

Squeezed:

the low earners audit

March 2009

This report presents data on the make-up and condition of members of low earner households: that is, those with below-median income who remain independent of state support. It considers the pressures faced by the group in the mixed economy: in some respects the same as those faced by benefit-dependent households, in some respects the same as those experienced by high earner households and in some respects unique. It looks in particular detail at the challenges the current economic climate presents to low earners.

There are 13.4 million adults living in low earner households in the UK. They face three distinct challenges:

1. Low earners are squeezed by the mixed economy

They are often too poor to benefit from the full range of opportunities provided by private markets but too rich to qualify for substantial state support. For example:

- Long-term care: low earners are often ineligible for free or subsidised care, yet their low incomes make purchasing care privately a significant financial burden.
- Financial advice: low earners find themselves stuck in an advice gap – unattractive to commercial providers of financial advice but not targeted by services provided by the voluntary sector.
- Housing: despite recent falls in house prices, low earners struggle to get on the housing ladder and are not eligible for social housing.

2. Low earners are particularly exposed in the current economic context

- Poor financial health: low earners have more financial exposure than benefit-dependent households and are less likely than high earners to have a safety net of savings or insurance.
- Uncertain employment prospects: low earners work in sectors likely to be hit hard in the recession (such as retail and services) and have lower skills than high earners, making it more difficult for them to return quickly to work.

3. Low earners risk being overlooked

- Invisible: low earners are not a well-defined group and the pressures they face are not well understood.
- Policy focus: there is a tendency for policy makers to focus on the most excluded members of society. The Foundation does not argue that low earners are more deserving, simply that they face particular challenges that are often overlooked.

Because they are the group most at risk of losing out in the recession, low earners are likely to be key beneficiaries of the various initiatives announced by the Government in response to the downturn. However, low earners will face fresh problems as public spending is cut during the recovery period. In addition to regular updates of this Audit, the Foundation is embarking on a new programme of work *Through the Adjustment* which will focus on how low earners fare as the economy adjusts.

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the well-being of low earners in today's mixed economy. We aim to deliver change in areas where this income group is currently disadvantaged by producing new research and engaging actively in the policy-making process.

Introduction

The UK operates as a mixed economy, characterised by a number of features:

- Markets for some goods are purely private, often attracting regulation and consumer protection mechanisms but nevertheless largely free to develop according to market forces with prices set at levels that match supply with demand.
- Direct redistribution takes place via the tax-benefits system, which helps to reduce the gap between the poorest and richest members of society.
- In addition, the state is involved in the provision and funding of social goods: those goods and services that have benefits for society as a whole and form part of a citizen's basic requirements but which may be unaffordable for some if left to private enterprises.
- In some instances, for example healthcare and education, the state provides universal access. In other instances, for example housing and social care, the state only provides support for those it assesses to be most in need.
- In all cases, private markets exist alongside public provision to allow those with sufficient resources to choose to substitute or top-up their baseline entitlement.

The mixed economy approach combines the benefits associated with well-functioning private markets with targeted state intervention. However, it inevitably results in a group which operates at the margin: too poor to benefit from the full range of opportunities provided by private markets but too rich to qualify for substantial state support.

This group of *low earners* is not the most vulnerable in society, nor does the Foundation argue that it is the most deserving; simply that it is squeezed by the workings of the mixed economy, exposed to unique pressures and frequently overlooked by public policy.

In truth, low earners do not form an obvious single constituency, but rather a series of sub-groups whose numbers and composition differ across policy areas, depending on the nature of the good or service, the cost and accessibility of private solutions and the volume and value of available state support. For example, the affordability of homeownership is likely to be most relevant to younger low earners, while long-term care is likely to be most relevant to older low earners.

However, there is much common ground. Analysis of the 2005 British General Election Survey found that around two-thirds of those we consider to be low earners agreed or strongly agreed with the proposition that “there is often a big gap between what people like me expect out of life and what we actually get”.¹

By looking at the wider low earner group as a whole, this note attempts to present a broad description of some of the pressures faced by those who are squeezed by the mixed economy. By contrast, the Foundation's major projects² look in more detail at the particular members of the low earner group who are affected by each policy circumstance.

At its broadest, we define the low earner group as including all those with below-median income (from all sources) who are not dependent on state support. For the purposes of analysis there are a number of different ways of capturing this group and this note uses a variety of methods, depending on the data available in the underlying sources.

- At its simplest, we consider the group to be made up of households in income deciles 3, 4 and 5: that is, with gross annual income between £11,650 and £27,150.³
- Around 7.6 million households fall into this category in the UK, equivalent to around 13.4 million adults. Box 1 provides further details of the group's composition.
- We define two other income groups in relation to low earners: households with above-median incomes (income deciles 6-10) are considered *high earners*, while those with below £11,650 income (deciles 1 and 2) are considered *benefit-dependent*.
- This definition inevitably excludes some low earners (those in income deciles 1 & 2 who are not benefit-dependent and those living in high earner households who are individual low earners) and includes some benefit-dependent individuals. However, it provides a reasonable picture of the position faced by the majority of low earners.

Low earners in the UK⁴

- 7.6 million low earner households
 - 4.6 million non-retired households; 2.9 million retired households
- 13.4 million adults in low earner households
 - 9.1 million working age; 4.4 million retired
 - 54 per cent female; 46 per cent male
 - 29 per cent of total adult population
- 4.3 million children
 - 33 per cent of total child population
- Low earner households over-represented in North West, Scotland and Eastern regions; under-represented in North East, Wales and London
- Heads of low earner households less likely to be white than heads of other income group households
- Heads of low earner households over-represented in older (>55) and younger (<34) adult age groups

¹ Analysis of 2005 British General Election Survey – low earners defined on basis of income and benefit receipt. Includes low earner households and low earner individuals.

² Projects to date include financial advice and long-term care.

³ ONS, *Family Spending: A report on the 2007 Expenditure and Food Survey*, November 2008, p27.

⁴ Analysis of ONS, *Effects of taxes and benefits on household incomes: 2006/07 – low earners defined on basis of deciles ranked by equivalised disposable household income*; and analysis of NMG Research, 2008 survey for Bank of England – low earners defined on basis of deciles ranked by gross household income.

Economic background

The UK entered technical recession in Q4 2008, following successive quarter-on-quarter GDP reductions of 0.6 per cent and 1.5 per cent.⁵ While cycles of economic growth and contraction are regular features of open market economies, the current downturn is distinctive because the global financial meltdown which pushed the world into recession is affecting the real economy's recovery prospects by continuing to undermine the ability of the banking system to lend to firms and individuals.

Forecasts of the path the economy will follow over the next 24 months are highly uncertain. There is however, broad consensus that the UK will experience a painful adjustment, with the IMF forecasting that the UK will suffer a deeper and longer recession than most other advanced economies.⁶

Financial health

Low earners live at the edge of their means, spending nearly all of their available income each week. In recent years they have reported increasing difficulties with debt and household bills.

Low earners who are reliant on income from savings, primarily pensioners, are facing lower than expected returns because of low interest rates and stock market losses.

The poor financial health of many low earners prior to the start of the economic downturn, characterised by a lack of savings and insurance products and exacerbated by a lack of access to financial advice, leaves them highly exposed to potential drops in income associated with recession.

Income and expenditure

Among low earner households in 2006/07:

- Average *original income* (e.g. earnings and investment returns) was £14,600.
- Average *gross income* (original income plus cash benefits) was £21,000.
- Average *disposable income* (gross income minus direct taxes) was £17,800.
- Average *post-tax income* (disposable income minus indirect taxes) was £13,900.
- Average *final income* (post-tax income plus benefits in kind⁷) was £20,100.

Low earner households live at the edge of their means, on average spending nearly all of their disposable income each week.

- Total expenditure among all members of the low earner group accounted for 97.5 per cent of their total disposable income in 2007; a similar proportion to that experienced by benefit-dependent households (96.5 per cent) and significantly higher than among high earners (86.1 per cent).
- Low earners spent around 27 per cent of their disposable income on essentials such as housing, fuel and food; expenditure on these items accounted for just 16 per cent of high earners' disposable income.⁸

Access to financial advice

Low earners are largely unable to access financial advice. Their advice needs are typically not met by the financial services industry, which packages up advice with product sales or offers it at commercial rates via independent financial advisers. As they are not reliant on benefits, low earners are also unlikely to be given advice through government or third sector schemes aimed at socially excluded and the most vulnerable groups in society.⁹ The Treasury and FSA's proposed Money Guidance service seeks to redress this.

Financial exposure

This combination of living at the edge of their means and absence of advice has left a high proportion of low earners in some difficulty. Chart 1 shows that 78 per cent of low earners were already in bad financial health prior to the start of the economic downturn, with 12 per cent being in an acute position.

Low earners have a higher level of financial exposure than benefit-dependent households: that is, they are more likely to hold financial products and have credit commitments but are less certain of their future income because it is primarily earnings-related. At the same time, low earners are less likely than high earners to have a safety net in place:

- Nearly one-third of low earners reported having no savings in 2006-07, while a further one-quarter had savings of less than £1,500.¹⁰
- They are also less likely than high earners to own life assurance (39 per cent compared with 58 per cent), critical illness (12 per cent compared with 25 per cent) and income protection (7 per cent compared with 17 per cent) products.¹¹

⁵ ONS Time Series IHYQ

⁶ IMF, *World Economic Outlook Update*, 28 January 2009, Table 1.1; and *Financial Times*, "IMF says Britain faces longest recession", 18 March 2009.

⁷ Services such as education and health provided by the state either free or subsidised at the point of use - households are assigned nominal income to reflect their use of these services, based on the estimated cost of provision.

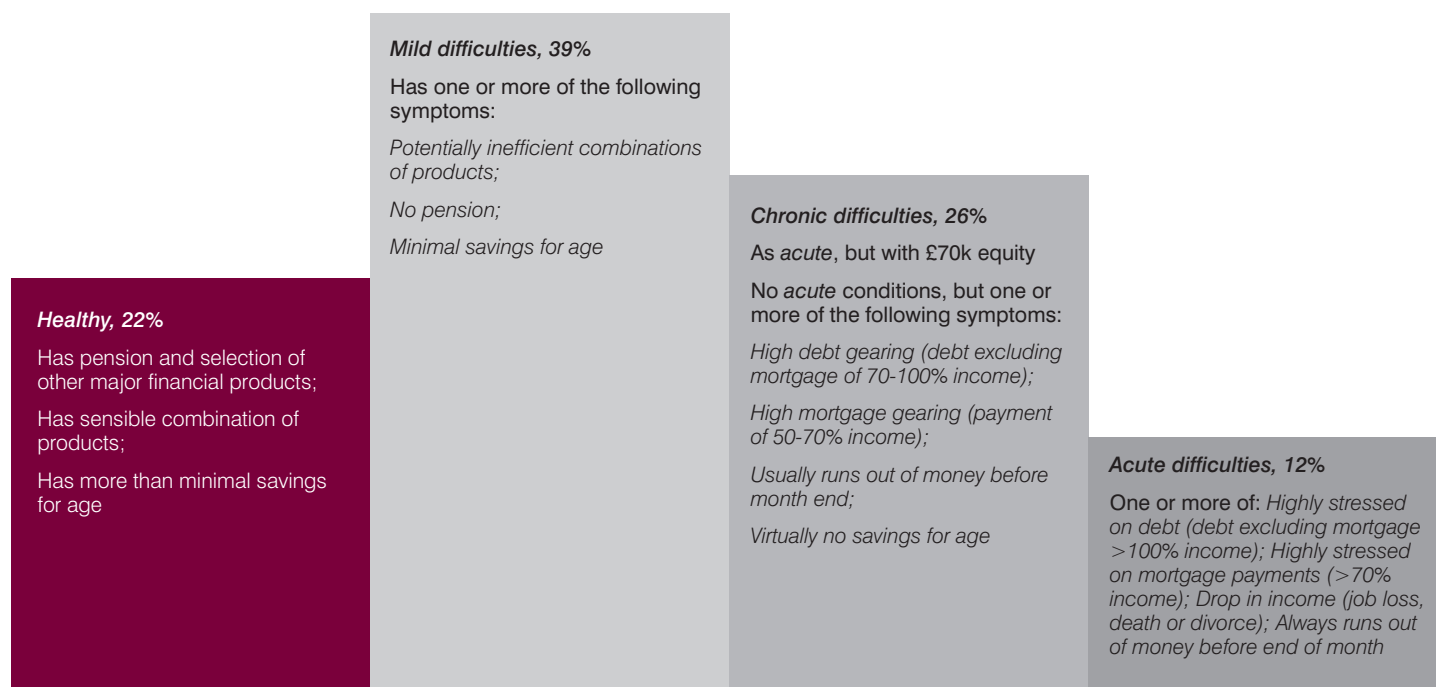
⁸ Analysis of ONS, *Family Spending: A report on the 2007 Expenditure and Food Survey*; and ONS, *The effects of taxes and benefits on household income 2006/07* - low earners defined on basis of deciles ranked by equivalised disposable income.

⁹ See Resolution Foundation, *Closing the advice gap: Providing financial advice to people on low incomes*, May 2006, p11.

¹⁰ Analysis of DWP, *Family Resources Survey*, Table 5.12 - low earners defined on basis of deciles ranked by gross household income.

¹¹ Alliance for Health & the Future, *Living in the Advice Gap: An Investigation into the Resolution Foundation's Target Group* - low earners defined on basis of income and benefit receipt. Includes both low earner households and low earner individuals.

Chart 1: Financial health of low earners: GB 2004



Note: Low earners defined on basis of income and benefit receipt. Includes both low earner households and low earner individuals.

Source: Analysis of the BHPS and FSA baseline survey

Credit and debt

At the beginning of October 2008, 63 per cent of low earner households owed money on secured or unsecured loans, with the average debt held by these households being £31,544. Low earners have reported increasing difficulties with debt during recent years:

- **Increasing financial burden:** the proportion saying that unsecured loans represent a “heavy” financial burden increased from 13 per cent in September 2005 to 20 per cent in October 2008.
- **Higher debt repayments:** 24 per cent of low earner households reported that their last debt payment was equivalent to more than 25 per cent of their monthly income in October 2008, up from 12 per cent in September 2005.¹²

Low earners recorded higher levels of repayment difficulty than high earners at the start of the current recession:

- **Struggling with payments:** 48 per cent of low earners said they struggled with household bill payments and credit commitments in October 2008, compared with 37 per cent of high earners.
- **Behind with payments:** a further 4 per cent of low earners said they were behind with these payments, compared with 2 per cent of high earners.¹³

Low earners’ increasing problems with personal debt leaves them highly vulnerable to the possibility of default during the recession. Faced with the threat of unemployment and reduced incomes, low earners with limited savings have few options for meeting their credit commitments:

- **Little scope for refinancing:** credit constraint and reduced levels of housing equity mean that low earners are largely unable to refinance their debts and are therefore primarily reliant on cutting back spending.
- **Little room for manoeuvre:** however, because essential items such as housing, fuel and food account for a sizeable proportion of weekly expenditure among low earner households, the group is restricted in its ability to reduce its outgoings.
- **Long-term damage:** low earners could choose instead to postpone some of their difficulties by reducing their spending on savings and insurance or by accessing non-mainstream credit. Alternatively, they could opt for bankruptcy, IVA or Debt Relief Order. Such courses of action could put low earners’ future financial health at risk.

¹² Analysis of NMG Research, *Survey for Bank of England*, various years – low earners defined on basis of deciles ranked by gross household income.

¹³ Analysis of NMG Research, *2008 survey for Bank of England* – low earners defined on basis of deciles ranked by gross household income.

Savings and pensions

Low interest rates and stock market losses mean that those with savings, including pensioners, are facing lower than expected returns and therefore reduced incomes. Such issues will again have the greatest impact on low earners: benefit-dependent households will retain some certainty over retirement income because they will primarily be reliant on the state pension, while high earners will have larger pots and a more diverse selection of products to draw on.

- **Lack of access:** low earners are less likely to have access to occupational pension schemes than high earners: around 60 per cent of working low earners were in jobs with superannuation schemes in 2004, compared with 83 per cent of high earners.
- **Lack of take-up:** even where occupational schemes are available, low earners are less likely to join them: just 53 per cent of those low earners whose employers offered a scheme in 2004 were members, compared with 81 per cent of high earners. Low earners are also less likely to have personal pensions: just 17 per cent reported having a private plan, compared with 27 per cent of high earners.¹⁴

The Pensions Act 2008 seeks to improve pension provision by introducing auto-enrolment.¹⁵ Given the difficulties low earners currently experience in saving for retirement, the policy is set to be of particular relevance to the group.

However, there is concern that auto-enrolment will result in some individuals retiring with an income that is smaller than the means-tested benefit that would have been available to them in the absence of a pension. Similarly, others might receive returns smaller than, or only slightly greater than, the value of their contributions adjusted for inflation.¹⁶ Variations in individual circumstances mean that no single group can be identified as being most “at risk”, however those with employment gaps and those on the cusp of means-tested benefits – low earners – are among those most likely to lose out.

Employment, skills and earnings

Low earners’ poor financial health and reliance on earned income means they are more vulnerable to the income effects of increased unemployment, reductions in hours, temporary lay-offs, short-term contract working and downward pressure on earnings than either high earner or benefit-dependent households.

Within each industry, low earners are likely to be at greater risk of job loss than high earners due to their lower skill levels and concentration in smaller firms. Where low earners become unemployed, they are less likely than high earners to receive sizeable redundancy payments and less likely to make a swift return to work, with many of their jobs going to more highly skilled applicants. Low earners who remain out of work for some time could potentially lose touch with the labour market altogether.

Economic activity

Table 1 compares the economic activity of low earners in Great Britain with all adults in the UK. It shows that, prior to the start of the recession:

- 55 per cent of low earners were economically active,¹⁷ compared with 64 per cent among the population as a whole.
- Low earners were more likely to be classified as economically inactive,¹⁸ primarily because the group includes relatively large numbers of students and retired individuals.
- 36 per cent of low earners were in paid employment, compared with 60 per cent among the population as a whole.
- 16 per cent of low earners were self-employed, compared with 8 per cent among the population as a whole.¹⁹

Table 1: Economic activity among adult 16+: 2006

	All ¹	Low earners ²
Economically active	64%	55%
- Employed	60%	36%
- Self-employed	8%	16%
- Unemployed	4%	3%
Economically inactive	36%	45%
- Full-time education	4%	10%
- Family care	5%	5%
- Long-term sick/disabled	4%	1%
- Other	2%	0%
- Retired	21%	29%

Note: ¹ UK, Oct-Dec 2006. Individuals can be both employed and self employed.

² GB, 2006. Low earners defined on basis of income and benefit receipt. Includes both low earner households and low earner individuals.

Sources: Alliance for Health & the Future, *Living in the Advice Gap: An Investigation*, ONS, *Labour market statistics: first release*, February 2009

¹⁴ Alliance for Health & the Future, *Living in the Advice Gap: An Investigation into the Resolution Foundation’s Target Group* – income groups defined on basis of income and benefit receipt. Includes both low earner households and low earner individuals.

¹⁵ Alliance for Health & the Future, *Living in the Advice Gap: An Investigation into the Resolution Foundation’s Target Group* – income groups defined on basis of income and benefit receipt. Includes both low earner households and low earner individuals.

¹⁶ See for example, PPI, *Are Personal Accounts suitable for all?* November 2006.

¹⁷ Employed or available for employment.

¹⁸ Not available for employment.

¹⁹ Individuals can be counted as both employed and self-employed in the population-as-a-whole figures, but are recorded as either/or in the low earner figures.

Low earner industries

Table 2 shows the approximate number and proportion of employee jobs within each industry in 2008 which attracted gross annual salaries of below the low earner upper earnings threshold of £20,350.²⁰ Individuals earning below this threshold may actually form part of the high earners group when their aggregate household income is calculated.

However, the relatively low levels of pay in certain industries highlights jobs in which low earners are likely to be over-represented.

For each industry, the table also details year-on-year change in company insolvency figures:

- The worst affected industries at the end of 2008 were largely those with higher proportions of high earners, such as financial intermediation (i.e. banking).

- However, sizeable increases in insolvencies were recorded in several of the industries with potentially large numbers of low earners. For example, there was a 39 per cent year-on-year increase in wholesale and retail company insolvencies and an 82 per cent increase in real estate company insolvencies, an industry that could employ up to 1.25 million low earners.

It is likely that the numbers of insolvencies in several of the service industries where low earners appear to predominate will increase during 2009. Credit constraint, households' desire to reduce their debt-income ratios and postponement of spending in the expectation of falling prices are all likely to ensure that UK consumer spending remains depressed for some time.

Table 2: Number and proportion of employee jobs¹ attracting below low earner threshold salary and year on year change in company insolvencies by industry: 2008

	Number of employees with salaries below £20,350 UK 2008 (000s)		Proportion of employees with salaries below £20,350 UK 2008 (000s)		Annual change in company insolvencies Eng & Wales Q3/Q4 2008
Wholesale & retail; repair of motor vehicles and personal & household goods	2,001	– 2,155	60%	– 70%	+39%
Education	1,949	– 2,126	50%	– 60%	:
Health & social work	1,382	– 1,508	50%	– 60%	+33%
Manufacturing	910	– 1,040	30%	– 40%	+39%
Real estate, renting & business activities	999	– 1,249	40%	– 50%	+82%
Hotels & restaurants	532	– 563	80%	– 90%	+28%
Transport, storage & communication	354	– 369	30%	– 30%	+47%
Other community, social & personal services activities	430	– 469	50%	– 60%	+31%
Public administration & defence	406	– 464	30%	– 40%	+83%
Financial administration	323	– 369	30%	– 40%	+104%
Construction	308	– 352	30%	– 40%	+56%
Agriculture, hunting & forestry	72	– 78	60%	– 70%	+17%
Electricity, gas & water supply	31	– 34	20%	– 25%	+30%
Mining & quarrying	6	– 9	10%	– 20%	+167%

Note: ¹Employees on adult rates who have been in the same job for more than a year.

Source: ONS, *2008 Annual Survey of Hours and Earnings*, Table 4.7a
Insolvency Service, *Insolvencies in the fourth quarter 2008*, Tables 1a & 1b

Exposure to reduced employment income

Within each industry, including those that are relatively high paying, employment effects such as reduced working hours, short term contracts and redundancy are likely to be felt disproportionately by low earners for a number of reasons:

- **Lower skill levels:** one-half of low earners have no qualifications beyond GCSE/O level and they are less likely than high earners to have received in-work training.²¹ As such, employers are likely to view low earners as more dispensable than higher skilled members of staff who they have invested in and who cost more to recruit.

²⁰ Threshold based on fact that, on average, wages and salaries account for around three-quarters of gross household incomes among non-retired low earners.

²¹ Analysis of NMG Research, *2008 survey for Bank of England*, Sep/Oct 2008; and Learning & Skills Council, *National Employer Skills Survey 2007* – low earners defined on basis of deciles ranked by gross household income.

²² Alliance for Health & the Future, *Living in the Advice Gap: An Investigation into the Resolution Foundation's Target Group*; Insolvency Service, *Insolvencies in the fourth quarter 2008*, Tables 1a & 1b.

- **Concentration in SMEs:** low earners are more likely than high earners to work for small- and medium-sized enterprises (SMEs): such ventures are less likely than larger organisations to be able to retain staff during a loss-making period and more likely to find the pressures associated with the credit crunch and recession to be terminal.²²
- **Concentration in self-employment:** low earners are much more likely than high earners to be self-employed: such individuals have no contract of employment and are therefore easier for firms to 'dismiss' in reaction to reduced activity within a sector. This is likely to be particularly true for the 22 per cent of self-employed individuals who work in the ailing construction industry.²³

Low earners are also more restricted than high earners in their ability to seek out alternative employment:

- **Time constraints:** low earners often work long and unsocial hours, particularly if they are self-employed.
- **In-work costs:** low earners are less well placed to absorb travelling, relocation and specialist clothing and equipment costs associated with some jobs.
- **Job search costs:** some low earners are unable to take time off work for interviews and application processes without suffering a fall in income.²⁴

Where unemployment occurs, low earners are less likely than high earners to receive sizeable redundancy payments to help soften their fall in income and less likely to be able to make a swift return to employment. Their opportunities are likely to be squeezed by unemployed skilled workers taking jobs at lower salaries as a way of returning to the labour market. The Social Market Foundation (SMF) has shown that the recession is already producing a polarisation between the fast-moving majority of unemployed people who are out of work for a few weeks and a numerically large minority who become long-term unemployed and therefore are in danger of losing touch with the labour market altogether.²⁵

In order to combat this effect, Government policies should focus on keeping people in work where possible and on ensuring those who are made unemployed retain contact with the labour market through the provision of training and re-skilling programmes.

Housing

House price increases during the last decade that have outpaced earnings growth resulted in some low earners being unable to join the housing market and others joining only by significantly stretching themselves.

Rapid price falls in recent months have pushed those with high loan-to-value mortgages into negative equity, with low earners being disproportionately affected. This trend is set to continue as house prices fall further. This will limit low earners'

ability to move and therefore their opportunity to relocate for work. It will also restrict their ability to fund consumption and restructure their other loans.

Low earner homeowners also face greater difficulty than high earners in meeting their mortgage payments, putting them at greater risk of having their homes taken into possession. Low earners falling off the housing ladder during this recession will find it difficult to return.

The magnitude of the housing boom in recent years means that reduced house prices remain out of reach for many low earners. Low earners also face restricted access to social housing because of stock reductions.

Tenure

Table 3 details housing tenure by income group in 2006-07. It shows that:

- Low earners are slightly more likely than benefit-dependent households to own their own home, but much more likely to still be repaying their mortgage. This reflects the fact that homeowners in the benefit-dependent group are likely to consist primarily of older households that entered the housing market prior to rapid house price inflation.
- Low earners are less likely than benefit-dependent households to be renting from the social sector.
- Low earners are more likely than either benefit-dependent households or high earners to be renting privately.

Table 3: Housing tenure by income group: UK 2006-07

	Benefit - dependent	Low earners	High earners	All households
Owners	50%	58%	84%	69%
- Owned outright	43%	37%	25%	33%
- Buying with a mortgage	8%	21%	58%	36%
Social rented sector tenants	39%	30%	7%	21%
- Rented from council	24%	17%	4%	12%
- Rented from housing association	15%	13%	3%	8%
Rented privately	11%	12%	9%	11%
- Rented privately, unfurnished	8%	9%	7%	8%
- Rented privately, furnished	3%	3%	2%	3%
All households	100%	100%	100%	100%

Note: Income groups defined on basis of deciles ranked by gross household income

Sources: Analysis of DWP, *Family Resources Survey 2006-07*, Table 3.11

²³ ONS, "Self-employment in the UK labour market", *Labour market trends*, September 2003.

²⁴ NCC, *more snakes than ladders? an insight into the lives of the forgotten working poor*, July 2008.

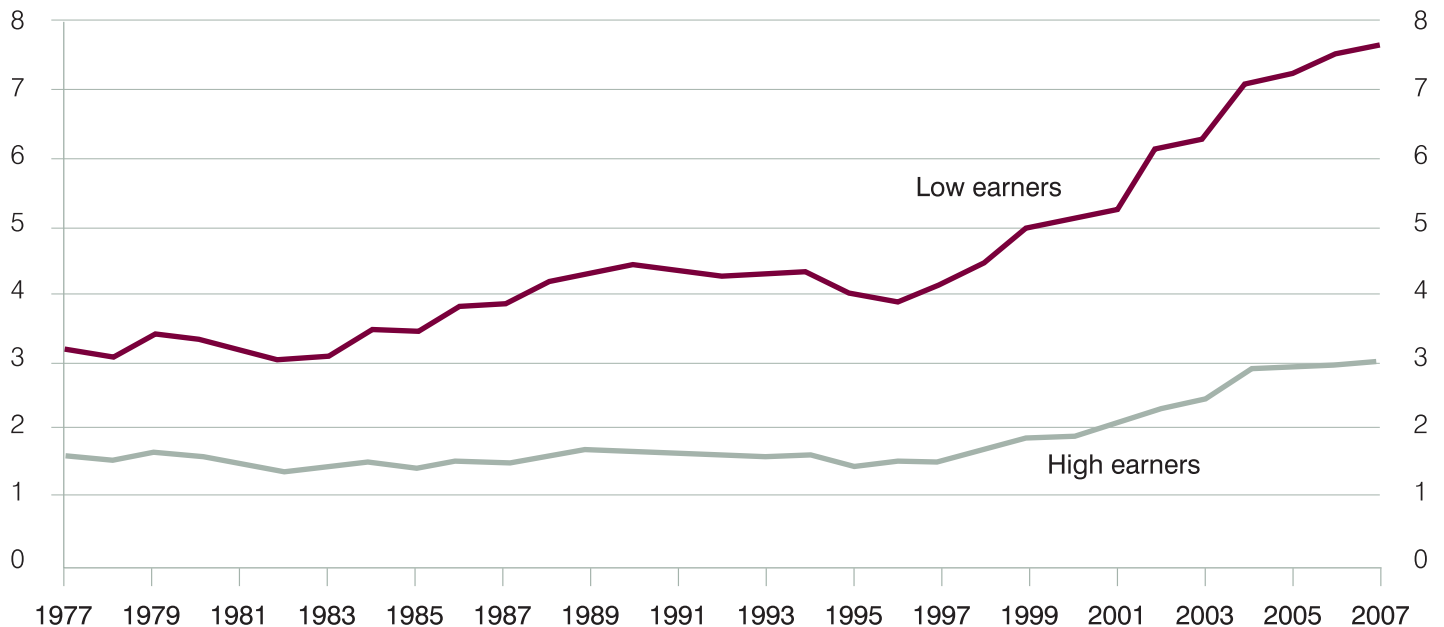
²⁵ SMF, Newsletter, Jan/Feb 2009.

Lack of access to homeownership

Chart 2 shows that decreased affordability of houses during the property boom has affected those at the margins – low earners – most. That is, while average first time buyer house prices have outpaced average incomes, they have done so at a faster rate relative to low earner incomes than relative to high earner incomes:

- Average first time buyer house purchase prices increased as a multiple of average low earner gross incomes in the period from 1977 to 2007, from 3.2 to 7.6.²⁶
- The proportion of low earner households with an outstanding mortgage decreased from 26 per cent in 2002-03 to 21 per cent in 2006-07, reflecting the fact that younger low earners have become less likely to join the housing market.²⁷

Chart 2: Ratios of average first time buyer house prices to average gross incomes: UK 1977-2007



Note: Income groups defined on basis of deciles ranked by equivalised disposable household income.

Source: Analysis of ONS, *The effects of taxes and benefits on household income, historic data*, Table 14; DCLG, *Live Table 505*

In addition to having reduced access to homeownership because of their lower incomes, low earners have more difficulty than high earners in getting a mortgage: partly because they are more likely to be self-employed; partly because they are less able to save for a deposit; and partly because their parents are less likely to be in a position to provide financial help, which up to half of first time buyers aged under 30 are estimated to obtain.²⁸

This situation has been made more difficult in recent months as banks have withdrawn higher loan-to-value (LTV) products. Despite significant reductions in house prices, property remains out of reach for many non-home-owning low earners.

Low earners have also benefitted less from the introduction of low cost home ownership (LCHO) schemes than high earners: the median income of those entering into LCHO arrangements has been above the national median and therefore above the low earner threshold.²⁹

Sustainability of homeownership

Low earners who have entered the housing market in recent years are more likely than high earners to be facing

sustainability problems. In order to get on the housing ladder they were likely to have stretched themselves considerably and taken out high LTV mortgages.

Low earners with mortgages are therefore in a vulnerable position following the bursting of the housing market bubble and the rapid fall in prices. Table 4 shows that, at October 2008:

- 3.6 per cent of low earner mortgage holders reported being in negative equity, compared with 2.6 per cent of benefit-dependent mortgagors and 2.4 per cent of high earners.
- A higher proportion of low earners than either of the other two income groups also reported outstanding loans in excess of 75 per cent of their property value, meaning that continued house price falls are likely to again hit low earners hardest.

²⁶ Analysis of ONS, *The effects of taxes and benefits on household income, historic data*, Table 14; and DCLG, *Live Table 505* – low earners defined on basis of deciles ranked by equivalised disposable household income.

²⁷ Analysis of DWP, *Family Resources Survey*, 2002-03 & 2006-07 – low earners defined on basis of deciles ranked by gross household income.

²⁸ CML, *news and views*, Issue no.21, 4 November 2008.

²⁹ Analysis of DCLG, *Who are the Low Cost Home Ownership (LCHO) purchasers and what is the demand for LCHO?* – low earners defined on basis of deciles ranked by gross household income.

Table 4: Distribution of loan-to-value among those with mortgages by income group: GB Sep/Oct 2008

	Benefit - dependent	Low earners	High earners	All households
0% - 25%	47.4%	30.6%	29.3%	31.0%
25% - 50%	26.3%	32.4%	32.9%	32.3%
50% - 75%	13.2%	19.8%	23.6%	21.9%
75% - 100%	10.5%	13.5%	11.8%	12.1%
> 100% (negative equity)	2.6%	3.6%	2.4%	2.7%

Note: Income groups defined on basis of deciles ranked by gross household income

Sources: Analysis of Bank of England, 2008 NMG Research Survey, Sep/Oct 2008

More generally, low earner homeowners are likely to experience greater difficulties than high earners in maintaining mortgage payments in the face of reduced income, putting them at increased risk of losing their homes:

- Average weekly mortgage payments among low earners with mortgages were equivalent to between 27 per cent and 40 per cent of average low earner disposable household income in 2007.
- This compares with average mortgage payments among high earning mortgage holders equivalent to between 19 per cent and 28 per cent of average high earner disposable household income.³⁰

Lack of access to social housing

While often too poor to access homeownership, low earners have also faced increased difficulty in accessing social housing, due to falls in the stock over the past 20 years.³¹ Priority is given to the most vulnerable and those with the lowest incomes, meaning that many low earners are squeezed out.

Falling between homeownership and social housing, a number of low earners have little option but to rent privately. Although for some, particularly younger low earners, this is likely to be a temporary – and perhaps welcome – situation, for others it is likely to represent an undesirable outcome:

- **Lack of rights:** private renters tend to have fewer rights than homeowners and social renters, with privately rented homes much more likely than other tenures to be considered “non-decent”.
- **Lack of security:** low earners who are tenants of buy-to-let properties face the prospect of being made homeless if their landlord is unable to maintain his mortgage payments in the face of the collapse of the housing market.

- **Higher costs:** rents in the private sector have also risen at a faster rate than in the social sector.³²

Cost of living

Price increases in basic goods such as food and fuel in 2008 resulted in households with lower incomes – including low earners – experiencing higher cost of living pressures than high earners.

Low earners have little spare capacity to meet increasing costs and are therefore more likely than high earners to be forced to cut back their consumption. To the extent that low earners have dipped into their savings or extended credit use to finance rising bills, they have left themselves more exposed to the consequences of falling income during the recession.

Although food and fuel prices have fallen from their peak more recently, global demand means that fuel prices are likely to remain permanently higher than in the last decade. Those on low incomes – including low earners – are therefore likely to continue to face higher cost of living increases than high earners in the next few years. This could create particular problems at a time when rising unemployment and a low and potentially negative official inflation rate restrict growth in average earnings, diminish the value of savings and increase the burden of debt.

Food and fuel cost pressures

The prices of essential products such as food and fuel increased rapidly during 2008:

- Domestic gas prices rose by 50 per cent in real terms in the year to December 2008.
- Domestic electricity prices rose by 30 per cent over the same period.³³
- Real terms annual increases in food prices peaked at 7.9 per cent in August 2008 and stood at 7.1 per cent in December.³⁴

As discussed above, these products account for a higher proportion of weekly spending among low earners than among high earners. Faced with increased costs and little spare capacity, low earners were presented with a choice of reducing consumption on these basic goods, substituting discretionary expenditure or funding expenditure from their savings or via an extension of credit use

³⁰ Analysis of ONS, *Family Spending: A report on the 2007 Expenditure and Food Survey*; and ONS, *The effects of taxes and benefits on household income, 2006/07* – low earners defined on basis of deciles ranked by equivalised disposable household income.

³¹ DCLG, *Live Tables 102 & 600*.

³² DCLG, *English House Condition Survey 2007: Headline Report*, Table 1; DCLG, *Live Tables 701, 703 & 731*.

³³ BERR, *Quarterly Energy Prices*, Table 2.1.3; ONS Time Series CHAW.

³⁴ ONS Time Series D7BT & D7BU.

Despite facing increased fuel cost pressures in 2008, low earners remained largely unable to access the social tariffs and state assistance available to some benefit-dependent households:

- **Lack of access to fuel efficiency grants:** grants such as Warm Front and Warm Deal, which are designed to help households make their homes more energy efficient, are primarily available to benefit recipients rather than low earners. A recent National Audit Office (NAO) review of Warm Front concluded that 57 per cent of vulnerable households in fuel poverty do not claim the relevant benefits to qualify for the Scheme, while nearly 75 per cent of households who would qualify are not necessarily in fuel poverty.³⁵
- **Inefficient housing stock:** low earners' greater reliance on privately rented accommodation means that they are more likely to live in energy inefficient homes than benefit-dependent and high earner households.³⁶

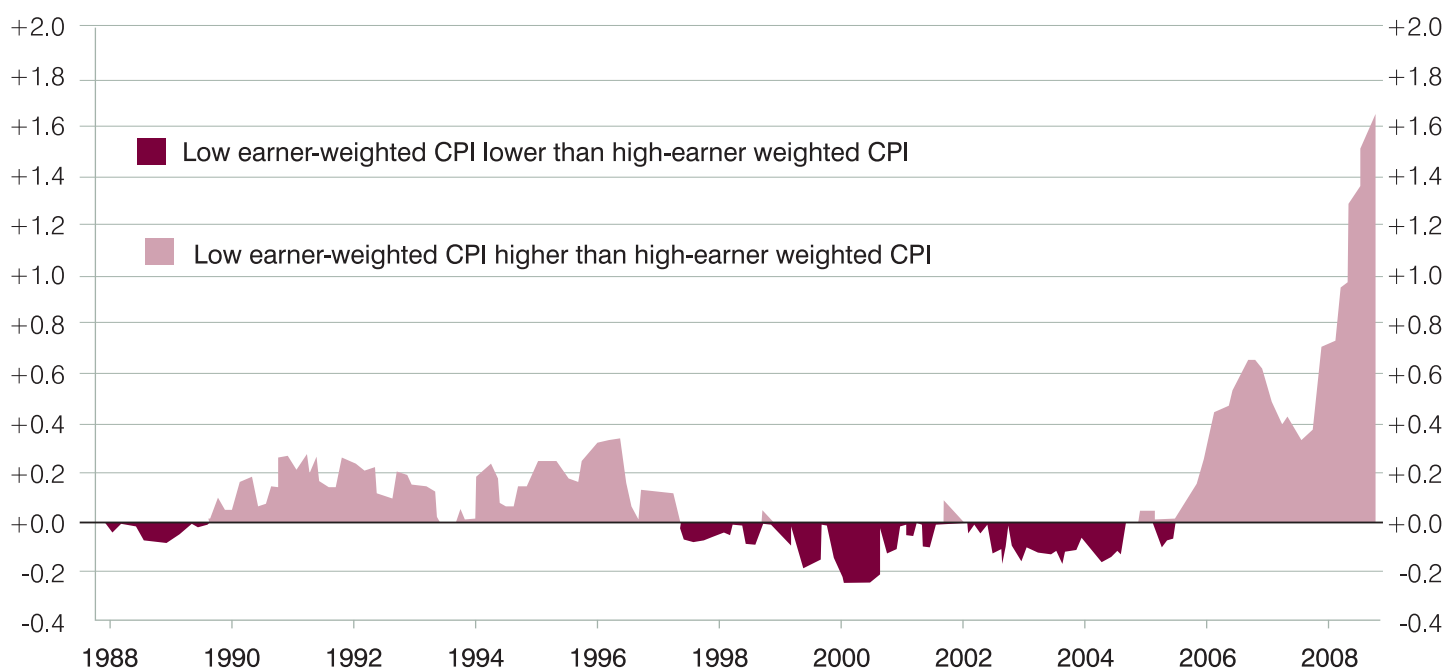
Income-weighted inflation

While the Consumer Prices Index (CPI) increased during 2008 because of the rising costs of food and fuel, the effects

were partially offset by reductions in other goods such as clothing, electronics and household furnishings. Chart 3 presents a re-weighting of the CPI to take account of the proportion of expenditure spent on different products across income groups:

- In the period from 1988, low earner and high earner groups experienced broadly similar levels of inflation, with low earners facing slightly higher prices between 1990 and 1998 and high earners facing slightly higher prices between 1998 and 2006.
- However, low earners have subsequently faced significantly higher levels of inflation, particularly in the latter half of 2008.
- Such wide disparity in the levels of inflation faced by different income groups calls into question the ongoing appropriateness of the public policy focus on the official CPI.

Chart 3: Difference between low earner-weighted and high earner-weighted price indices: UK Jan 1998 - Feb 2009



Notes: Low and high earner CPI weights based on proportion of total expenditure spent on CPI components in 2007. Income groups based on deciles ranked by gross household income.

Sources: Analysis of ONS Time Series; ONS, *Family Spending: A report on the 2007 Expenditure and Food Survey*, 26 November 2008, Table A8; and ONS, *The effects of taxes and benefits on household income, 2006/07*, Table 14

³⁵ NAO, *The Warm Front Scheme*, 4 February 2009.

³⁶ DCLG, *English House Condition Survey 2007: Headline Report*, Table 9.

Future cost of living pressures

While food prices have recently fallen from their peak, the price of oil remains above its long-run trend. It is expected to remain relatively high due to increased demand associated with the industrialisation of emerging economies such as China and due to reduced supply as finite resources are exhausted.³⁷

The public policy response to permanently higher unit costs of fuel is to promote improvements in energy efficiency. However, low earners have less capacity to self-fund home improvements than high earners but are largely disqualified from accessing state assistance. They are therefore likely to continue to face higher-than-reported inflation and face more acute cost of living pressures than high earners.

NHS and care

Low earners are squeezed by aspects of the NHS charging system: they are less able than high earners to pay for private treatment but less likely than benefit-dependent individuals to get assistance with NHS costs.

Older low earners also often find themselves in a difficult position when faced with the means testing criteria of the current long-term care system. The market for social care needs reform before future levels of state funding can be determined. However, it is clear that a new funding settlement is required in the medium- to long-term and that a number of immediate reforms can be taken forward to help people access sources of private finance.

NHS charges

The NHS charges for a number of services in England, including prescriptions and dental treatment. Exemptions based on age, income and condition mean that around half of the population are exempt from prescription charges and around one-quarter are exempt from dental charges.

Many low earners do not qualify for assistance, while people on high incomes who meet age and condition criteria do. The House of Commons Health Select Committee stated in 2006 that: "Those most affected by charges are working adults on incomes just above the level of Income Support".³⁸

According to figures from Citizens Advice, 0.8 million people in England and Scotland failed to collect a prescription in 2007 because of the cost involved.³⁹ Citizens Advice also found that around 7.4 million people did not visit an NHS dentist in the 19 months from April 2006 due to difficulties finding one. Of these, around 4.7 million attended a private dentist instead and 2.7 million received no treatment.⁴⁰

The British Medical Association (BMA) has called for a "major review and overhaul" of the current prescription charges and exemption categories system, which it has

described as "outdated, iniquitous and detrimental to the health of many patients".⁴¹

Long-term care

Older people in England assessed by their local authority as needing a care home placement are means-tested to determine who pays. The means test consists of a capital element and an income element. Individuals with qualifying capital above the upper threshold of £22,250 receive no financial support. Those with less than £13,500 capital are assessed on the basis of their income only. Those with capital valued between the two thresholds are assessed on the basis of their income and their "tariff (capital-related) income".

Older low earners are frequently income-poor and asset-rich: too rich to be eligible for state subsidised care:

- In 2002, 72 per cent of low earners aged over 60 had wealth greater than the higher capital threshold.⁴²

The assets low earners own tend to be illiquid: they hold disproportionately more of their wealth in housing assets than other income groups.⁴³ These low-income, low-liquid wealth homeowners are therefore faced with a limited number of choices:

- sell their home and downsize, using the remaining capital to purchase domiciliary care;
- sell their home and move into residential care (perhaps prematurely);
- resort to (rather than choose) informal care; or
- go without care.

A new long-term funding settlement is required to more efficiently and more fairly meet the growing demand for long-term care. In the short- to medium-term, the supply of financial products such as equity release, designed to assist individuals with meeting the cost of their care, needs to be improved. This improvement can best be achieved via a mixed market of state-sponsored and private funding mechanisms that co-exist and complement each other.⁴⁴

Public expenditure

Large increases in public expenditure in the period since 1997 have benefitted those on lower incomes, including low earners. In tandem with the introduction of tax credits and the national minimum wage, this spending has helped to reverse the trend of previous decades in which low earners have become poorer relative to high earners and benefit-dependent households.

³⁷ IMF, *World Economic Outlook Update*, 28 January 2009, Figure 4.

³⁸ Health Select Committee, *NHS Charges*, 18 July 2006.

³⁹ Citizens Advice press release, "Prescription costs are barrier to health says Citizens Advice", 27 February 2008.

⁴⁰ Citizens Advice press release, "Millions have difficulties accessing an NHS Dentist", 16 January 2008.

⁴¹ BMA, *Department of Health Review: Prescription charges for those with long-term conditions: British Medical Association response*, 5 March 2009.

⁴² Deloitte analysis of *Wealth and Portfolio Choice 2002*. Low earners defined on basis of annual individual income and benefit receipts.

⁴³ Deloitte analysis of *Wealth and Portfolio Choice 2002*. Low earners defined on basis of annual individual income and benefit receipts.

⁴⁴ See for example, Resolution Foundation, *Facilitating increases in long-term care funding – a discussion paper*, December 2008

In response to the recession, the Government has launched a fiscal stimulus worth £20 billion in the period to 2010-11. Because they are the group most at risk of losing out in the recession, low earners are likely to be among the main beneficiaries of this spending.

However, cuts in public spending expected from 2010-11 are likely to affect those on the margins of state assistance most, meaning that low earners could once again be squeezed disproportionately. In returning the UK to fiscal balance, the next government will need to recognise the pressures faced by low earners to ensure that they do not bear the brunt of the adjustment.

Tax-benefit balance

Measured in terms of final income, low earner households have become poorer relative to both high earner and benefit-dependent households over the last 30 years, although extension of cash benefits, development of tax credits and real-terms increases in public spending have helped reverse this trend more recently:

- In 1977, average low earner final income was equivalent to 63 per cent of high earner final income and 154 per cent of benefit-dependent final income.
- In 1997, average low earner final income had fallen to 49 per cent of high earner income and 138 per cent of benefit-dependent income.⁴⁵
- By 2006/07, the two proportions had increased slightly to 53 per cent and 140 per cent, still lower than in 1977.

The tax-benefits balance of non-retired low earners has changed over the same period. They have moved from a position of net contribution to the state to one of net benefit:

- Prior to 1992, non-retired low earner households consistently paid more in direct and indirect taxes than they received in cash and in-kind benefits.
- As unemployment increased in the period 1990-1994, low earners' direct tax payments fell and the value of cash benefits received by the group increased. This pushed non-retired low earner households into a position of net benefit.
- As low earners subsequently moved back into employment they returned to a net contributory position.
- Low earners' balance has again improved in the period since 1998/99, primarily because of a significant increase in the average value of benefits in kind received.
- In 1998/99, non-retired low earner households paid an average of £1,220 more in tax than they received in benefits; this means, for every £1 they paid in tax they received £0.87 in benefits.

- In 2006/07, non-retired low earner households received an average of £580 more in benefits than they paid in tax; this means, for every £1 they paid in tax, they received £1.06 in benefits.

Through the adjustment

The current recession and the Government's fiscal stimulus should have the effect of improving low earners' positive balance still further in the next year or two, particularly as low earners are most at risk of the effects of the downturn and therefore most likely to draw on additional state support. However, the fiscal contraction due for 2010-11 onwards is likely to produce a sharp reversal in the growth of benefits in kind receipts.

The IMF estimates that government debt in the UK will grow from 44 per cent of GDP in 2007 to 69 per cent of GDP in 2010. Attempts to reduce this debt are likely to lead to a very painful adjustment period:

- The IFS has pointed out that, while the burden of the Government's proposed tax increases will fall primarily on the richest members of society, public spending cuts will form a much larger part of the fiscal response: the Government will raise around £4 billion net from tax increases in 2012-13, compared to almost £19 billion from spending cuts.
- These spending cuts will hit poorer members of society hardest, particularly those at the margin of state support – low earners.
- As a result, unless public policy is designed to protect low earners from the worst effects of falling expenditure, non-retired low earner households will return to a significantly net contributory tax-benefit position in the period from 2010-11.

The full report of *Squeezed* is available to download at www.resolutionfoundation.org. For hard copies and further information please contact info@resolutionfoundation.org

⁴⁵ Analysis of ONS, *The effects of taxes and benefits on household incomes, 2006/07* – income groups defined on basis of deciles ranked by equivalised disposable income.

⁴⁶ IMF, *The State of Public Finances: Outlook and Medium-Term Policies After the 2008 Crisis*, 6 March 2009

⁴⁷ Robert Chote, *Opening remarks at IFS post-PBR briefing*, 25 November 2008