,940,000	*49%*	2,810,000	*47%*		
Single with children	590,000	*32%*	930,000	*50%*	330,000	*18%*		
Couple without children	370,000	*6%*	1,380,000	*22%*	4,410,000	*72%*		
Single male without children	1,640,000	*24%*	1,670,000	*24%*	3,570,000	*52%*		
Single female without children	1,160,000	*24%*	1,350,000	*27%*	2,420,000	*49%*		
Pensioner couple							4,190,000	100%
Single male pensioner							1,420,000	100%
Single female pensioner							3,140,000	100%

Notes: UK.
Source: RF analysis of DWP, *Households Below Average Income*

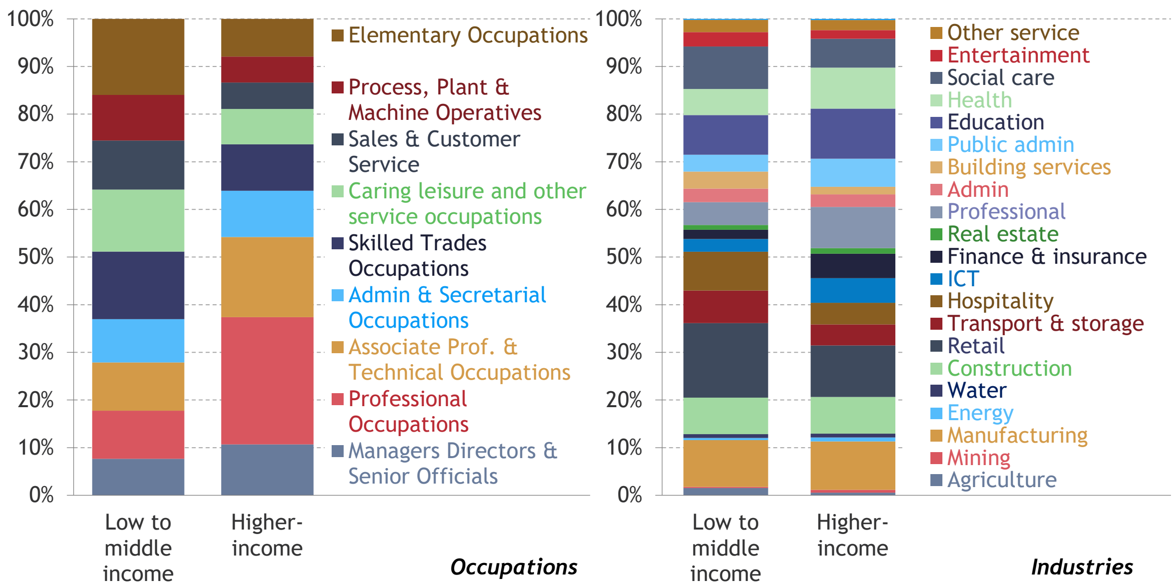
By population (including children), the majority (58 per cent) of the low to middle income group are couples with children.

To further understand the diverse make-up of the low to middle income group, it should be noted that among low to middle income couples without children, 40 per cent include at least one adult with a disability, and the median age (for both partners) is 51. In contrast, among the low to middle income singles without children, the median age is 35. However, as these figures are based on family units rather than households (a household may contain multiple singles or couples), a majority of the low to middle income singles without children actually live in households that contain other adults.

Although our categories are based on family status and income, we can also look at the occupations and industries of the adults in our low to middle income (and high income) group. Figure 55 shows that low to middle income adults are much less likely to be in managerial and professional occupations than those in higher-income family units and more likely to be in lower skilled occupations. While such a large population group inevitably includes people working in all sorts of industries, low to middle income adults are also more likely to be working in some sectors such as retail, hospitality, social care, building services and transport and storage. They are also somewhat more likely to be working in the private sector than those in higher-income family units.

Figure 55: Those in low to middle income family units are more likely to be in lower-skilled occupations and sectors

Proportion of working low to middle income / higher-income adults, 2017-18

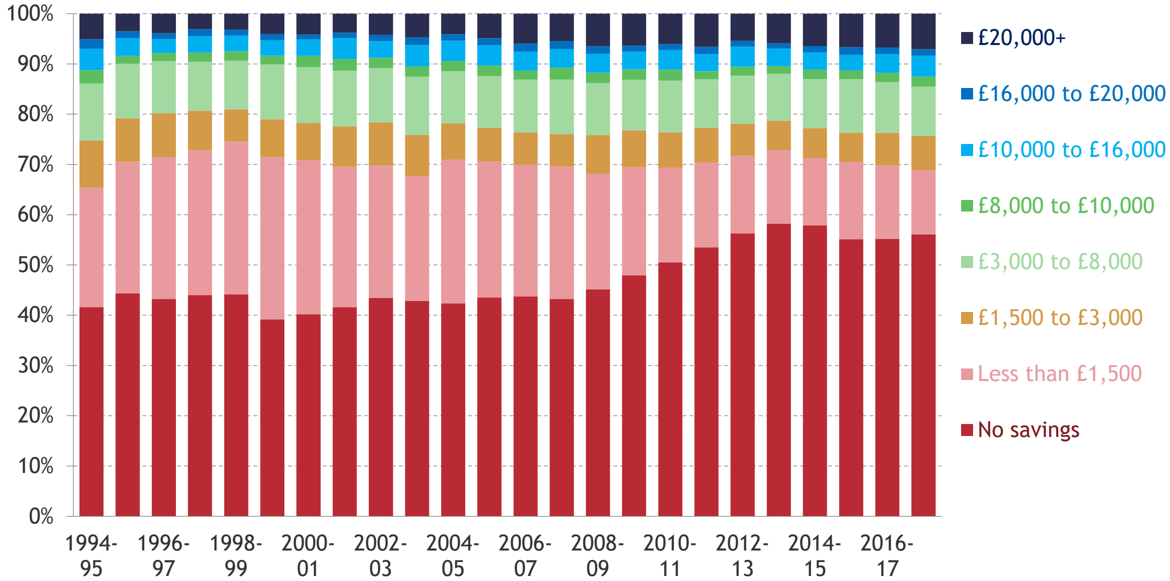


Notes: UK. Excludes unknowns.
Source: RF analysis of DWP, *Households Below Average Income / Family Resources Survey*

Turning to the assets of low to middle income family units, Figure 56 shows that over half report having no savings at all. This proportion rose after 2007-08 and shows no sign of falling back to pre-crisis levels.

Figure 56: Over half of low to middle income family units report having no savings, higher than pre-crisis

Proportion of low to middle income family units by savings band



Notes: UK from 2002-03, GB before. Savings figures are not adjusted for inflation.
Source: RF analysis of DWP, *Households Below Average Income*

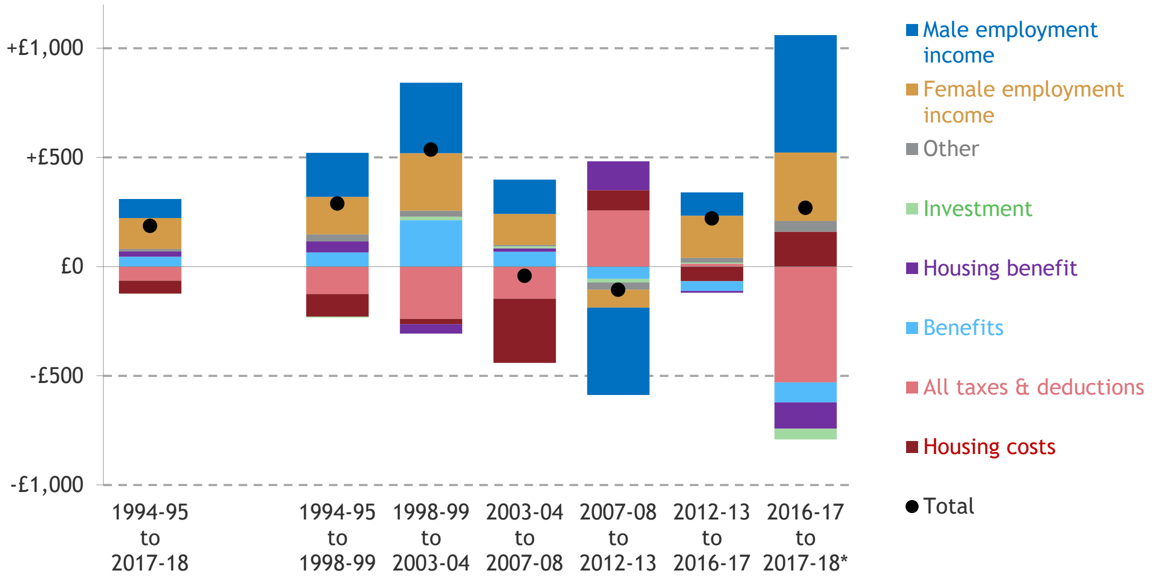
The size of the low to middle income group – by our definition – has grown over time as the number of non-working families has fallen,[70] which will affect changes over time such as this. But it is nonetheless notable that over two thirds of in-work low to middle income family units have savings of under £1,500, and that this is no lower than in the mid-1990s.

We can also repeat Section 5's analysis of the sources of income growth, but looking only at low to middle income family units. Looking at overall income changes between 1994-95 and 2017-18, employment income is still inevitably the largest component of income growth. But, within that, female employment income growth has actually been more important than male employment income – which for this group was still lower in 2017-18 than in 2007-08. Benefit income has also been a significant component of growth – particularly in the 1998-99 to 2003-04 period – while housing costs have been a notable drag – particularly in the 2003-04 to 2007-08 period.

[70] A Corlett, S Clarke, C D'Arcy & J Wood, *The Living Standards Audit 2018*, Resolution Foundation, July 2018

Figure 57: For low to middle income family units, female earnings have been the largest source of income growth since 1994-95

Contribution to average annual change in real (CPI-adjusted, 2018-19 terms) equivalised disposable household income (after housing costs) for low to middle income family units



Notes: GB.
Source: RF analysis of DWP, *Households Below Average Income*

Annex 2: Methods

Decomposing incomes

Section 5 decomposes household income into its constituent parts to understand what has driven changes in household income since 1994-95, using the Family Resources Survey/Households Below Average Income. We exclude Northern Ireland as data is only available from 2002-03. This method is based on previous work by Mike Brewer and Liam Wren-Lewis, produced for the Resolution Foundation as part of the Commission on Living Standards.[71] First we decompose equivalised household income, after housing costs, into its constituent parts. Gross income is the sum of:

+ Housing benefit

+ Other benefits

+ Investment income

+ Pension income

+ Male employment income

+ Female employment income

+ Other

And then disposable income is calculated by subtracting:

– Housing costs

– Non-employment taxes (Council Tax, and some Income Tax)

– Employment deductions (Income Tax, National Insurance, pension contributions)

We also decompose employment income (for both men and women) into three parts:

- **Wage growth**
- **Changes in hours worked**
- **Changes in employment**

[71] M Brewer & L Wren-Lewis, *Why did Britain's households get richer? Decomposing UK household income growth between 1968 and 2008–09*, Resolution Foundation, December 2011

To do this we decompose the change in employment income into that which is the result of changes in the hours worked (the "hours" effect), changes in the number of people in work (the "employment" effect) and the change in wages within these categories (the "wage" effect).

For example to calculate the "hours" and "wage" effects we collect data on the employment income earned by men and women in the household and the hours they have worked. We then group people based on the number of hours worked (1 – 20, 21 – 35, 36 – 39, 40, 40 – 49, 50+). Once we have done this we can calculate the change in employment income (Δ gross employment income for men/women) and the change in the proportion of people in each hours group (Δ share of people in each category). We can then calculate:

"Wage" effect = Δ gross employment income * average share of people in each category across both periods

"Hours" effect = Δ share of people within each category * average employment income in each category across both periods

In order to calculate the employment effect we then calculate:

"Employment" effect = Δ share of people employed * average employment income in each category across both periods

The total effect is the sum of the wage, hours and employment effects.

Nowcasting 2018-19 incomes

In this report we present some household income results for 2018-19. To do this we take the 2017-18 Family Resources Survey/Households Below Average Income data (the latest) and roll it forward to account for wage growth, employment and demographic changes, new tax and benefit rates and more.

Our full methodology is set out in The Living Standards Outlook 2019, which focuses on nowcasting and forecasting.[72] We have updated the 2018-19 projection to make use of labour market and demographic information from the full year's Labour Force Survey data as well as the 2017-18 Family Resources Survey data.

[72] A Corlett, *The Living Standards Outlook 2019*, Resolution Foundation, February 2019. Our nowcasting process includes statistical data from ONS which is Crown Copyright. The use of the ONS statistical data in this work does not imply the endorsement of the ONS in relation to the interpretation or analysis of the statistical data. This work uses research datasets which may not exactly reproduce National Statistics aggregates.

Resolution Foundation

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:

- undertaking research and economic analysis to understand the challenges facing people on a low to middle income;
- developing practical and effective policy proposals; and
- engaging with policy makers and stakeholders to influence decision-making and bring about change.

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