Wealth check

What the new Government needs to know about household wealth as it navigates the challenges ahead

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British household wealth has been on a rollercoaster ride in recent years. In Q1 2024, it was estimated to be worth more than six times GDP (630 per cent), more than 50 per cent higher than the last time Labour came into power (410 per cent in 1997). The key driver of this huge rise in wealth is unearned passive gains. These gains have stretched the gap between the wealthy 'haves' and the less fortunate 'have nots': today, families in the top tenth of the wealth distribution have £1.3 million more in wealth per adult on average than those around the middle (fifth decile). Yet, despite huge increases in wealth, revenues raised from wealth-related taxes have barely moved, at around 3 per cent of GDP. Tapping unearned gains on wealth could be an appealing option for the Government, if it wants to avoid sharp cuts to some public services and maintain commitments not to raise the headline rates of taxes on income. To that end, reforms to Capital Gains Tax and Inheritance Tax could collectively raise almost £10 billion.

But not everyone has been able to join in on Britain's wealth boom. Historically low levels of active saving have left many families with small financial buffers. In June, three-in-ten Britons (27 per cent) said their household would be unable to cope with an unexpected bill of £850. Many workers are also failing to save enough in their pensions, despite the success of auto-enrolment during the 2010s. These two problems – of low precautionary savings today and insufficient pensions for the future – require a joined-up solution. For example, a higher default rate for auto-enrolled pension contributions could be coupled with contributions to a liquid 'sidecar' savings account, which have been shown to boost precautionary savings for employees. The Government could complement this by expanding Help to Save, an existing scheme that incentivises saving for those on low incomes.

Household wealth in Britain now stands at more than six times national income, largely due to passive gains on existing wealth

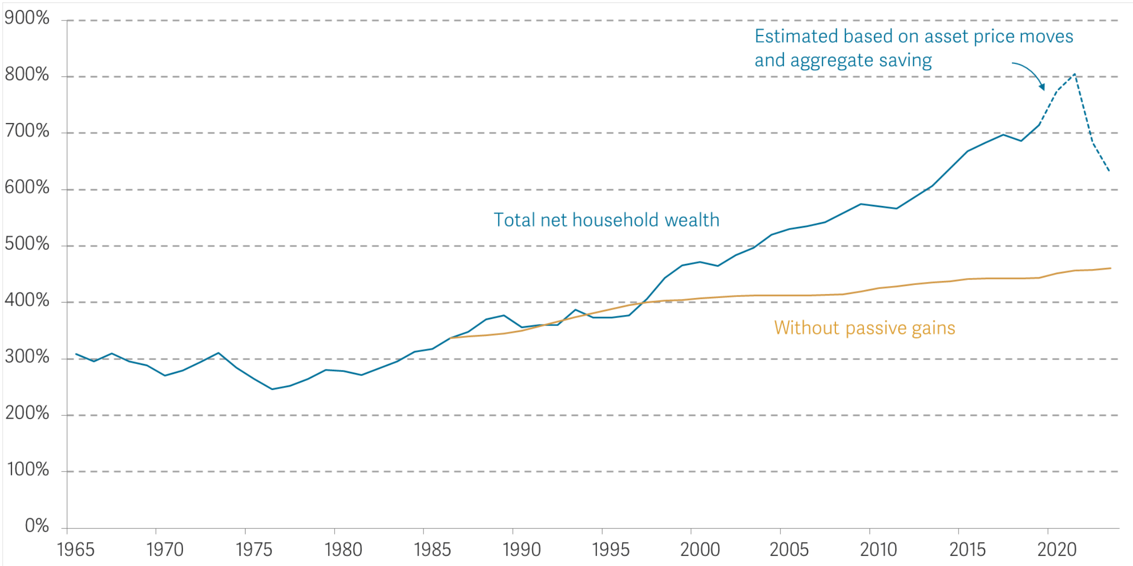
The new Government faces no shortage of economic challenges. Public services are under severe pressure, while households are still recovering from a cost of living crisis that saw prices rise by 22 per cent in just two years, all against a backdrop of low wage growth and chronic under-saving. The Government will need to think carefully about policy to support household finances. And, on the back of the biggest tax-raising Parliament since the Second World War, it's time to reconsider the role of wealth taxes in today's system. On both fronts, it's critical to understand the nature of household wealth in Britain today and its main drivers over the recent past.

In recent decades, Britain has lived through an unprecedented surge in the value of household wealth. As shown in Figure 1, when Labour last came into power, the combined wealth of British households was worth around four-times national income (410 per cent in 1997). Now, despite falling recently as global longer-term interest rates increased, it sits at more than six times national income (an estimated 630 per cent in Q1 2024) – in cash terms, this is an increase of £9.7 trillion.

This rise has led to big 'wealth gaps' in between British families, increasing the pounds and pence gaps between those at opposite ends of the wealth distribution, and making it harder to move up the wealth distribution by saving out of one's own income. It also means a bigger role for gifts and inheritances – with the total value of the latter forecast to double over the next 20 years – something that undermines social mobility by tightening the link between people's economic fortunes and those of their parents.

Figure 1 **Aggregate household wealth grew from 300 per cent of GDP in the 1980s to around 800 per cent in 2021, but has fallen sharply since**

Household wealth as a share of national income: UK



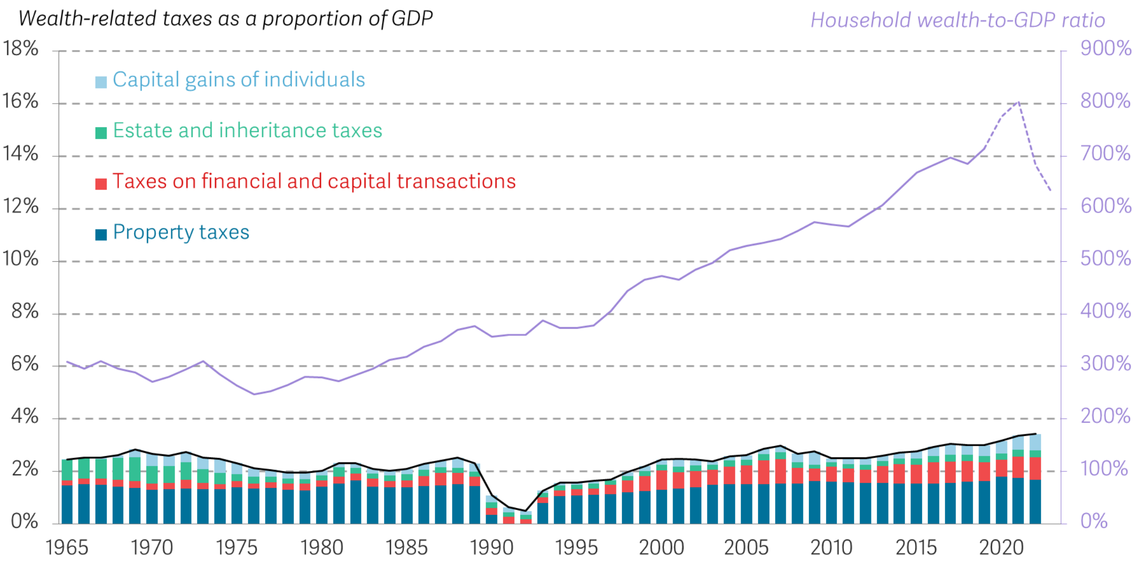
Notes: Data from 2020 to 2023 are estimated using the methodology set out in Box 1 of M Broome, I Mulheirn and S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023. 'Without passive gains' is an estimated counterfactual, where the household sector's cumulative net lending in the financial account (within the UK Economic accounts) adds to household net wealth in the year it occurs, and earns a return of nominal GDP growth in subsequent years.
Source: RF analysis of OECD; D Blake & J Orszag, Annual estimates of personal wealth holdings in the United Kingdom since 1948, Applied Financial Economics 9, 1999; ONS, Economic accounts & Wealth in Great Britain.

Britain's wealth boom has been predominantly driven by 'passive' capital gains, rather than active saving. In particular, the period from the mid-1980s to the pandemic saw an unprecedented fall in global interest rates to near-zero levels. This pushed up the value of wealth, delivering large passive gains to those who owned wealth at the beginning of this period. The yellow line in Figure 1 shows an estimate for the value of UK household wealth in the absence of these extraordinary gains, where the value of accumulated financial assets grows in line with GDP. If this were the case, household wealth would be worth 4.5 times national income today, some £4.7 trillion less than its actual value in 2023.

Passive wealth gains haven't shown up in tax revenues...

One might hope that huge passive gains from wealth would have brought with them higher tax revenues. Unfortunately, this hasn't been the case. As shown in Figure 2, while household wealth more than doubled relative to national income over the past half-century, the revenues raised from wealth taxes have failed to follow suit. Although higher Capital Gains and Stamp Duty revenues have pushed revenues from wealth-related taxes to an all-time high in 2022 (3.4 per cent of GDP), this is far from a doubling (in 1972, revenues were 2.5 per cent of GDP).

Figure 2 **Wealth has soared, but wealth tax revenues have not**
Total household wealth and wealth-related taxes as a proportion of GDP: UK

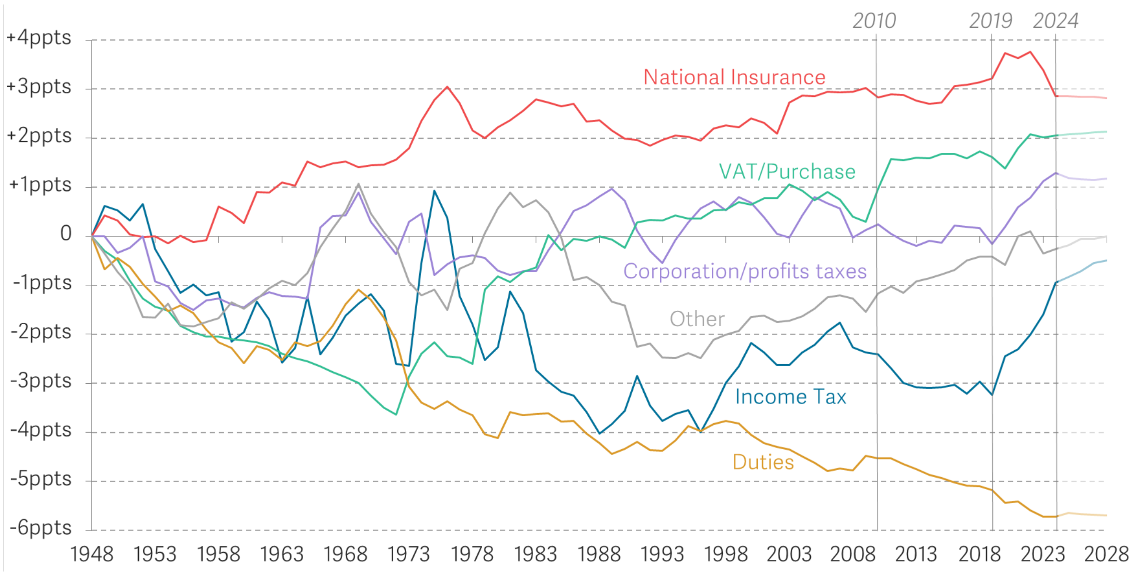


Notes: Data from 2020 to 2023 are estimated using the methodology set out in Box 1 of M Broome, I Mulheirn and S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.
Source: RF analysis of D Blake & J Orszag, 'Annual estimates of personal wealth holdings in the United Kingdom since 1948', Applied Financial Economics 9, 1999; ONS, UK National Accounts, ONS, Total Wealth, Wealth in Great Britain, ONS Gross Domestic Product at market prices; Current price: Seasonally adjusted £m; OECD, Details of Tax Revenue.

However, the wider context here is not one of flatlining taxes. The Parliament just gone saw the largest increase in the tax-to-GDP ratio since the Second World War, and the tax-to-GDP ratio in the current financial year is expected to be the highest since 1949.

With wealth tax revenues refusing to budge, this means the burden of higher taxes falling on other forms of taxation. As Figure 3 shows, Income Tax shouldered a particularly heavy load in the last Parliament. The combination of high inflation and frozen earnings thresholds meant that Income Tax revenues rose by 2 per cent of GDP between 2019 and 2024.

Figure 3 **Income Tax and Corporation Tax rose sharply over the last parliament**
Cumulative change in tax revenue as a share of GDP since 1948, by type of tax: UK



Source: RF analysis of OBR, Economic and Fiscal Outlook, March 2024; OBR, Historical public finances database.

…suggesting that we should reconsider the way we tax wealth

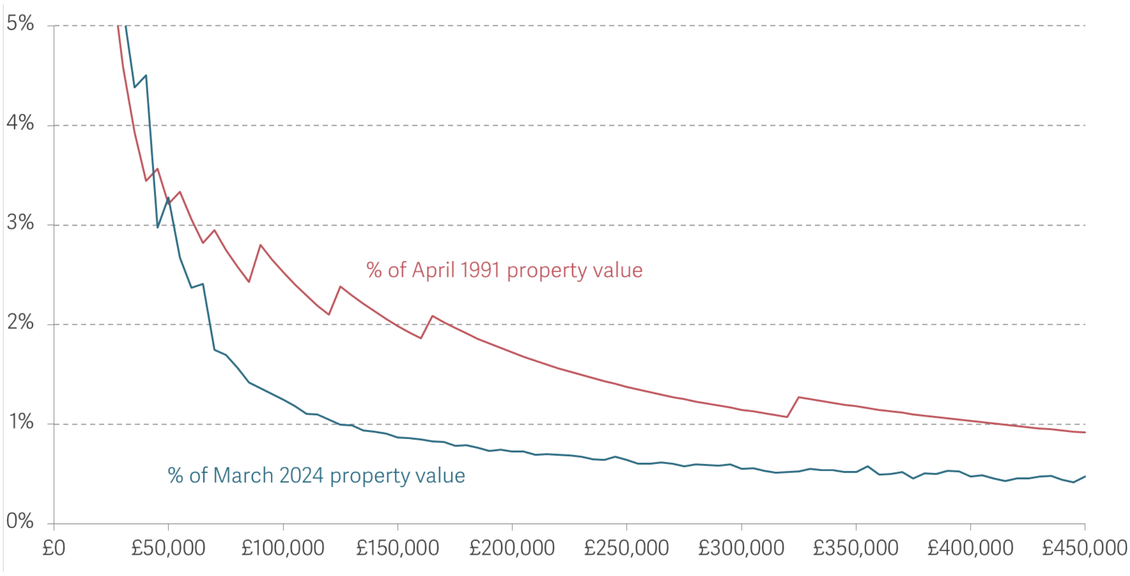
Despite a higher tax take, the Government's fiscal arithmetic remains challenging. It has committed to delivering falling debt as a proportion of the economy which, on current plans for tax revenues, implies sharp cuts to funding for unprotected departments, including Justice, the Home Office and local government. On the plans set out by the previous Government, per-person spending in these departments is set to fall by 13 per cent between 2024-25 and 2028-29 – something that would amount to a repeat of three-quarters of the cuts made in the years of austerity between 2010 and 2015.

If the Government is unwilling to deliver these cuts, taxes may well need to rise by more than is implied by existing plans. Given the dominant role played by unearned passive gains in Britain's wealth boom, tapping these gains could provide a way of raising more revenue without reneging on commitments not to raise the main rates of the big income taxes.

When thinking about inequities in the way we tax wealth, two taxes in particular stand out: Inheritance Tax and Council Tax.[1] Generous reliefs mean that the very wealthy often pay a low effective rate of Inheritance Tax. Curtailing these reliefs would raise revenue (up to £2 billion per year) while also improving the perceived fairness of one of the country's most-disliked taxes.

Unlike Inheritance Tax, which is fundamentally progressive in the absence of reliefs, Council Tax is regressive by design. As shown in Figure 4, in England, the average effective rate of tax for properties worth £500,000 (0.5 per cent) is less than half of that for properties worth £100,000 (1.2 per cent).[2] This difference reflects the design of Council Tax, with flat tax bills within bands, small differences between bands, and bills determined by property valuations from a third of a century ago (1st April 1991 in England and Scotland). Reforming Council Tax would no doubt come with political risk. But, with careful and gradual implementation, it should be possible to improve the way in which the tax is collected.

Figure 4 **Council tax is regressive with respect to property values**
Annual Council Tax bill as a percentage of March 2024 and 1991 property value: England



Notes: The red line (annual Council Tax bill as a percentage of property values at 1 April 1991) is based on the average 2023-24 billing authority in England. The blue line (average Council Tax bill as a percentage of property values in March 2024) is calculated by matching the average 2023-24 Council Tax bill in each region and Band to properties in Wave 12 Understanding Society. Property values from Understanding Society Wave 12 have been uprated to March 2024 using HM Land Registry's May 2024 House Price Index.
Source: RF analysis of Department for Levelling Up, Band D Council Tax Live Tables, Housing and Communities, March 2023, analysis of Wave 12 Understanding Society; HM Land Registry, UK HPI.

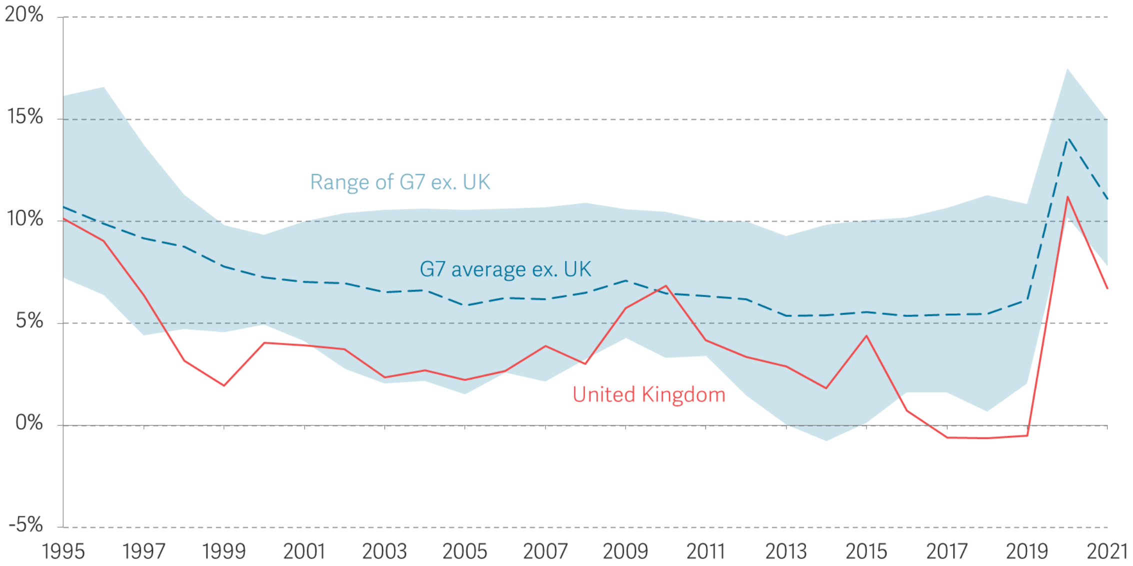
Another source of unfairness in our tax system is the unequal treatment of different sources of income. Although this issue stretches beyond wealth taxes, low rates of Capital Gains Tax (CGT) are part of the problem. Raising CGT rates on shares to match that on dividends (and aligning both with tax rates faced by employees) would raise revenue and boost the efficiency of the tax system by reducing incentives to change the form of remuneration purely to reduce tax. To offset the impact of higher headline CGT rates, they could be paired with a reintroduction of inflation indexing, meaning only real gains are taxed. Raising marginal CGT rates and reintroducing inflation indexing would raise up to £7.5 billion per year.[3]

But many families have insufficient financial buffers and retirement savings

In stark contrast to rising wealth levels, Britain's rate of saving over the past 30 years has remained stubbornly low. Figure 5 compares the rate of saving by UK households to that of their counterparts in other G7 countries. Between 1995 and 2021, there was just one year (2010) in which Britons saved at an above-average rate compared to the rest of the G7.[4] The flipside to low domestic saving is a heavy reliance on borrowing from abroad to fund investment, a problem that will only become more acute given the need to invest more to boost our capital stock and meet the Government's net-zero commitments.

Figure 5 **UK households save less than those in other large rich countries**

Household saving ratio: G7 members

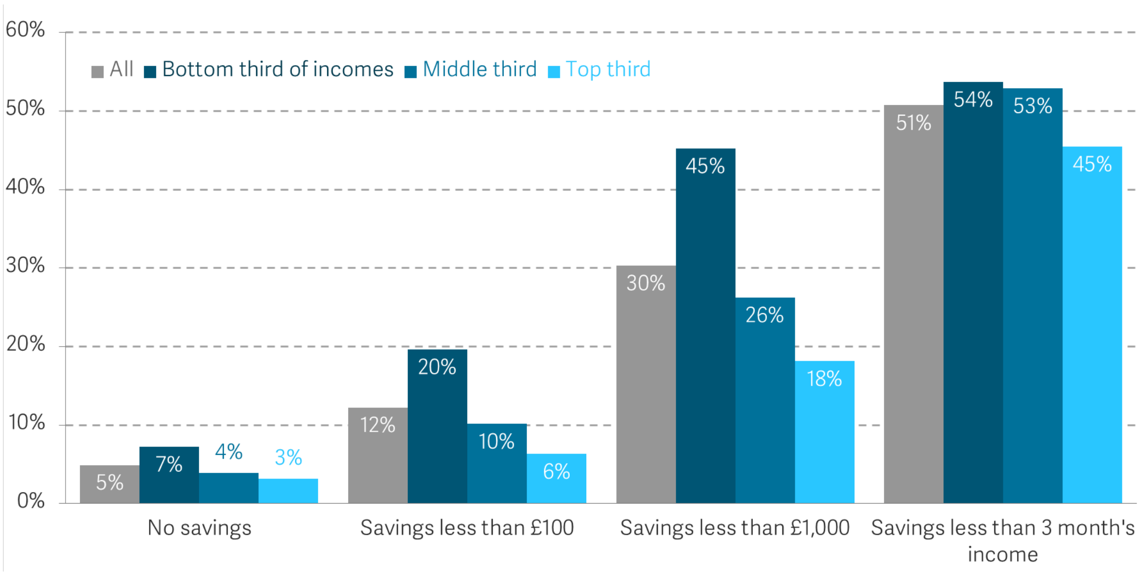


Notes: Household saving is defined as household net disposable income plus the adjustment for the change in pension entitlements less household final consumption expenditure (households also include non-profit institutions serving households). The net household saving rate represents the total amount of net saving as a percentage of net household disposable income. Data is shown up to 2021 due to a lack of available data for all countries in subsequent years.
Source: RF analysis of OECD, Household savings.

Given Britain's historically low level of active saving, it shouldn't come as a surprise that many families have insufficient financial buffers to fall back on. Figure 6 shows that, on the eve of the pandemic, a third of working-age Britons (30 per cent) were living in families with less than £1,000 in readily-accessible savings. This proportion rose to nearly half (45 per cent) of those in the bottom third of the income distribution.

Figure 6 **Many families have low levels of easily-accessible savings**

Proportion of the working-age population living in families with savings below a given threshold, by income tertile: GB, 2018-20



Notes: Savings and income measured at the benefit unit level. Savings defined as current accounts in credit, value of savings account, value of ISAs and value of national savings products. Savings thresholds are cumulative, for instance, savings of less than £1,000 also includes those with savings of less than £100.
Source: RF analysis of ONS, Wealth and Assets Survey.

In the years since the start of the pandemic, the families' total stock of liquid savings has risen, but the gains haven't been equally shared. British households saved at record rates during Covid lockdowns. The aggregate rate of saving then normalised but, surprisingly, then rose during the cost of living crisis. By the end of 2023, it had reached four times its pre-pandemic level, far more than would have been expected from higher rates and greater economic uncertainty. At the same time, total outstanding consumer debt (such as credit cards, overdrafts and personal loans) fell to its lowest level on record, as a share of household income.

But, despite this improvement, poorer families have still struggled to put money away. For example, households in the bottom fifth of the income distribution were the only group more likely to report a fall, rather than a rise, in savings during the pandemic. This left many poorer families with little financial resilience to cope with the subsequent cost of living crisis, during which a lack of savings has been linked to higher use of debt, falling behind on bills and adverse health outcomes. Coming out of the cost of living crisis, there remains an uncomfortably high share of financially vulnerable families in Britain. In June, three-in-ten Britons (27 per cent) said their household would be unable to pay an unexpected bill of £850.

Historically low saving rates also show up in workers' pensions. Pensions auto-enrolment has been an unmitigated success in boosting pension coverage among employees: in 2021, four-in-five (79 per cent) were participating in a workplace pension scheme, up from half of employees (47 per cent) in 2012. But many workers are not on track for decent incomes in retirement, particularly the self-employed. Analysis by the Department for Work and Pensions suggests that around 40 per cent of working-age people today will be unable to maintain a similar standard of living when they reach retirement.

In the coming Parliament, there is a clear case for policies to increase financial resilience across the income distribution

So, as things stand, too many families have insufficient financial buffers today and too many workers are facing the prospect of insufficient incomes in retirement. Any approach to tackling these two problems must be joined up, not least because evidence from the rollout of auto-enrolment suggests a tension between contributing to a pension and saving for a rainy day. When the auto-enrolment default contribution rate was increased between April 2018 and April 2019, 66p out of every £1 of higher pension contributions was funded by less saving or more debt. Therefore, a piecemeal approach – seeking to increase pension contributions without considering its impact on precautionary saving, or vice versa – risks exacerbating the problem.

As we have proposed in previous work, one way to navigate this tension is by incorporating precautionary saving within the UK's pensions architecture, as is already the case in a number of other countries. The best way to bring this about is for the Government to articulate a medium-term aim of increasing pension contributions for middle and higher earners, and accompany this boost to pension saving with greater flexibility in the system. Building on the success of trials run by Nest Insight, it could introduce a 'sidecar' savings scheme, where a slice of pension contributions initially flow into an accessible savings account – up to a limit of £1,000 – before becoming pension contributions once the savings account is full. In addition, we could learn from the US and allow people to borrow limited amounts from their pension pots, making up the difference with higher contributions in future. This would effectively provide employees with access to low-cost credit when faced with large financial shocks, reducing the need to fall back on high-cost borrowing like credit cards and overdrafts.

On top of reforming the pension system, the Government should also look at policies to boost savings among those who need it most – namely low-income families. Fortunately, such a policy already exists. Help to Save is a scheme open to anyone in receipt of Universal Credit (UC), Working Tax Credit, or eligible for Working Tax Credit and receiving Child Tax Credit. Individuals receive a bonus on their savings over two two-year saving periods equal to 50 per cent of their maximum account balance, with deposits capped at £50 per month. For many of the poorest families, operating with a 'negative budget', saving at the end of the month would clearly be inappropriate. But that is not true for all: those already using Help to Save are often maxing out their monthly deposits. But awareness of the scheme seems to be a barrier to wider take-up. Tackling this awareness gap, as well as automatically equipping UC claimants with a Help to Save account and potentially expanding the eligibility criteria for the scheme, would be a practical way to boost financial resilience for a wider set of low-income families.

When it comes to household wealth, we are facing some big challenges. The cost of living crisis shone a spotlight on the importance of financial resilience and, with the tax burden approaching a historic high, the issue of raising tax fairly is more important than ever. But the new Government has the opportunity to take these challenges head on. Unfortunately, there are no silver bullets, and the solutions will create winners and losers. Progress will need to be made carefully and in full consideration of the nature of household wealth in the UK today.

[1] We include Council Tax here as it is the UK's main recurrent domestic property tax and is a common way of taxing housing wealth across countries. However, even if Council Tax were proportional and used up-to-date property valuations, a household's Council Tax bill would not necessarily relate to its level of (net) housing wealth, as Council Tax does not distinguish between those who own their homes outright from those who own with a mortgage, or rent.

[2] Council Tax in England and Scotland places households into eight bands – from A to H – based on the estimated value of the property on 1 April 1991 (including properties that did not exist at the time). In Wales, a revaluation took place in 2003 when a new top band – band I – was also introduced. The Welsh Government has also announced that it will seek to implement regular revaluations on a five-year cycle starting in 2028, and will consult on further changes to Council Tax in the next Senedd term. In Northern Ireland, domestic property is taxed via the domestic-rates system.

[3] At present, capital gains on shares are taxed at a basic rate of 10 per cent and a higher rate of 20 per cent, though with another 10 per cent rate available via Business Asset Disposal Relief or Investors' Relief, and a 28 per cent rate for 'carried interest'. Our proposal to equalise rates with marginal rates faced by employees would mean a basic CGT rate for shares of 16 per cent (up from 10 per cent) and higher and additional rates of 32 and 37 per cent respectively (both up from 20 per cent).

[4] Comparing household saving across countries is difficult, due to the inclusion of pension saving. In some countries (e.g. France and Germany) the state plays a much larger role in pension provision than in others (e.g. the UK and US). In countries where the state plays a larger role, a greater share of pension saving is done by the government on behalf of households – rather than by households themselves – and so isn't captured in the household saving ratio. Instead, we can look at the whole economy's saving ratio as a comparable and more comprehensive measure of saving (although one that includes all saving by companies and governments, as well as saving done by and on behalf of households). On this measure, the UK's rate of saving compares even less favourably: since 1980, the UK has on average had a lower saving rate than all other G7 countries in four of every five years.