Resolution Foundation

*www.resolutionfoundation.org*

November 2010

# *Squeezed Britain*

## The 2010 Audit of Low-to-Middle Earners

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## The 2010 Audit of Low-to-Middle Earners

## 1. Summary



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## *The Resolution Foundation*

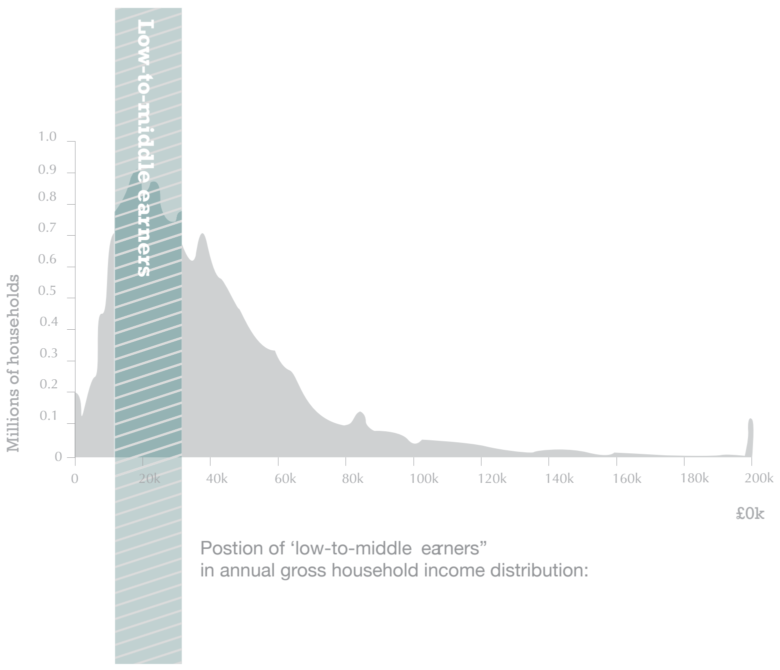
The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low-to-modest incomes – who we refer to as low-to-middle earners (LMEs) – by delivering change in areas where they are currently disadvantaged. We do this by:

+ undertaking research and economic analysis to understand the challenges facing LMEs;
+ developing practical and effective policy proposals; and
+ engaging with policy makers and stakeholders to influence decision-making and bring about change.


## *Acknowledgements*

We are grateful to members of the *2010 Audit* steering group – Tony Dolphin, Axel Heitmueller, Donald Hirsch, Peter Robinson and Steve Wilcox – for providing feedback on an earlier draft of this report. Thanks are also due to members of the DWP's *Households Below Average Income* team, for their comments on our definitional approach. Any remaining errors are our own.

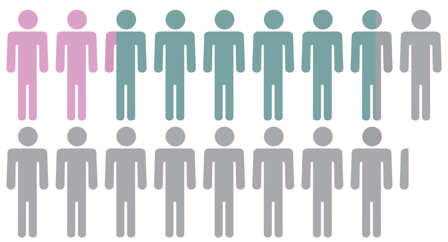
# Squeezed Britian




Number of Households

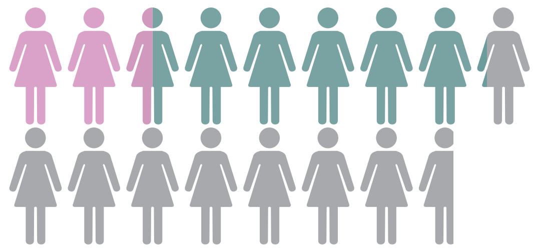
Benefit-reliant *3.3m*
Low-to-middle earners *6.0m*
Higher earners *9.4m*

Number of Men



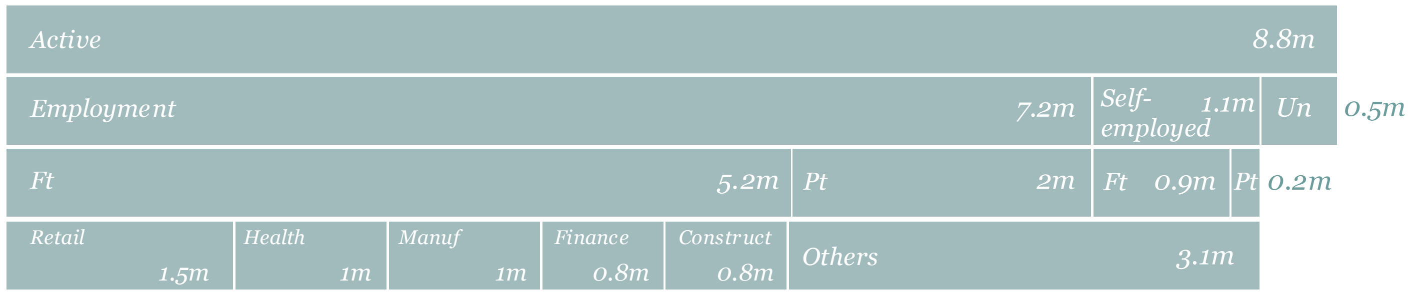
Benefit-reliant *2.2m*
Low-to-middle earners *5.4m*
Higher earners *9.6m*

Number of Women

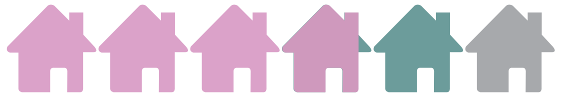


Benefit-reliant *2.5m*
Low-to-middle earners *5.6m*
Higher earners *8.7m*

Low-to-middle earner economic activity

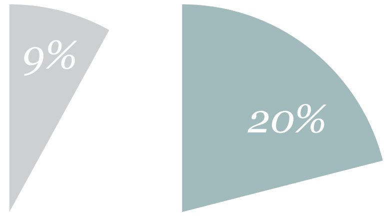



Housing Tenure - Owners, Private and Social Renters

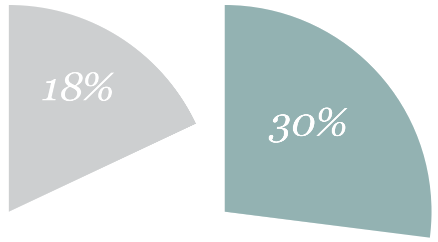


3.9 m LME home owning households
1.1 m LME rented privately
1.0 m LME social rented sector tenants

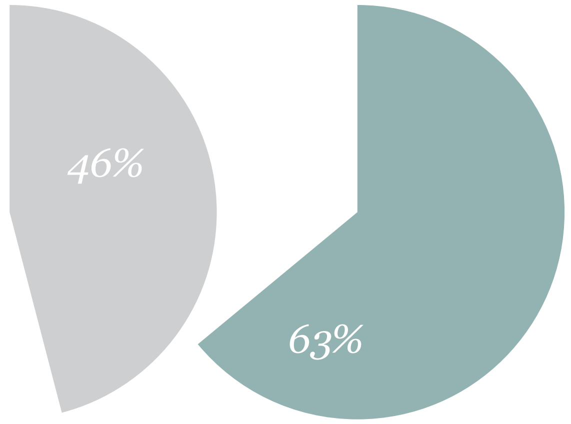
Proportion of homeowners finding it difficult to meet mortgage payments



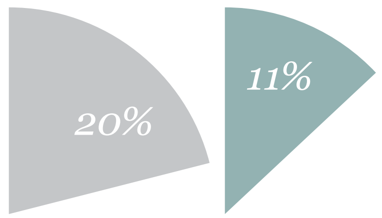

Proportion of homeowners buying/bought with 100% mortgage



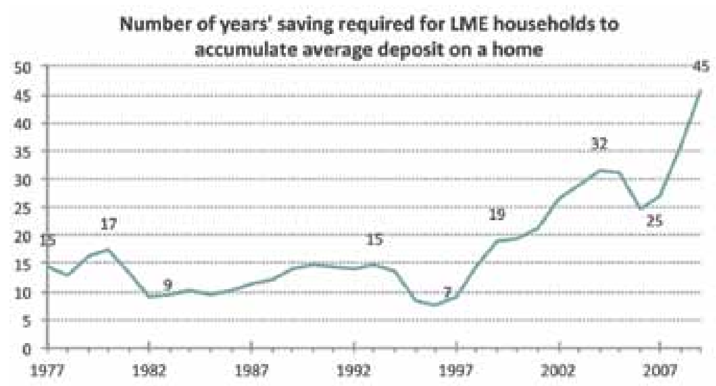

Proportion holding a fixed rate mortgage




Proportion of homeowners buying/bought with gift or loan from family or friend




Proportion of mortgagors whose payments fell during year

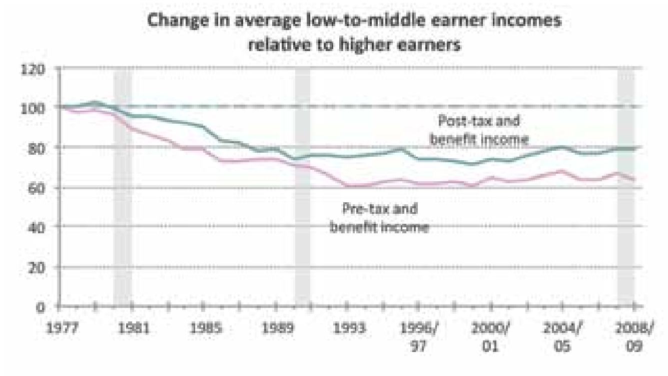




Key
Low-to-middle earners
Higher earners

Savings adequacy:
Proportions with less than one month's income in savings

52%

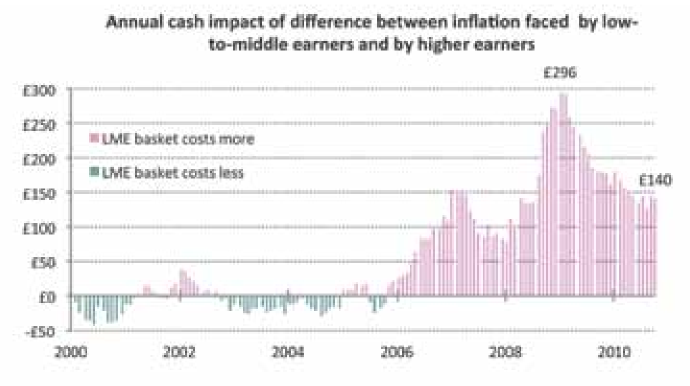
39%




Saving desire:
Proportions who would like to save at least £10 a month but can't afford it

43%

16%




Debt burden:
Proportions describing unsecured debt repayments as a heavy burden

16%

8%

Expenditure:
Average spend as proportion of average house hold income

85%

64%

Expenditure:
Average spend on selected commodites as proportion of average income

10% 12% 13% 4%

4% 7% 12% 3%

Key
Low-to-middle earners
Higher earners

Debt and bills:
Proportions of households who struggle to some extent to meet repayments and bills

29%

52%

Pension ownership among working-age adults:
Proportions with no private/occupational pension

41%

66%

Use of extra money available to mortgagors as result of fall in mortage rates:

Paying off debt

34%

28%

Paying into saving/investments

4%

25%

Levels of deprivation:
Proportion who would like, but can't afford

Hoildays away from home

14%

40%

Replace/repair broken electrical goods

6%

23%

Replace worn out furniture

10%

32%

Hobby or leisure activity

4%

15%

Key
Low-to-middle earners
Higher earners

***Too poor to access private markets; too rich to qualify for state support…***

# 1. Summary

## 1.1 Why low-to-middle earners?

The UK's mixed economy 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, falling in the gap between private and public provision.

Members of this group of largely independent working households with low-to-middle incomes – what we call *LMEs* – are not the most vulnerable in society, nor does the Foundation argue that they are the most deserving; simply that they face a range of often unique pressures and that all too often they have received little attention. Too rich to rely heavily on all the support mechanisms of the welfare state, many have found themselves too poor to flourish in the market economy.

These pressures, set against the backdrop of recession, sluggish recovery and fiscal tightening, mean that living standards in the group are under particular strain in the current context.

## 1.2 A snapshot of LMEs in 2008-09

In March 2009, we published the first ever audit of LMEs.[1] The report presented a statistical review of the experiences of people on low-to-middle incomes in 2007-08, and concluded that members of the group were:

+ *Squeezed*: often too poor to benefit from the full range of opportunities provided by private markets but too rich to qualify for substantial state support;
+ *Exposed*: living at the edge of their means and therefore vulnerable to changes in circumstances; and
+ *Overlooked*: despite being the focus of some specific attention – such as the development of tax credits – the failure to recognise the impact of policy changes such as the 10p tax withdrawal on LMEs all too often undermined their position.

This annual update considers the position of LMEs in 2008-09 – the latest year for which the large-scale survey data we use is available – thereby capturing how the position of the group was altered by the start of the recession. It also looks forward to the major challenges the group face in the year ahead.

For the purposes of analysis we define the LME group by focusing on those members of the working-age population in income deciles 2-5[2] who receive less than one-fifth of their gross household income from means-tested benefits.

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1. *Squeezed: the low earners audit*, March 2009
2. We 'equivalise' household income prior to establishing the decile distribution, in order to account for the different living standards associated with varying household compositions. As such, couples with no children fall into deciles 2-5 if their gross household income (from all sources) is between £12,000-£30,000 a year, while couples with two children qualify if their income is in the range £17,000-£42,500 and those living alone need an income between £8,000 and £20,000. Further details of this process, and why we define the group in this way, are contained in Chapter 8.

***6 million LME households; 11.1 million adults...***

We identify two other income groups in relation to LMEs. Those households either in decile one or with more than one-fifth of their gross income sourced from means-tested benefits are considered *benefit-reliant*. Those households with above median gross income are termed *higher earners*.

Based on these definitions, there were six million LME households in the UK in 2008-09 and around 11.1 million LME adults, representing one-third of the working-age population.

Our analysis suggests that, as the country entered recession in 2008-09, the living standards of LMEs remained squeezed. The exposure evident prior to the economic downturn was brought even more sharply into focus by the weakening of the labour market, the restriction of access to credit, food and fuel price increases and uncertainties in the housing market.

***Highly exposed to recession and economic uncertainty...***

In relation to those already largely reliant on state support, those on low-to-middle incomes were more likely to have jobs to lose and mortgage payments to maintain; while in relation to those with above average incomes, LMEs were more likely to face unemployment and *under*employment, less likely to return to work quickly and much less likely to have access to safety nets in the form of savings, insurance and redundancy payments.

## 1.3 LMEs and work

*Economic activity*

***8.3 million in work...***

Four-fifths of LME adults were economically active in 2008-09, including 8.3 million in work:

+ 47 per cent were in full-time employment;
+ 8 per cent were in full-time self-employment;
+ 19 per cent were in part-time employment; and
+ 2 per cent were in part-time self-employment.

There were half a million unemployed, and 2.3 million economically inactive, adults who qualified on the basis of the incomes within the households they lived in. More than two-thirds (70 per cent) of the economically inactive LMEs were women, 42 per cent of whom were looking after family or the home.

*Industrial sectors*

***Primarily in retail, health, manufacturing, finance and construction...***

LME jobs are evident across different industrial sectors. In 2008-09, 5.1 million LME jobs were spread across the five biggest sectors of:

+ *retail* (18 per cent of all LME jobs);
+ *health and social work* (12 per cent);
+ *manufacturing* (12 per cent);
+ *financial services* (10 per cent); and
+ *construction* (10 per cent).

There were a further 2.5 million in *transport*, *education*, *restaurants and hotels*, *public administration*, *arts and leisure* sectors.



Within sectors, LMEs were over-represented in:

+ *accommodation and food services* (48 per cent of all jobs in the sector were held by LMEs);
+ *retail* (42 per cent);
+ *construction* (37 per cent);
+ *manufacturing* (35 per cent); and
+ *transport and communications* (34 per cent).

*Qualifications*

***Typically have low-to-mid level skills profile...***

LMEs have a range of qualification levels. While 5 per cent had no formal qualification in 2008-09, 16 per cent were educated to degree level. The distribution was skewed towards low-to-mid level skills, however, with 44 per cent of LME adults having no qualification beyond GCSEs.

*Recession and recovery*

***More likely to have lost jobs during the recession and less likely to have bounced back quickly...***

Our analysis finds evidence of a shift from full-time to part-time work among LME adults – particularly males – at the start of the recession, although the nature of the 2008-09 survey data means that it does not reveal more recent LME employment outcomes. However, consideration of the performances of typical LME industries, occupations and skills profiles suggests that the group has been harder hit by unemployment than higher earners in the last two years.

In addition to being more likely to lose their jobs, LMEs have been less likely than higher earners to make swift returns to work. In September 2010, long-term unemployment among those who usually work in the *elementary* occupations typical of low earners stood at 176,000; in contrast, just 14,000 *professionals* had been out of work for more than six months.

## 1.4 LMEs and household finances

*Incomes*

***Average net household income of £20,300...***

Average (mean) gross income among LME households was £25,700 in 2008-09, including an average of £19,500 in gross household earnings. Average net income was also £20,300. By way of comparison, across all working-age households, average gross income was £43,500 and average net income was £31,500.

Although our definition of the group supposes that few LME households are in crisis, around 930,000 (16 per cent of the total) had net incomes before housing costs in 2008-09 of less than 60 per cent of the national median, meaning that they were considered to be living in relative poverty.

While LMEs by definition receive relatively little from the state in the form of means-tested benefits, they are the major recipients of tax credits. In 2008-09, 30 per cent of LME families received tax credit awards, compared with 25 per cent of benefit-reliant families and 10 per cent of higher earners.

***Income growth lower in last year than for other income groups...***

Compared to 2007-08, LME net incomes increased in nominal terms by 2.5 per cent. In contrast, benefit-reliant incomes – driven by above-inflation increases in several benefit payments – rose by 4.7 per cent and higher earner incomes – increased by 3.5 per cent.

*Spending*

On average, LME households spent around 85 per cent of their weekly net income in the 2008 calendar year – compared with a figure of 64 per cent among higher earner households.

***Spend 40 per cent of weekly net income on housing, fuel, transport and food...***

Of particular note is the proportion of income allocated to commodities that are difficult to cut back on: household spending on the four categories of *housing*, *fuel*, *transport* and *food* amounted to 40 per cent of net household income among LMEs, compared to just 26 per cent among higher earners.

Spending pressures have resulted in some LMEs going without. For example, in 2008-09:

+ 12 per cent of LME households said they were unable to keep their accommodation warm enough, compared with 3 per cent of higher earner households;
+ 40 per cent of LME households said they would like to take a holiday away from home once a year for at least one week, but could not afford it, compared with just 14 per cent of higher earner households; and
+ 32 per cent of LME households were unable to afford to replace worn out furniture, compared with 10 per cent of higher earner households.

***One-fifth of households are materially deprived...***

Overall, one-fifth (18 per cent) of LME households were 'materially deprived' in 2008-09.

*Cost of living*

***Faced higher rates of inflation than higher earners...***

The spending pressures faced by LMEs have been exacerbated in recent years by increases in the cost of living that have been skewed towards the lower half of the income distribution.

Compared to January 2000, the cost of the typical LME basket had increased by 18 per cent by January 2009; in contrast, the typical higher earner basket increased by 16 per cent. As such, LME purchasing power was around £300 a year lower than it would have been if the group had been subject to the same cumulative level of inflation over this period as higher earners.

*Safety nets*

In general, LMEs are not financially excluded. Just 2 per cent of LME households reported having no form of financial account in 2008-09, the same proportion as among higher earner households. However, they are less likely than higher earners to own certain types of financial products. For example, just 11 per cent had stocks and shares in 2008-09, compared with 26 per cent of higher earner households. Similarly, just 9 per cent of LME adults had some form of investment product in 2008-09, compared with 22 per cent of higher earners.

***Over half have less than one month's net income in savings...***

LMEs are less likely than higher earners to have safety nets of savings and insurance to fall back on and are therefore typically more highly exposed. Two-thirds (66 per cent) of LME households had less than £1,500 in savings in 2008-09, compared with one-third (36 per cent) of higher earners.

Even when measured in relation to their income levels, LME households performed less well: 52 per cent had less than the equivalent of one month's net income in savings, compared with 48 per cent of benefit-reliant households and 39 per cent of higher earners.

***Two-thirds not saving for a pension...***

LMEs also appear much less likely than higher earners to be saving for the long-term. Two-thirds (66 per cent) of LME adults were not contributing to a pension in 2008-09, compared with 41 per cent of higher earners.

*Credit, debt and household bills*

LME households have a similar debt profile to the population as a whole, but there is some evidence that they experience greater difficulties than higher earners in maintaining these commitments.

Just under three-quarters (71 per cent) of LME households reported having an outstanding debt in late-2009: 38 per cent had a secured debt (primarily mortgages) and 59 per cent had an unsecured one. The average size of debt was £80,400 among those with a secured loan and £4,640 among those with an unsecured one.

***Debts represent a burden for many...***

While these debts were manageable for most LMEs, half (49 per cent) of those households with unsecured debts said that repayments represented something of a burden – with 16 per cent saying that this burden was 'heavy'. In contrast, just 8 per cent of higher earner households with unsecured debts spoke of a heavy burden.

***Half struggle with household bills...***

Taking all household bills into consideration, half (52 per cent) of LME households said that they struggled to meet their commitments in late-2009, compared with 29 per cent of higher earner households. Around 6 per cent of LME households said they were behind with some of their bills.

Nearly half (49 per cent) of those households that were struggling said that they would deal with their difficulties by cutting back. However, one-quarter (24 per cent) said that they had no coping strategy in place.

***Restricted access to credit since 2008...***

Those on low-to-middle incomes have typically engaged in mainstream credit markets. However, the restricted access experienced by all households since the credit crunch risks excluding some members of the group from affordable lending. In late-2009, 30 per cent of LME households suffered from perceived or actual credit constraint: that is, 25 per cent were put off spending because they were concerned they would not be able to get credit and 12 per cent said they were not able to borrow because they found it too expensive. A balance of 35 per cent of LME households said that they were finding it more difficult than in 2008 to borrow to finance spending.

### 1.5 LMEs and housing

*Access to home ownership*

***Overall, two-thirds are home owners...***

In 2008-09, nearly two-thirds of the six million LME households were home owners – either outright or with a mortgage. In total:

+ 3.9 million LME households owned their own home;
+ 1.1 million were in private rented properties; and
+ 1.0 million lived in the social rented sector.

***Just 17 per cent of younger LMEs own their own homes...***

There was, however, significant variation across LME households by age. Nearly two-thirds (63 per cent) of those LME households headed by someone aged 16-24 were living in the private rented sector, with just 17 per cent being home owners.

Although such trends are in part a function of the life-cycle, with people entering home ownership as they age, the pattern is much more pronounced among LMEs than among others – 16 per cent of LME 16-24 year-old households had a mortgage, compared with 43 per cent of higher earner households of the same age.

***LMEs account for a declining share of first time buyers…***

Home ownership is becoming less common among LMEs over time; the proportion of English first time buyer properties purchased by LMEs fell from 28 per cent in 1977 to 19 per cent in 2009.

This has been driven over the longer term by increases in house prices that have stretched affordability for LMEs, with the ratio of average first time buyer house prices to average LME incomes more than doubling in the period 1977-2009, from 3.4 to 7.6.

Successive governments have attempted to ease access to home ownership via a series of Low Cost Home Ownership (LCHO) programmes. However, while LMEs appear to have been the main beneficiaries of the Right to Buy scheme – 59 per cent of homes owned in England in 2007-08 that had been bought from the local authority were owned by LMEs – in the main it is those on incomes of between £40,000 and £60,000 that have been best placed to take advantage of various LCHO options.

***Long-term trend accelerated by credit crunch…***

The long-term gradual decline in LME home ownership has been accelerated in the last two years by restricted access to credit. Tighter conditions have increased deposit requirements, thus disadvantaging younger LMEs who struggle to put money aside. The proportion of mortgages advanced in the UK with a loan-to-value of 75 per cent or less increased from 50 per cent in 2007 to 71 per cent in 2010. Similarly, the proportion of new mortgages with a loan-to-value of 95 per cent and above declined from 5.5 per cent to 0.5 per cent.

***LMEs struggle to acquire necessary deposit…***

LME households that put aside 5 per cent of their disposable income each year would take 45 years to accumulate the average first time buyer deposit in 2009. In 2006 it was estimated that 38 per cent of first time buyers under 30 had received help from parents and others. By the second quarter of 2009 this had increased to nearly 80 per cent.[3] LMEs are less likely than higher earners to be able to access this kind of support: among those LME home owners in their first home in England in 2007-08, 11 per cent had paid part of their deposit with money from family or friends, compared with 20 per cent of higher earners in this position.

*Sustainability of home ownership*

***Those who have bought have stretched themselves…***

The difficulties faced by LMEs in accessing home ownership mean that some who have entered the housing market in recent years are likely to have overstretched themselves. Among those buying in 2007-08, nearly one-third (30 per cent) had relied on a 100 per cent mortgage.

3 CML, 'First-time buyers – are they really getting older?' *CML News and Views*, Issue 15, 4 August 2009



In the same period, 16 per cent of LME mortgagors said they found it 'rather difficult' to keep up with their mortgage payments and 3 per cent described their situation as 'very difficult'. In contrast, 8 per cent of higher earner mortgages said keeping up was rather difficult and just 1 per cent said it was very difficult.

***Some helped by falling mortgage rates…***

While the recession has caused substantial problems for some mortgagors who have lost their jobs, there has not been the predicted explosion in repossession orders. In part this is likely to be due to the extension of government support and creditor forbearance; however, it has also been driven by historically low interest rates, which have resulted in lower payments for many households.

***But majority have not benefited…***

LMEs have done less well in this regard than higher earners, however. Of those with a mortgage, 42 per cent of LME households reported lower payments in late-2009 compared with the previous year; among higher earner mortgagors the proportion was 56 per cent. This difference appears to be driven by a greater appetite for fixed rate mortgages within the LME group – 63 per cent of mortgages owned by LMEs in late-2009 were fixed, compared with 46 per cent of those held by higher earners – which is likely to reflect demand among those on low-to-middle incomes for repayment certainty.

***More likely to be in negative equity…***

Because of their greater reliance on high loan-to-value mortgages during the boom, LME home owners are more likely than higher earners to be in negative equity following the crash. In late-2009, around 8 per cent of UK LME home owners were thought to have a loan-to-value in excess of 100 per cent, compared with just 5 per cent of higher earner mortgagors.

*Rented accommodation*

Reduced access to home ownership over time means that younger LMEs are increasingly reliant on rented accommodation.

***17 per cent live in social housing…***

Just under one-fifth (17 per cent) of LME households reside in social rented properties. While a sizeable proportion, this share is dwarfed by that recorded within the benefit-reliant group, where 51 per cent of households live in the social rented sector.

The difference between the two income groups is likely in part to reflect lower levels of demand for the tenure among LMEs. However, it is also driven by a shortage of suitable housing. In England, the local authority waiting list grew by 73 per cent between 1997 and 2009 – approaching 2 million – while the stock of authority housing declined by 8 per cent. Against this backdrop, those on low-to-middle incomes are often passed over in favour of others in more immediately vulnerable situations.

***Increasingly live in private rented sector…***

Faced with restricted access to both home ownership and the social rented sector, an increasing number of LMEs find themselves with little option but to enter the private rented sector. While the overall proportion of LMEs in this sector is 19 per cent, rates are much higher among younger LMEs: nearly two-thirds (63 per cent) of LME households headed by someone aged 16-24 live in private rented accommodation, compared with 49 per cent of higher earners and 47 per cent of benefit-reliant households.

*Some families complain about lack of choice, costs and conditions...*

Among LME tenants, younger households without children tend to view the sector as a stepping-stone, and are largely satisfied with their situation. In contrast, older families who see renting as a long-term housing solution are more likely to voice concerns.

Costs are one source of complaint, with private rents having grown substantially faster than those in the social rented sector in recent years. In real-terms, private sector rents in England increased by 37 per cent between 1995-96 and 2007-08, compared with growth of just 9 per cent in average local authority rents. Choice is another issue; in certain locations there is a lack of suitable accommodation, especially for larger families.

## 1.6 Trends in income shares

*Income divide between middle and top been growing for decades...*

The widening of the gap between those households with low-to-middle incomes and those on above-average incomes was well in train before the start of the recession, and this is likely to have been exacerbated by employment effects that occurred during the period.

Despite the broadly progressive nature of the UK's tax and benefit system, LMEs have become poorer relative to higher earners over time. Between 1977 and 2008-09, average disposable household income has gone up in real-terms by half (57 per cent) among LMEs, but doubled (105 per cent) among higher earners. This trend has been driven primarily by larger increases in higher earner original income – that is, income from employment, investment and other non-state sources.

*Reflects shift from labour to capital...*

Underpinning this is two deeper trends. First, there has been a redistribution of rewards from labour to capital in recent decades, with compensation of employees as a share of GDP falling from 59 per cent in 1970 to a post-war low of 52 per cent in 1996. Despite some subsequent improvement, it remained low by historic standards at 54 per cent in 2010. Given that profits tend to be concentrated more narrowly in the hands of those at the top of the income scale than wages, this redistribution has contributed to growing inequality.

*And growing wage inequality...*

The second trend relates to wage inequality. Although more equitably shared than profits, the distribution of wages has become less even over time, meaning that the falling wage share of GDP has impacted most heavily on those with low-to-middle incomes.

## 1.7 Challenges in 2011 and beyond

*Fiscal consolidation*

Looking to the years ahead, we have argued that working-age households on low-to-middle incomes are in danger of shouldering a disproportionate amount of the pain associated with reducing the budget deficit.

At the macro level, fiscal tightening poses particular risks for LMEs because – as with the initial recession – any slowdown or reversal of economic growth associated with the reduction in public sector activity is likely to once again fall hardest on those on modest incomes and in insecure jobs.

*Tax credits under threat...*

LME incomes will fall as a result of cuts in the generosity of in-work tax credits, including support with childcare costs, although for some these losses will be partially offset by the increases in the income tax personal allowance and the National Insurance primary threshold in April 2011.



Over the medium-term, the introduction of a Universal Credit, while positive for those on the very lowest incomes, risks increasing the marginal deduction rates faced by those LMEs who access tax credits but no income-related benefits.

*Hit by cuts to public services...*

More generally, LMEs will be hit harder than higher earners by cuts to public services. The distributional analysis set out in the October Spending Review suggests that households in quintile 2 (the middle of the LME group) consume public services[4] with a value of around £10,700 a year, compared with just £5,500 a week in the top quintile.

*Work and skills*

*At risk from public sector job cuts...*

Departmental cost savings include plans for half a million job cuts in the public sector over the next four years. While LMEs appear to be under-represented in the public sector, it is once again likely to be those workers with the low-to-mid skill levels typical of LMEs who prove most expendable.

The duration of the transition from public sector to private sector is uncertain, with the CIPD arguing that 300,000 new jobs a year will need to be created for the next four years just for overall employment to stand still.[5] The situation will potentially be particularly acute in regions such as Wales and the North East where the public sector accounts for a disproportionate share of all jobs and where there is little evidence as yet of a surge in private sector activity.

*And ongoing weakness in private sector...*

To the extent that growth does return to the private sector, LMEs are less well placed than higher earners to share in the spoils. The abolition of Train to Gain and reductions in funding for further education will compound the difficulties LMEs face in accessing training and so risks reducing the opportunities available for older (i.e. over 25s) members of the group to up- and re-skill in order to take advantage of private sector openings.

*Under pressure from falling real wages...*

Explicit nominal pay freezes and increases in employee pension contributions will place particular pressure on the take-home pay of public sector workers. However, across the economy as a whole, real wages are expected to fall in the period to 2013. While those public sector workers earning less than £21,000 will receive partial protection, it is LMEs more generally who are likely to bear the brunt of this fall in pay, reflecting the long-term trend of growing wage inequality.

*Household finances*

*Cost of living pressures will persist...*

While employment effects and welfare cuts will act to reduce LME incomes, cost increases are likely to amplify expenditure pressures. Rising costs are inevitable in relation to the increase in VAT from January 2011, which will increase LME household bills by £270 a year on average.

More generally, cost of living pressures that fall disproportionately on those in the lower half of the income distribution are likely to persist for some years. In relation to fuel, for example, costs will increase both because of extra demand from rapidly developing economies such as China and from the exhaustion of the world's most accessible (and therefore cheapest) energy sources.

4 Not all public service consumption can be modelled. These figures relate to the two-thirds of resource expenditure that the government is able to provide estimates for.
5 CIPD Press Release, "CIPD estimates 1.6 million extra private sector jobs needed by 2015-16 simply to offset full impact of Coalition Government's spending cuts and VAT rise", 1 November 2010

**Less support for saving...**

With budgets under increasing pressure, LMEs' capacity for savings is likely to be further reduced. In this context, the decision not to roll out the Savings Gateway and the abolition of the Child Trust Fund appear unfortunate. However, the introduction of auto-enrolment should improve pension saving among LMEs and the roll out of the National Money Advice Service will also be welcome.

Interest rates are projected to grow only gradually in the coming year, with the Bank of England of the opinion that inflation will fall in the medium term due to the extent of spare capacity in the economy. However, the persistence of above-target inflation is likely to lead to calls for monetary tightening, especially if the recovery proves stronger than expected. In such an environment, LMEs are likely to be particularly disadvantaged because of their relatively low levels of savings and relatively large levels of debts. In particular, those LMEs who have been able to maintain mortgage payments only because of the historic falls in rates, are likely to find it more difficult to sustain their position.

*Housing*

**Private rental market to be of increasing importance...**

Ongoing tightness in the credit market is likely to mean that home ownership remains beyond most LMEs, even if house prices fall further. Therefore, developments in the rented sector will be key.

The 74 per cent cut in the Communities and Local Government capital spending budget between 2010-11 and 2014-15 set out in the October Spending Review will inevitably have a major impact on the provision of affordable housing. Given the shortages already apparent in social housing, any further restriction of access is likely to push still more of those with low-to-middle incomes into the private rented sector.

Here too there is a danger of inadequate investment. While the Homes and Communities Agency's attempts to encourage large-scale private investment have been met with a positive response, the focus remains on the higher end of the market: extending this model to the lower end of the market should now be a priority.

### 1.8 Conclusions

**More squeezed, more exposed...**

Compared to their position at the time of the last *Audit*, it is apparent that LMEs are even more squeezed in 2008-09. They are more exposed due to deterioration of the economy. In political terms they are less overlooked than they were, but this is due to the fact that they have been at the sharp edge of the downturn.

**Facing a potential 'triple crunch' on earnings, costs and state support...**

However, an ongoing failure to understand the particular pressures experienced by members of the group risks further undermining their economic independence in the coming years. LMEs face a potential 'triple crunch':

+ *An earnings crunch* – driven by unemployment and cuts in working hours in the public sector and by weak labour market recovery in the private sector; and
+ *A cost of living crunch* – driven by permanent global pressures on the cost of essential items such as food and fuel, by the forthcoming VAT increase, by increases in the costs of public transport, by the continued shortage of suitable housing supply and by the likely introduction of higher user-charges for a number of public services.

Taken together, these pressures mean that earnings are set to fall in real terms, with the average LME household due to be £720 worse off by 2012. The overall squeeze on living standards will vary from household to household, depending on how exposed they are to the third element of the triple crunch:

+ *A tax-benefit crunch* – driven by withdrawal of various forms of financial support for working families, particularly tax credits.

Increases in the income tax personal allowance and the National Insurance primary threshold will benefit the average LME household by £340 by 2012, offsetting some of the earnings losses set out above. However, cuts in tax credits will reduce - and potentially wipe out - any such gains for many LME households, with the precise outcome depending on the exact composition and income of the household.

For all LME households, the financial impacts of the triple crunch will be amplified by:

+ *Pressures on access to services* – driven by permanent reductions in state funding for social goods.

## 2. Introduction and definitions

*There are 11 million low-to-middle earners defined on the basis of: **age** – we focus on working-age households only; income – LMEs are in income deciles 2-5; and **benefit-receipt** – those households that receive more than one-fifth of their income from means-tested benefits are removed from the group.*

***Low-to-middle earners are squeezed, exposed and overlooked...***

***Typically in work and largely independent of state support...***

At the heart of the Foundation's mission is the analysis of how the mixed economy of private enterprise and state intervention can fail to meet the needs of those households that find it difficult to make the most of private sector opportunities, while consistently falling on the wrong side of eligibility for state support.

Such households are rarely in crisis; they can more accurately be described as being *squeezed*, *exposed* and *overlooked*. Squeezed because they face limited options: too poor, for example, to easily access home ownership, but not considered priorities for social housing. Exposed because they live towards the edge of their means: unable to build up sufficient savings to maintain their lifestyles in the face of a drop in income. Overlooked because their needs are not adequately understood: considered to be 'doing fine', despite enjoying a fragile economic independence.

This group incorporates households with incomes in the range £12,000 to £30,000, usually in work and with relatively little income sourced from the state. We use the term *low-to-middle earners* or *LMEs* as shorthand.

Within the overall group, the numbers and types of people that are squeezed in different policy areas depend on the nature of the good or service, the cost and accessibility of private solutions and the volume and value of available state support.

The *Audit* provides a snapshot of this group. Original analyses of a number of large-scale surveys are supplemented with qualitative research and literature reviews to produce a detailed consideration of the condition and experiences of LMEs in 2008-09, across the themes of incomes, work, budgets and housing.

By taking this approach, we attempt to present a broad description of some of the pressures faced by those who are disadvantaged by the mixed economy, without trying to claim that all LMEs are affected by all of the issues we raise. In contrast, our major in-year projects look in more detail at the particular members of the LME group who are affected by each policy circumstance.[6]

### 2.1 Navigating the Audit

In this chapter and the next we provide background for the remainder of the report. Chapter 2 sets out details of how we define the LME group and why we have settled on this approach, and should be of most interest to researchers who wish to understand more about our methodology. We also present some top level data for 2008-09, in order to paint a clearer picture of the profile of the LME group.

6 Projects to date include LMEs' access to financial advice and long-term care.



Chapter 3 provides historical context by exploring how incomes among those in the low-to-middle group have changed in relative terms over the past 30 years. We look at trends in a range of economic indicators over a similar period, with particular attention on the performance of the economy in the last two years, before setting the scene for future years by considering the likely impact on the UK economy of planned fiscal consolidation.

Building on this background, Chapters 4-6 set out details of LME experiences across three themes:

+ Chapter 4 looks at work and skills;
+ Chapter 5 analyses household finances; and
+ Chapter 6 considers housing.

Each of these thematic chapters describes the lives of LMEs against the backdrop of economic recession, offering a comparison with outcomes in 2007-08 where relevant.

While the report is therefore largely backward-looking, Chapter 7 sets out the range of challenges likely to affect LMEs in the coming years and discusses the role policy-makers can play in supporting the group.

Finally, Chapter 8 looks more closely at the technical LME definitions associated with the various sources used in the *Audit* and provides details of the qualitative research cited.

### 2.2 Defining LMEs

*The analytical definition*

Moving from the conceptual definition of LMEs set out above to one that allows statistical analysis is not without its difficulties, and our ultimate definition is unavoidably imperfect. In addition, because our statistical analysis is based on large-scale survey data,[7] we are only able to report on the group with a time-lag. We have attempted, however, to adopt an approach that ensures that we get as close as possible to capturing the experiences of largely independent working households living on low-to-middle incomes

The analysis in the *Audit* focuses on LME *households*. We do this in an effort to remove the distortions associated with capturing a large number of students and non-working members of high income families when adopting an individual approach. The cost of this is that, in relation to households in which income and expenditure is not equally shared, we are likely to miss some individuals who fit the LME profile. However, in making the assumption that income is usually shared, we are consistent with the approach used by the DWP in its *Households Below Average Income* study.

The precise definition of the group varies from source to source but, as far as possible, we aim to follow the same three-stage process, whereby we filter on the basis of age, income and benefit receipt.

7. Details in Chapter 8.

*Focus on working-age households…*

We first remove retired households from the overall population. The reduced earnings faced by most people at retirement means that many of those considered LMEs during their working lives will fall into the benefit-reliant group in retirement, while some higher earners will drop into the LME group. However, because such households are also likely to face reduced spending commitments, the pressures they face should be less intense than those experienced by working-age households in corresponding income bands. More generally, we remain interested in older households, but our focus in this report is on working-age LMEs.

*In income deciles 2-5…*

Among the remaining population of working-age households, we equivalise gross incomes to weight for differing household sizes and compositions. This matters because LMEs are in part defined by the fact that their living standards are squeezed and, for any given level of income, a household of five adults is likely to achieve a lower standard than a single-person household. The equivalisation process takes account of such differences by inflating the incomes of smaller households and deflating the incomes of larger ones.

Incomes before housing costs (BHC) are used. While an after housing costs (AHC) approach might better capture the living standards of those households that pay more for housing than is warranted by the quality of their accommodation (some households in London for example), it would also understate the living standards of those living in property of a higher quality than is suggested by their costs. In addition, the BHC approach is consistent with the government's child poverty target and allows better read across of the LME group to other surveys in which housing costs are not captured.

We next rank the working-age households on the basis of their equivalised incomes and separate them into ten equally sized deciles (where decile 1 has the lowest income). Given that we are concerned with those on low-to-middle incomes, we use median income – the boundary between deciles 5 and 6 – as the upper threshold of the group. At the lower end we create a threshold at the boundary between deciles 1 and 2. We do this in part because it represents the approximate level of earnings associated with working full-time at the minimum wage, and in part because decile 1 often produces unusual results due to the large number of households within it that have temporarily low incomes or incomes that come neither from employment nor the state.

*Household income range £12,000 - £30,000…*

Therefore, at this stage, the LME group comprises all of those working-age households with equivalised gross incomes in deciles 2-5 of the income distribution (£12,000 - £30,000 for a couple with no children). For simplicity, we refer to those households with above median incomes as *higher earners*, while those households with the lowest incomes are classified as being *benefit-reliant*. Chart 2.1 shows the relative position of the LME group after stage two.

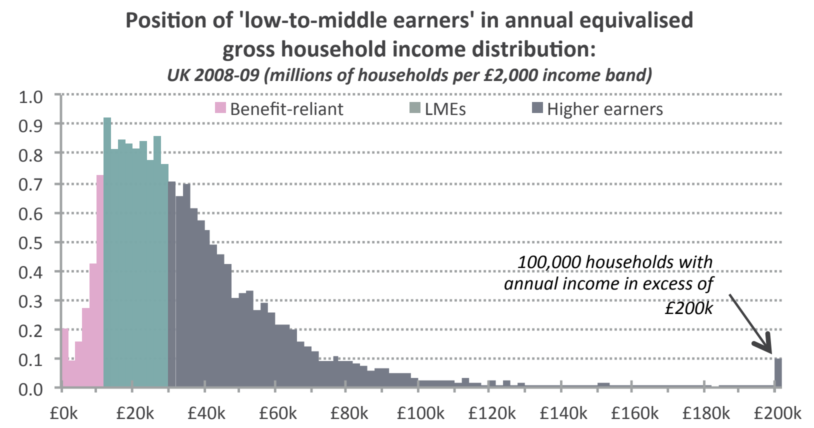



Chart 2.1: Equivalised gross household income distribution: UK 2008-09
Note: Income groups based on first two stages of FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*And less than one-fifth of income from means-tested benefits…*

Our third stage filters out all those households that receive more than one-fifth of their household income from income-related benefits[8], moving them to the benefit-reliant group. The specification of *income-related* means those in receipt of universal benefits such as Child Benefit are not excluded from the group. Tax credit receipts do not count towards a household's total level of income-related benefit because of their definition not as benefits but as a negative tax for those on low-to-middle incomes.

Where relevant data sources do not provide sufficient detail to undertake this three-stage process, we adopt simpler approaches. In some instances we are unable to identify the sources of households' incomes and therefore cannot apply the third filter described above; in others we are unable to determine household size and cannot therefore equivalise incomes. Each data output in the *Audit* includes a brief description of the definitions underpinning the income group division, and further details are provided in Chapter 8.

### *Households, adults and benefit units*

As discussed above, the *Audit* uses the household as the basis of measurement of LMEs. However, in accordance with the level of analysis provided in the DWP's *Family Resources Survey*, we also present data at adult and benefit unit level.

*Households* are defined as 'a single person or group of people living at the same address who either share one meal a day or share the living accommodation'.

*Adults* are primarily allocated to income groups based on the status of their household. That is, if a household is categorised as *LME* based on the three-stage process set out above, all adults within that house are considered to be LMEs. In relation to *non-conventional households* comprising unrelatedsharers however, we allocate adults to one of the three income groups on the basis of their place within the individual working-age income distribution. An additional filter is introduced, namely that all who described themselves as full-time students are removed from the analysis entirely.

8. Includes Council Tax Benefit, Housing Benefit, Pension Credit, Income Support, Lone Parent Benefit Run On, Job Grant, Income Based Job Seekers Allowance, Income Related Employment and Support Allowance, Maternity Grant, Funeral Grant, Community Care Grant, Return to Work Credit, Work-related activity premium and Child Maintenance Bonus

*Benefit unit* is a term that relates to the tighter family definition of 'a single adult or couple living as married and any dependent children'. So, for example, a man and wife living with their young children and an elderly parent would be one household but two benefit units. As with adults, those benefit units living in conventional households are assumed to share income and expenditure and are therefore allocated to the same income group as their overall household. Similarly, however, those benefit units living in non-conventional households are categorised on the basis of a three-stage process that centres on a benefit unit income distribution. Throughout the report we use the term benefit unit interchangeably with families and family units.[9]

### *Capturing changes over time*

Significant numbers of people move in and out of the three income groups we define at different life-stages: young people in particular, many of whom are just starting out in their careers, will move out of the LME group as their income rises.

Therefore, while analyses of changes over time are provided in some parts of the *Audit*, in most instances this represents no more than a comparison of snapshots of the LME group in different years. Conversely, where we consider retrospective data – as in relation to first time buyer trends for example – we are focusing our analysis on people who are LMEs today but who may have been higher earners or benefit-reliant (and perhaps both) during the relevant earlier periods.

In addition, it should be remembered that LMEs are defined on a relative basis. That is, as economic conditions and household incomes change, so the boundaries of the LME group move in line. As such, the proportion of the population covered by the group should not alter much over time on the basis of the first two stages of our process.[10]

## 2.3 LMEs in 2008-09

### *Population numbers*

***6 million households and 11.1 million adults...***

Table 2.1 shows that the definitions described above captured a total of 6.0 million LME households in the UK in 2008-09, representing around one-third of the UK working-age total.

The group comprised 11.1 million adults (one-third of the working-age total) and 5.3 million children (42 per cent of the total).

***Representing one-third of working-age population...***

The 8.0 million LME benefit units included 7.6 million working-age units and 0.4 million pensioner units – included because they lived in households in which the household reference person was under retirement age.

9. The DWP also uses the terms interchangeably in its *Households Below Average Income* publication.
10. However, there is some scope for changes in relation to the third stage if eligibility for, or generosity of, income-related benefits are altered.



Table 2.1: Summary data for households, individuals and benefit units by income group: *UK 2008-09*

| *000s* | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| **Working-age households** | | | | |
| Total | 3,300 | 6,000 | 9,400 | 18,800 |
| Without children | 1,900 | 3,100 | 6,500 | 11,400 |
| With children | 1,500 | 3,000 | 3,000 | 7,400 |
| **Individuals within working-age households** | | | | |
| Total adults | 4,700 | 11,100 | 18,200 | 34,000 |
| Women | 2,500 | 5,600 | 8,700 | 16,800 |
| Men | 2,200 | 5,400 | 9,600 | 17,200 |
| Total children | 2,600 | 5,300 | 4,700 | 12,700 |
| **Benefit units in working-age households** | | | | |
| Total | 4,000 | 8,000 | 11,800 | 23,900 |
| Working-age units | 3,900 | 7,600 | 11,300 | 22,900 |
| Couple with children | 600 | 2,200 | 2,700 | 5,500 |
| Male single without children | 1,200 | 1,900 | 2,800 | 6,000 |
| Female single without children | 800 | 1,400 | 1,700 | 3,900 |
| Couple without children | 400 | 1,300 | 3,800 | 5,600 |
| Lone parent | 900 | 800 | 300 | 1,900 |
| Pensioner units | 100 | 400 | 500 | 1,000 |
| Pensioner couple | 100 | 300 | 400 | 800 |
| Female pensioner single | 0 | 100 | 100 | 200 |
| Male pensioner single | 0 | 0 | 0 | 0 |

Notes: Income groups based on FRS definitions: see Chapter 8
Figure may not sum due to rounding.
Note: RF analysis of DWP, *Family Resources Survey 2008-09*

### *Social class*

***One-third of households in C1 social class...***

As might be expected given their position on low-to-middle incomes, LMEs are largely grouped in middle-to-lower social classes. Chart 2.2 shows that, in 2008-09, one-third (32 per cent) of heads of lower earner households were in class C1, 28 per cent were in C2 and 21 per cent were in D. There were very few LMEs in the extremes of A and E.

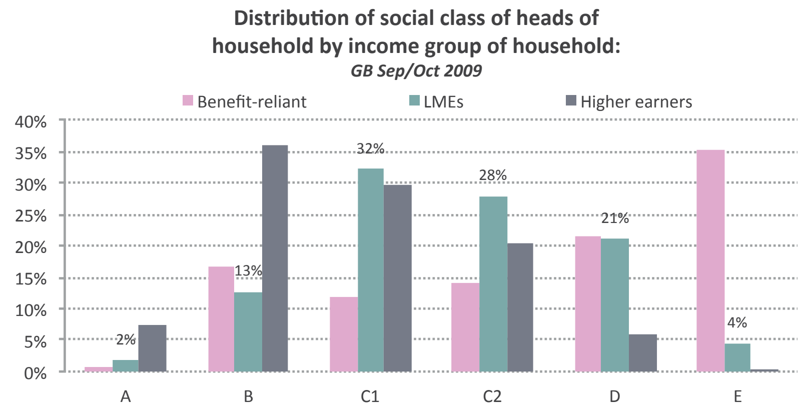



Chart 2.2: Social class of household heads by income group: UK 2008-09
Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

### *Regional distribution*

*Highest proportion in Northern Ireland…*

Chart 2.3 details the regional distribution of households by income group. Overall, 32 per cent of UK adults lived in LME households. The proportion was highest in Northern Ireland (39 per cent), Yorkshire & the Humber (38 per cent) and the North East (38 per cent). The proportion was lowest in London (22 per cent), the South East (28 per cent) and the Eastern region (29 per cent).

*Lowest in London…*

This geographical split reflects two factors. First, average earnings differ across the country, meaning that households in London and the South East are more likely to appear in the top half of any national-level income distribution (i.e. be 'higher earners'). Secondly, the proportion of households receiving means-tested benefits (and therefore classed as 'benefit-reliant') vary across regions in line with levels of economic activity and (in relation to Housing Benefit) average rents.

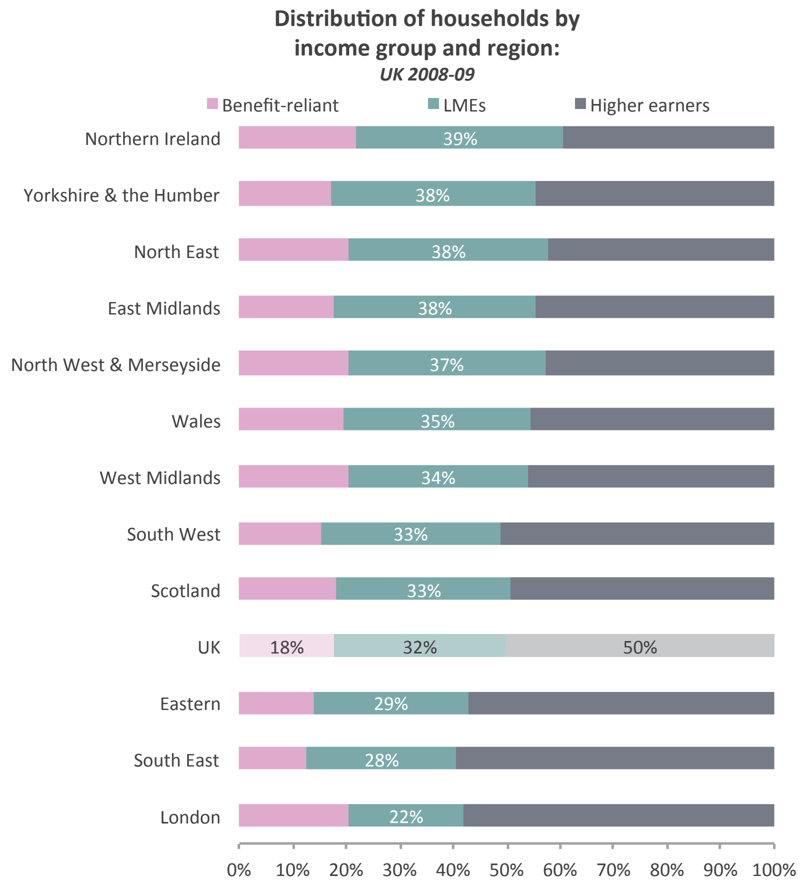



Chart 2.3: Regional distribution by income group: UK 2008-09
Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

### *Average incomes*

*Average net household income of £20,300…*

Table 2.2 shows that average unadjusted (i.e. non-equivalised) net household income (from all sources) among LMEs in 2008-09 was £20,300. Average gross income from earnings (employment and self-employment) only was £19,500: this compares with averages of £1,900 among benefit-reliant and £59,500 among higher earner households.



Table 2.2: Average annual income among households by income group: *UK 2008-09*

| | £ | Benefit- | LMEs | Higher | All |
|---|---|---|---|---|---|
| | Original (non-benefit) income | 2,200 | 20,800 | 63,700 | 39,100 |
| + | Benefit income | 8,300 | 2,200 | 1,000 | 2,700 |
| + | Tax credits | 1,300 | 1,500 | 200 | 800 |
| + | Remaining income[1] | 600 | 1,300 | 1,100 | 1,100 |
| = | Gross household income | 12,500 | 25,700 | 65,800 | 43,500 |
| - | Direct taxes and other deductions[2] | 1,300 | 5,400 | 20,100 | 12,100 |
| = | Net household income | 11,300 | 20,300 | 45,700 | 31,500 |

Notes: Income groups based on FRS definitions: see Chapter 8.
[1] Includes income derived from sub-tenants, odd-jobs, free school milk and/or meals, private benefits (such as personal health insurance, trade union strike pay and government training allowances), student/school grants, royalties, allowances from friends, relatives or an organisation and allowances from local authorities for foster and adopted children.
[2] Income is net of: income tax payments; NICs; domestic rates/council tax; contributions to occupational pension schemes; maintenance and child support payments; parental contributions to students living away from home; and student loan repayments.
Sources: RF analysis of DWP, *Family Resources Survey 2008-09 & 2007-08;*
RF analysis of DWP, *Households Below Average Income 2008-09 & 2007-08*

### *Work and economic activity*

*Three-quarters of LME adults in work…*

Table 2.3 sets out economic activity among adults in each income group. Four-fifths (80 per cent) of LME adults were economically active in 2008-09, comprising 6.1 million in full-time work, 2.2 million in part-time work and 0.5 million unemployed.

Table 2.3: Economic activity among adults by income group: *UK 2008-09*

| *000s* | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Economically active | 1,900 | 8,800 | 16,800 | 27,500 |
| In work | 1,200 | 8,400 | 16,600 | 26,100 |
| *Full-time employee* | *400* | *5,200* | *13,100* | *18,700* |
| *Full-time self-employed* | *300* | *900* | *1,200* | *2,300* |
| *Part-time employee* | *400* | *2,000* | *2,000* | *4,500* |
| *Part-time self-employed* | *100* | *200* | *300* | *600* |
| Unemployed | 700 | 500 | 200 | 1,400 |
| Economically inactive | 2,800 | 2,300 | 1,400 | 6,500 |
| Looking after family/home | 700 | 700 | 400 | 1,700 |
| Permanently sick/disabled | 1,300 | 600 | 200 | 2,200 |
| Retired | 300 | 500 | 500 | 1,300 |
| Student | 100 | 100 | 100 | 200 |
| Temporarily sick/disabled | 100 | 0 | 0 | 200 |
| Other inactive | 400 | 300 | 200 | 900 |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*1.5 million work in retail; 1 million in health & social work; and 1 million in manufacturing…*

Table 2.4 shows the distribution of LME jobs in 2008-09 across industrial sectors. Of the 8.3 million LME jobs recorded (each worker can have more than one job), 1.5 million were in *retail*, 1.0 million were in *health and social work* and 1.0 million were in *manufacturing*.

Within sectors, LMEs were over-represented in *accommodation and food services* (48 per cent of all jobs were held by LMEs), *agriculture, forestry and fishing* (44 per cent) and retail (42 per cent). They were under-represented in *professional, scientific & technical activities* (16 per cent), *public administration, defence & social security* (23 per cent) and *financial services* (23 per cent).

### Table 2.4: Jobs held by LME adults by industry: *UK 2008-09*

| | Number (000s) | % of all jobs in industry | % of all low earner jobs |
|---|---|---|---|
| Retail | 1,470 | 42% | 18% |
| Health and social work | 1,030 | 31% | 12% |
| Manufacturing | 970 | 35% | 12% |
| Financial services | 840 | 23% | 10% |
| Construction | 830 | 37% | 10% |
| Transport and communications | 610 | 34% | 7% |
| Education | 590 | 25% | 7% |
| Accommodation and food services | 520 | 48% | 6% |
| Public administration, defence & social security | 440 | 23% | 5% |
| Arts, entertainment & recreation | 290 | 29% | 4% |
| Agriculture, forestry & fishing | 190 | 44% | 2% |
| Energy, water and mining | 120 | 25% | 2% |
| Professional scientific & technical activities | 110 | 16% | 1% |
| Other service activities | 250 | 44% | 3% |
| Total jobs[1] | 8,270 | 32% | 100% |

Notes: LMEs based on FRS definitions: see Chapter 8.

[1] Does not include jobs not allocated to one of the industrial categories above.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

***1.4 million in elementary jobs; 1.2 million in skilled trades; and 1 million in administrative and secretarial occupations...***

Table 2.5 sets out the distribution of LME employees in 2008-09 by occupation level. Of the 8.3 million LME employees identified, 1.4 million were categorised as working in *elementary* occupations, 1.2 million were in *skilled trades* and 1.0 million were in *administrative* and *secretarial* occupations.

LMEs were over-represented in *elementary* (54 per cent of all employees in this category), *sales and customer service* (51 per cent) and *process, plant and machinery* (48 per cent) occupations. They were under-represented in *professional* (11 per cent), *managers and senior officials* (17 per cent) and *associate professional and technical (21 per cent) occupations.*

### Table 2.5: LME employees by occupational category: *UK 2008-09*

| | Number (000s) | % of all employees in occupation | % of all low earner employees |
|---|---|---|---|
| Elementary occupations | 1,370 | 54% | 17% |
| Skilled trades occupations | 1,230 | 41% | 15% |
| Administrative and secretarial occupations | 1,010 | 34% | 12% |
| Personal service occupations | 980 | 45% | 12% |
| Process, plant and machinery operatives | 910 | 48% | 11% |
| Sales and customer service occupations | 880 | 51% | 11% |
| Associate professional and technical occupations | 830 | 21% | 10% |
| Managers and senior officials | 690 | 17% | 8% |
| Professional occupations | 410 | 11% | 5% |
| Total employees[1] | 8,300 | 32% | 100% |

Notes: LMEs based on FRS definitions: see Chapter 8.

[1] Does not include employees not allocated to one of the occupational categories above.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

### *Housing tenure*

***3.9 million home owners, 1.1 million in private rented sector and 1 million in social housing...***

Table 2.6 details the distribution in 2008-09 of households in each income group across tenure types. Of the 6.0 million total LME households, 2.7 million were buying a home with a mortgage, 1.2 million owned outright, 1.0 million were social rented sector tenants and 1.1 million were in the private rented sector.

### Table 2.6: Housing tenure among households by income group: *UK 2008-09*

| *000s* | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Owners | 800 | 3,900 | 7,900 | 12,600 |
| *Owned with mortgage* | *400* | *2,700* | *5,900* | *9,000* |
| *Owned outright* | *400* | *1,200* | *1,900* | *3,500* |
| Social rented sector tenants | 1,700 | 1,000 | 300 | 3,100 |
| *Rented from housing association* | *800* | *500* | *200* | *1,500* |
| *Rented from council* | *900* | *500* | *100* | *1,500* |
| Rented privately | 800 | 1,100 | 1,200 | 3,200 |
| *Rented privately - unfurnished* | *600* | *800* | *900* | *2,300* |
| *Rented privately - furnished* | *200* | *300* | *400* | *900* |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

# 3. Recent economic context

*Income inequality has grown in the last 30 years, driven by a shift in rewards from labour to capital and by growing wage inequality. Earnings gaps between the top and the bottom and between the top and the middle continue to grow, but the gap between the middle and the bottom has levelled-off in the last decade. Low-to-middle earners have therefore become poorer relative to higher earners but incomes within the group have become more bunched.*

*Development of tax credits and investment in public services in the last decade means LMEs have moved from being net contributors to the tax-benefit system to being net gainers. But this is likely to be reversed during a period of fiscal tightening.*

***Recession and recovery have implications for LMEs…***

The recession of 2008-09 has weighed heavily on outcomes for many UK households, particularly those with low-to-middle incomes and those in insecure jobs. Future economic performance will also have significant implications, with the pain of fiscal tightening and the opportunities associated with recovery likely to be distributed unevenly across households. However, the position of LMEs relative to other members of society has also been affected by a number of longer-term trends.

***But also affected by more long-term trends…***

In this chapter we describe some of those trends, before looking briefly at how the conditions and causes of the recent recession compared with previous downturns. More detailed considerations of the specific impacts of the recession on LMEs are included in Chapters 4-6. Finally we discuss the government's plans for fiscal tightening and the prospects for economic recovery. Again, the specific implications of the planned consolidation are considered at a later stage – in Chapter 7 of the *Audit*.

## 3.1 Pay, rewards and incomes

### *Income shares*

Table 2.2 showed average incomes across the three income groups in 2008-09 and detailed the composition of these averages. The ONS release *The effects of taxes and benefits on household incomes* provides similarly detailed data for income deciles over time. It adds two additional layers of income: first, it includes a line on indirect taxes paid; secondly, it presents an estimate of the income obtained from benefits-in-kind – that is, public services consumed. However, given that the ONS acknowledges that it is not possible to 'reasonably allocate' around half of all government spending on the basis of household income, this second detail provides only a partial representation of the true picture.

Figure 3.1 details the relationship between each stage of income covered in the ONS release. It shows that a household's *final income* represents its *original income* plus cash benefits and benefits-in-kind, minus any taxes paid and deductions made. Changes in government policy can therefore have a significant impact on how final incomes compare to original incomes.

| | | |
|---|---|---|
| | **Original income** | *returns from employment, investments, occupational pensions and other non-state sources* |
| *+ cash benefits* | **Gross income** | *income from all sources, before any deductions* |
| *- direct tax* | **Disposable income** | *income available for spending and saving* |
| *- indirect tax* | **Post-tax income** | *income after all taxes/deductions are paid* |
| *+ benefits-in-kind* | **Final income** | *income after all state intervention including value of public services consumed* |

Figure 3.1: Composition of income

The nature of the ONS dataset is such that we are unable to filter households on the basis of benefit receipt and must instead define our three groups on the basis of age and place in the income distribution only. In the following charts and tables, the LME group is therefore taken to include those working-age households in income deciles 2-5 (where income is distributed on an equivalised disposable basis).

Table 3.1 uses this measure to detail income compositions across the three income groups we define. The differences in approach mean that the figures are not directly comparable with those in Table 2.2. On this basis, average gross LME household income in 2008/09 was £26,000 and average disposable income was £21,700.

Table 3.1: Average household incomes, taxes and benefits by income group: *UK 2008/09*

| | | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|---|
| | Original income | 5,400 | 20,600 | 58,900 | 38,200 |
| + | *plus cash benefits* | 5,000 | 5,400 | 1,900 | 3,600 |
| = | Gross income | 10,400 | 26,000 | 60,700 | 41,800 |
| - | *less direct taxes & employees' NICs* | 1,200 | 4,300 | 14,300 | 9,000 |
| = | Disposable income | 9,100 | 21,700 | 46,500 | 32,800 |
| - | *less indirect taxes* | 3,300 | 4,400 | 6,600 | 5,400 |
| = | Post-tax income | 5,800 | 17,300 | 39,800 | 27,400 |
| + | *plus benefits in kind* | 7,700 | 7,200 | 4,500 | 5,900 |
| = | Final income | 13,500 | 24,400 | 44,300 | 33,300 |

Note: Income groups based on ONS definition: see Chapter 8.

Source: RF analysis of ONS, *The effects of taxes and benefits on household income, 2008/09*, Table 16

***Pre-state intervention incomes have become much less evenly shared over time…***

The division of total household income between the three income groups has altered over time. Chart 3.1 compares shares of original income in the period 1977–2008/09, with shares of final income.

Over the period, the share of original income going to LME households fell from 30 per cent to 22 per cent and the share accounted for by benefit-reliant households fell from 3 per cent to 1 per cent, meaning that society would have become much less equal over this period without any state action.

*Taxes and benefits have countered the trend, but distribution has still become more unequal…*

The more concentrated distribution of final incomes in each year points to the broadly progressive effects of tax and benefits. However, as with original income, shares have become less evenly distributed over time. The share of final income accounted for by LME households fell from 34 per cent in 1977 to 29 per cent in 2008/09, while the benefit-reliant share dropped from 6 per cent to 4 per cent.[11] These findings suggest that tax and benefit policies have not been sufficient to overturn the effect of growing disparities in original incomes.

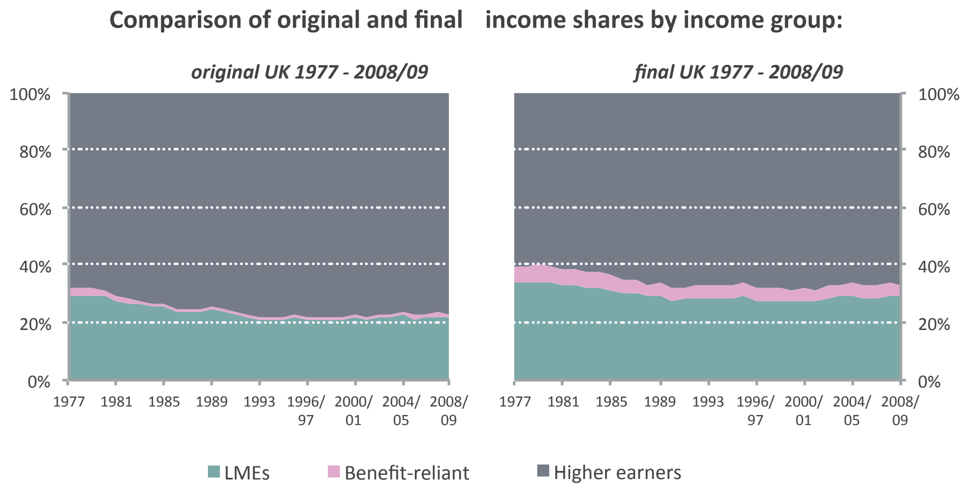



Chart 3.1: Original and final income shares by income group: UK 1977-2008/09
Note: Income groups based on ONS definition: see Chapter 8.
Source: RF analysis of ONS, *The effects of taxes and benefits on household incomes, 2008/09*, historical data

### *Drivers of inequality*

Measured in real terms, LME household original incomes increased by just under one-third (30 per cent) between 1977 and 2008/09, compared to a doubling (104 per cent) among higher earner households. This growing inequality appears to have been driven by two factors: a redistribution of rewards from labour to capital; and widening wage differentials between different types of jobs.

*Driven by shift of rewards from labour to capital…*

Chart 3.2 shows how the shares of GDP accounted for by labour (employee compensation) and capital (profits) changed over the period 1970-2010. The labour share increased sharply at the time of the first oil price crisis in the mid-1970s, and has also grown during periods of recession – including the most recent downturn – because of the falling productivity of labour associated with reductions in average hours.

However, the overall trend has been away from labour in favour of capital. The labour share fell from 59 per cent at the start of the period to 54 per cent at the end, while the capital share increased from 22 per cent to 27 per cent. This shift is likely to have fed through into inequality in original incomes because profits are much more concentrated in the hands of those at the top of end of the income distribution than wages are.

11 Given that the income groups are defined purely on the basis of income deciles, their shares of the overall population do not change over time.



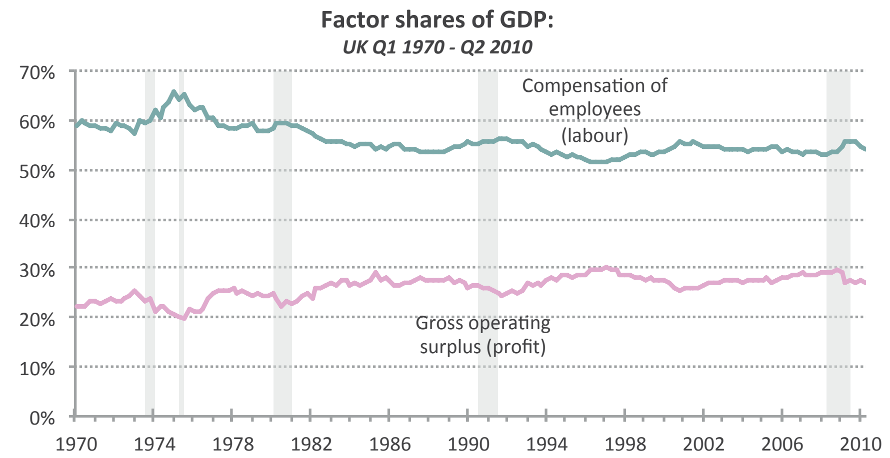



Chart 3.2: Factor shares of GDP: UK 1970-2010
Source: ONS time series IHXM, IHXO & IHXP

*And by growing wage inequality…*

In relation to wage differentials, consideration of the 90-10 ratio over recent decades – that is, the ratio of full-time weekly wages earned by the 90th and the 10th percentiles in the earnings distribution – shows that inequality has clearly grown since the 1970s, with dramatic increases in the 1980s giving way to more gentle growth in the last decade, as evident (for males) in Chart 3.3.

As such, while wages remain more equitably shared than profits, the distribution has become less even over time, meaning that the falling wage share of GDP has impacted most heavily on those with low-to-middle incomes.

*Gaps between top and bottom and between top and middle become more stretched…*

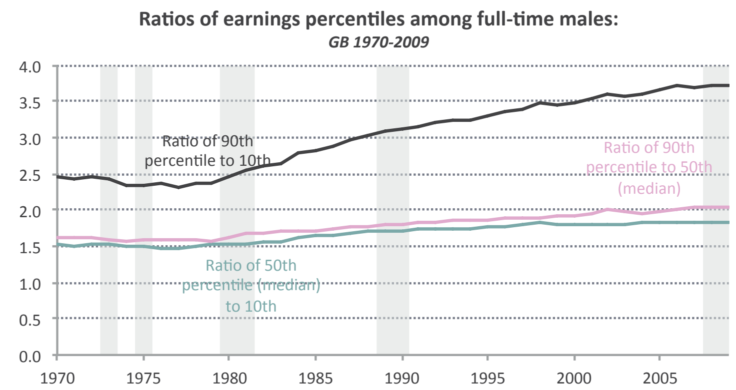



Chart 3.3: Earnings ratios among full-time males: UK 1970-2010
Source: ONS, ASHE for period from 1997 and New Earnings Survey for earlier

*But gaps between middle and bottom have levelled-off…*

Interestingly, while the 90-50 ratio (the gap between the top and the middle) appears to have grown throughout the period, the 50-10 ratio (the gap between the middle and the bottom) has been relatively flat since the mid-1990s, with a slight fall in 1999 perhaps being driven by the introduction of the National Minimum Wage. This suggests that wage inequality in the top half of the earnings distribution is continuing to grow, while inequality in the lower half has levelled off, meaning that earnings within the LME group have become more bunched while at the same time drifting further away from earnings in the higher earner group.

## 3.2 Taxes and benefits

As discussed above, progressive tax and benefit policies have gone some way to mitigating the effects of growing inequality in original incomes. Chart 3.4 displays the effects of taxes and benefits on differences in LME and higher earner incomes in the period 1977-2008/09. It shows that, compared to the ratios between the two in 1977, LME final incomes have kept pace with higher earner incomes a little better than original incomes have. However, the dominance of the growth in inequality in original incomes is highlighted by the fact that, even on the final income measure, LMEs have become poorer relative to higher earners.

*LMEs have become poorer relative to higher earners in last 30 years...*

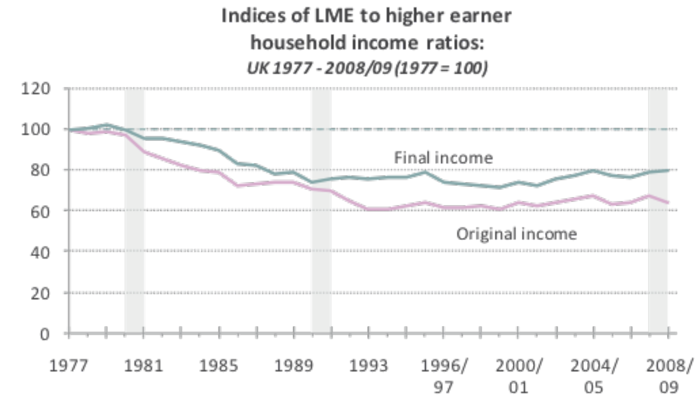



Chart 3.4: LME to higher earner income ratios: GB 1977-2008/09
Note: Income groups based on ONS definition: see Chapter 8.
Source: RF analysis of ONS, *The effects of taxes and benefits on household incomes, 2008/09*

An ONS study into the redistributive effects of the UK tax and benefits system noted that, in the period 1977-2006/07, cash benefits had the largest effect on income inequality, with progressive direct taxes tending to cancel out regressive indirect taxes.

Chart 3.5 highlights this finding, with direct taxes in 2008/09 accounting for the largest share of gross incomes among the higher earner group, and indirect taxes accounting for the largest share among benefit-reliant households. The distribution of cash benefits and benefits-in-kind was, however, strongly progressive.

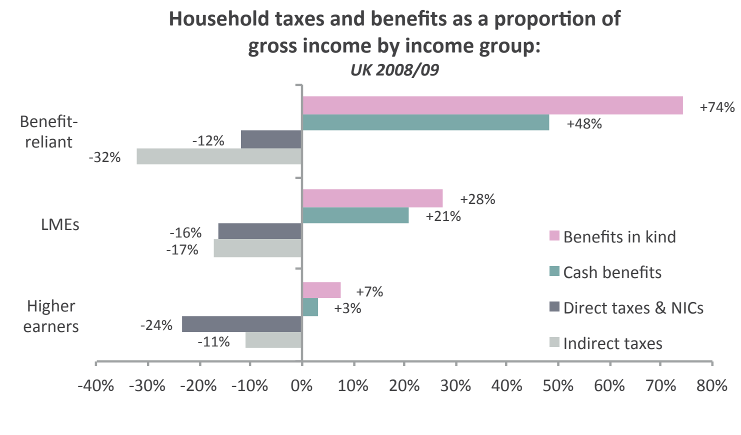



Chart 3.5: Household tax and benefits by income group: UK 2008/09
Notes: Income groups based on ONS definition: see Chapter 8.
Tax credits included as cash benefits.
Source: RF analysis of ONS, *The effects of taxes and benefits on household incomes, 2008/09*

The ONS study found no evidence of any major change in the magnitude of redistribution caused by cash benefits over the period but some increase in the redistribution effect of taxation from the mid-1990s onwards. However, the report concluded that any improved equalising effect of taxation in this period was limited by the large increase in inequality in original income.[12]

*LME tax-benefit balance has improved in last decade...*

Among LMEs, the tax-benefit balance has improved in recent years, as shown in Chart 3.6. The chart compares the value of all benefits received (in cash) and consumed (in-kind) by LME households, with the value of all direct and indirect taxes paid. Over the period, the balance has tended to improve during – and for some time after – periods of economic downturn. This is likely to reflect increased unemployment, which reduces the value of taxes paid and increases benefit receipts.

*Primarily due to investment in public services...*

However, the balance also improved for LMEs during the years of sustained economic growth years from 2000/01. In part this was driven by the development of tax credits. Housing Benefit receipts are also likely to have increased in line with rising rents.[13] However, as Chart 3.7 shows, the primary cause was the substantial growth in public sector spending and associated consumption of benefits-in-kind.

*Likely to be reversed in period of fiscal tightening...*

While the LME balance has again grown during the most recent recession, planned spending cuts and reductions in the generosity of tax credits are likely to push this trend into reverse in the coming years. As such, the LME balance could head back towards neutrality, or even a negative position.

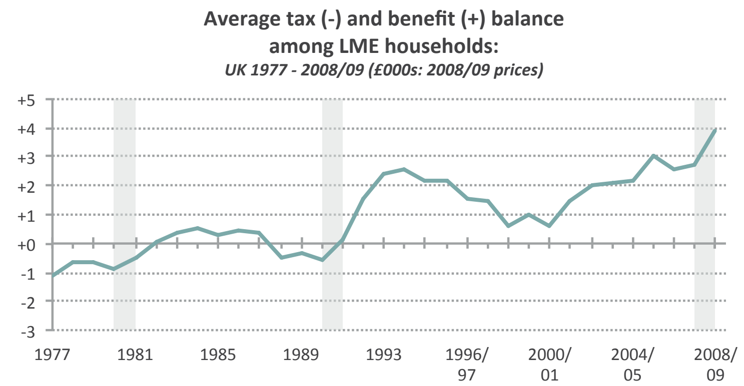



Chart 3.6: Tax-benefit balance among LME households: UK 1977-2008/09
Note: LMEs based on ONS definition: see Chapter 8.
Source: RF analysis of ONS, *The effects of taxes and benefits on household incomes, 2008/09*

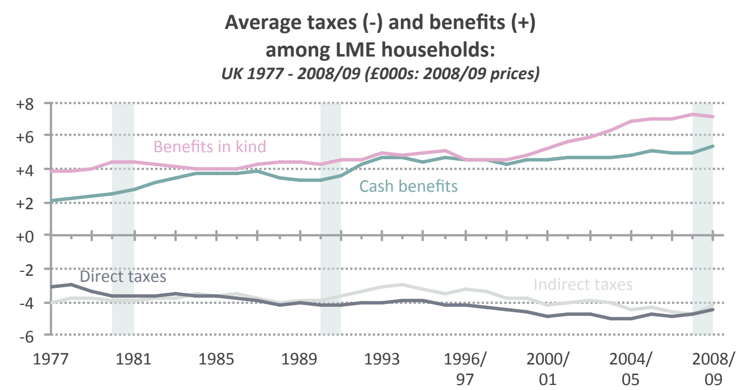



Chart 3.7: Taxes and benefits among LME households: UK 1977-2008/09
Note: LMEs based on ONS definition: see Chapter 8.
Source: RF analysis of ONS, *The effects of taxes and benefits on household incomes, 2008/09*

12 ONS, "The redistribution of household income 1977 to 2006/07", *Economic and Labour Market Review*, Vol 3 No 1, January 2009

13. Housing Benefit is likely to be a more important source of income for low earners in relation to this survey than it is in others because, as discussed, in this instance we are unable to remove households in receipt of means-tested benefits from the low earner group.

## 3.3 The 2008-09 recession

*Causes and conditions of recession differ from previous post-war downturns...*

Following significant volatility in the 1970s and 1980s, the period from 1992 to 2007 was characterised in the UK by low interest rates, low inflation and steady GDP growth. Similar conditions around the world led some economists to argue that a new, more stable, economic era had been established. However, the speed with which problems in global credit markets in 2007 and 2008 spread to real economies around the world, exposed the fact that some of the preceding decade's economic growth had been built on unstable foundations. Growth in the UK was particularly fuelled by increased household borrowing and a prolonged housing boom. The international credit crunch thus helped push the UK into recession in Q2 2008.

*Characterised by household indebtedness, historically low interest rates and inflation and near-collapse of banking system...*

These underlying conditions and causes meant that the UK economy at the start of the recession differed in a number of ways from earlier periods of downturn, with significant implications for subsequent economic performance. While other post-war recessions had been preceded by inflationary booms, the most recent downturn resembled the financial and commodity boom-driven contractions which took place before the First World War. Four distinct differences can be observed:

+ *Higher household indebtedness*: Lending to individuals rose from 25 per cent of GDP at the start of the 1980 recession, to 60 per cent at the start of the 1990 recession and 101 per cent of GDP in Q2 2008. The stressed position of households appears to have contributed to a particularly severe consumer retrenchment, potentially undermining recovery. The apparently necessary rebalancing of the economy from domestic consumption towards export-driven growth is also likely to create transition difficulties for many.

+ *Lower interest rates*: The official Bank Rate in mid-2008 was 5.3 per cent, significantly lower than in 1980 (17.0 per cent) and 1990 (14.8 per cent). While some businesses and households have benefited from further subsequent reductions in interest rates, the room for monetary stimulus was limited by the relatively low starting point. The Bank of England – in common with other central banks – has therefore engaged in an unprecedented bout of quantitative easing. It is not yet clear what impact this action has had, nor how it will unravel as the economy recovers. The already loose monetary position also limits options for boosting private sector activity in response to public sector contraction beyond maintaining the current position for longer than might otherwise have been the case.

+ *Lower inflation*: Annual RPI inflation stood at 18.4 per cent prior to the 1980 downturn and at 9.8 per cent at the start of the 1990 recession. In contrast, RPI inflation was 4.2 per cent in Q2 2008. Relatively low inflation has helped to maintain stability in the economy and fears of a period of deflation appear to have subsided. However, the relatively low level of price increases means that debt levels are not being eroded at the same rate as in previous downturns, with implications for households, businesses and government.

+ *The near-collapse of the financial system*: The credit crunch exposed the fundamental structural weaknesses of many banks' balance sheets. Despite significant government support for the funding position of major UK banks, the outlook in mid-2008 was highly uncertain. While the position is now more stable and regulatory improvements have been made, concerns remain that future global problems could again destabilise the entire system. Credit conditions for many house-holds and businesses in the UK are likely to be tight for some time to come, with implications for aggregate demand in the economy.



## 3.4 Economic recovery and fiscal consolidation

### *Public finances*

The nature of the global financial crisis and subsequent recession set out above contributed to a significant deterioration in the UK's public finances in 2008-09 and 2009-10. While the decision to combat the depth of the recession with a short-term government-led fiscal stimulus ensured that government expenditure increased, the primary cause of the jump in the annual deficit was the collapse in government revenues associated with reduced economic output.

*£29 billion tax increases and £81 billion spending cuts by 2014-15...*

The June Budget and October Spending Review set out the government's plans to meet its fiscal mandate to achieve balance on the cyclically-adjusted budget deficit – that is, the annual overspend that would exist even if the economy was operating at full capacity – by the end of the rolling, five-year forecast period via a combination of tax increases and spending cuts. By 2014-15, the government intends to have generated a total discretionary consolidation of £110 billion, comprising £29 billion in increased tax revenues and £81 billion in spending cuts.

According to IFS analysis, the cuts represent the tightest overall squeeze in public sector spending since World War II, while the departmental cuts are the deepest over a four-year period since those in place from April 1975 to March 1980.[14]

### *Economic outlook*

Although economic output has grown in each of the last four quarters, and at a faster rate than many predicted, economic indicators remain some way below pre-crisis trends.

Economic recovery is likely to be supported by ongoing monetary stimulus, growth in global demand and the past depreciation of sterling. However, there are a number of countervailing downside risks, producing concerns that the rebound will be sluggish at best.

*Fiscal consolidation, tight credit conditions and pace of global growth will all affect UK prospects...*

Most obviously, the fiscal consolidation plans set out above are likely to dampen consumer and corporate demand. Consumers will be affected because of the purchasing power impact of the planned rise in the standard rate of VAT to 20 per cent in January 2011, the employment and income effects associated with job cuts and pay freezes in the public sector and because of reductions in eligibility for, and generosity of, transfer payments. Private sector businesses will be affected by reduced public sector demand for their goods and services.

Another potential headwind for the UK recovery is the uneven pace of global recovery, with the country's main trading partners in the euro area and the US growing less quickly than markets elsewhere in the world. In addition, tight credit conditions for households and businesses are likely to persist, further reducing scope for increases in domestic consumption and investment.

14. IFS, *Spending Review 2010: briefing and analysis*, 21 October 2010

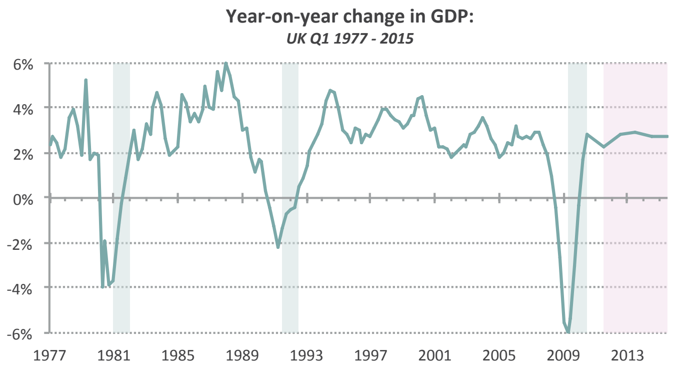



Chart 3.8: GDP: 1977–2015
Note: Projections are central OBR forecast.
Sources: Outturn: ONS Time Series, IHYR;
Projection: OBR, *Budget forecast*, June 2010, Table C2

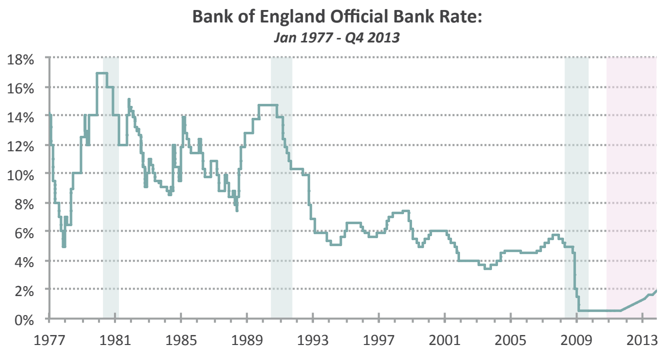



Chart 3.9: Base rate: 1977–2013
Note: Projections based on forward market interest rates.
Sources: Outturn: Bank of England;
Projection: Bank of England, *Inflation Report*, November 2010, p43

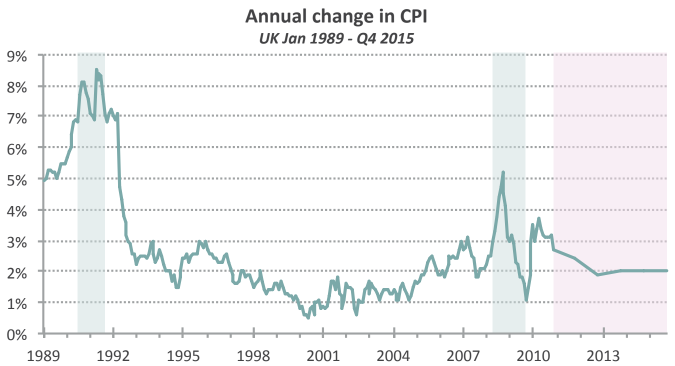



Chart 3.10: CPI inflation: 1989–2015
Note: Projections are central OBR forecast.
Sources: Outturn: ONS Time Series, D7G7;
Projection: OBR, *Budget forecast*, June 2010, Table C2

Based on the coalition government's forward spending plans at Budget 2010, the OBR produced forecasts for a number of key economic indicators. Chart 3.8 shows GDP projections and Chart 3.10 details inflation expectations to 2015. In addition, Chart 3.9 sets out Bank of England base rate projections in the period to 2013.

Chart 3.8 shows that GDP growth is forecast to strengthen in 2011, peaking at 2.9 per cent in 2013, before falling to 2.7 per cent in the final two years of the period.

The slight reduction in growth reflects demographic changes that are expected to reduce the potential labour supply. However, the forecast remains above trend.

Chart 3.9 suggests that the base rate will grow slowly, in the next few years, approaching 2½ per cent by the end of the forecast period.

Chart 3.10 shows that inflation is forecast to remain above target (2 per cent) throughout 2011 andmuch of 2012, because of the impending VAT rise, oil price pressures associated with global economic recovery and increases in import costs flowing from previous depreciation of sterling.

The OBR expects the extent of spare capacity in the economy and cuts in public spending to place downward pressure on inflation in the medium-term. CPI inflation is forecast to fall below 2 per cent in late-2012, before settling at target in the second half of the period.



These forecasts are based on central case projections. In truth, the unknown interaction discussed above between those factors that will support economic recovery and those that will hinder it, means that both the OBR and Bank of England emphasise high degrees of uncertainty in their projections.

***Outlook is highly uncertain...***

Projections collated from a range of independent sources in the Treasury's most recent *Forecasts for the UK economy* publication highlight this uncertainty, with the highest and lowest estimates of GDP growth in 2011 differing by 1.8 percentage points, and the gap between extremes on RPI inflation varying by 2.2 percentage points.

***Consumer and business surveys paint mixed picture...***

Forward-looking business and consumer confidence measures paint a similarly mixed picture. Table 3.2 details results from four such surveys in the period from October 2007.

Table 3.2: Business and consumer confidence: UK 2007-2010

| | Future output expectations[1] *(CBI)* | Consumer confidence[2] *(GfK NOP)* | Household income expectations[3] *(Nationwide)* | Economic Sentiment Indicator[4] *(European Commission)* |
|---|---|---|---|---|
| Oct 2007 | +10 | -8 | +18 | 111.9 |
| Oct 2008 | -31 | -36 | +1 | 80.9 |
| Oct 2009 | +4 | -13 | +6 | 91.3 |
| Jan 2010 | +4 | -17 | +4 | 98.2 |
| Feb 2010 | +7 | -14 | +9 | 98.3 |
| Mar 2010 | +5 | -15 | +7 | 100.9 |
| Apr 2010 | +14 | -16 | +4 | 101.7 |
| May 2010 | +17 | -18 | 0 | 102.4 |
| Jun 2010 | +15 | -19 | 0 | 99.4 |
| Jul 2010 | +6 | -22 | -7 | 100.8 |
| Aug 2010 | +10 | -18 | -3 | 102.3 |
| Sep 2010 | +12 | -20 | +1 | 100.2 |
| Oct 2010 | +18 | -19 | : | 100.5 |

Notes: [1-2] Balance of proportion of survey respondents expecting improvement over proportion expecting deterioration.
[3] Balance of proportion of consumers expecting improvement in household finances in six months time over proportion expecting deterioration.
[4] Composed of Commission's industrial confidence indicator (40%), service confidence indicator (30%), consumer confidence indicator (20%), construction confidence indicator (5%), and retail trade confidence indicator (5%). Its long term average (1990-2008) equals 100.

Sources: CBI, *Industrial Trends Survey (monthly)* from ONS database, series: ETCU;
GfK NOP, *Consumer Confidence Survey* on behalf of the European Commission
Nationwide, *Consumer Confidence Index*
European Commission Directorate-General for Economic and Financial Affairs, *Business and Counsumer Survey Results*, Table 1

A balance of 18 per cent of firms responding to the CBI's Industrial Trends Survey in October 2010 stated that they believed output would increase in the next four months. In contrast, the balance of responses to the GfK/NOP *Consumer Confidence Survey* – which measures consumers' expectations of improvement in economic conditions in the next four months – remained negative in October 2010.

The *Nationwide* balance of households' expectations of future incomes has fluctuated around a neutral position in the second half of 2010, following positive balances throughout the previous 12 months, possibly reflecting growing awareness of the implications of the impending fiscal correction.

The European Commission's economic sentiment indicator for the UK is a composite of corporate and consumer confidence. It reached a low point in March 2009 (65.4, compared with an average for 1990-2008 of 100.0). While improvement in the indicator has not been linear in 2010, it has topped the average for the period 1990-2008 in recent months.

# 4. Work and skills

*Both unemployment and underemployment have increased sharply since the start of the recession. Typical low-to-middle earner sectors such as manufacturing, construction and retail have been worst affected. Within sectors, it is individuals in the lower level occupations typical of LMEs that have been most likely to suffer. LMEs have experienced larger growth in part-time working in the last year than members of other income groups.*

*Once out of work, lower-skilled workers have taken longer than higher-skilled ones to bounce back. LMEs have also been more exposed than higher earners because of the lower level of redundancy payments received.*

*The shape of recovery in the labour market is uncertain, and will depend on both the general economic climate and the level of spare capacity in firms. Public sector job cuts will act as a direct drag and will hit some regions harder than others. Pay has grown more slowly than prices throughout 2010, and is expected to continue to do so until 2013. LMEs are likely to once again be the most exposed to these continuing weaknesses.*

## 4.1 Labour market conditions in recession and recovery

### *Trends in unemployment*

***Smaller than expected growth in unemployment since start of recession…***

Chart 4.1 details unemployment in the UK in the period from January 1977. It records both a three-month average of the numbers of people considered unemployed on the ILO definition and monthly numbers claiming Job Seekers Allowance.

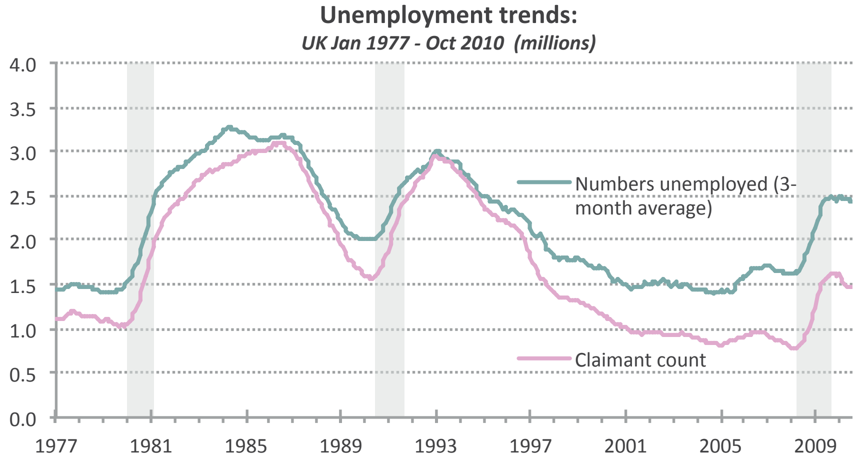



Chart 4.1: Unemployment trends: UK 1977-2010
Source: ONS Labour Market Datasets MGSC & BCJD

On the ILO measure, unemployment increased from 1.6 million in the three months centred on April 2008, to 2.5 million in the three months centred on October 2009. The claimant count increased at a similar rate, doubling from 0.8 million in April 2008 to 1.6 million in October 2009.

***Government policies likely to have helped…***

Despite such sharp increases, the proportional rise in unemployment was smaller than the proportional fall in GDP. Moreover, unemployment has levelled out since the end of the recession, rather than continuing to rise as it did for several quarters following previous periods of downturn. Thus ILO unemployment remained at 2.5 million in the three months centred on August 2010 and the claimant count stood at 1.5 million in October 2010.

There are a number of potential explanations for this surprising resilience, not least the business support measures (such as the Enterprise Finance Guarantee and Working Capital) and active labour market policies (for example, the Job Guarantee Fund) introduced by the previous government which helped to both contain the number of firms going bust and get those losing their jobs back into work.

***But also retention of skilled staff…***

However, within the labour market itself, there appear to be three main factors at play. First, businesses are likely to have retained staff in anticipation of recovery. This is particularly true of the highest skilled members of the labour force who are harder and more expensive to hire and lay off and who firms are more likely to have invested time and money in. The increase in skill levels within the UK economy compared to earlier periods of downturn means that this response is likely to have been more common this time around.

***Pay restraint…***

Secondly, wages have been more flexible than in previous recessions. Having averaged 4.0 per cent in the period 2001-2007, annual increases in average weekly earnings averaged 2.2 per cent[15] etween the start of the recession and August 2010, falling as low as 1.0 per cent at the end of 2009.

***And growth in under-employment…***

Thirdly, unemployment has been mitigated to some extent by an increase in *underemployment*. ONS analysis of Labour Force Survey statistics shows that the number of individuals who wanted to work more hours than are currently available to them increased by 594,000 in the year to Q3 2009, to stand at 2.8 million. The underemployment rate[1] increased by 2.2 percentage points – from 7.7 per cent to 9.9 per cent – compared with an increase of 2.0 percentage points in the unemployment rate.[16]

Chart 4.2 shows how falling full-time employment since the start of the recession has been in part compensated by rising part-time employment, but that this has coincided with a sharp increase in the proportion of part-time workers who are in this position because they are unable to find full-time work.

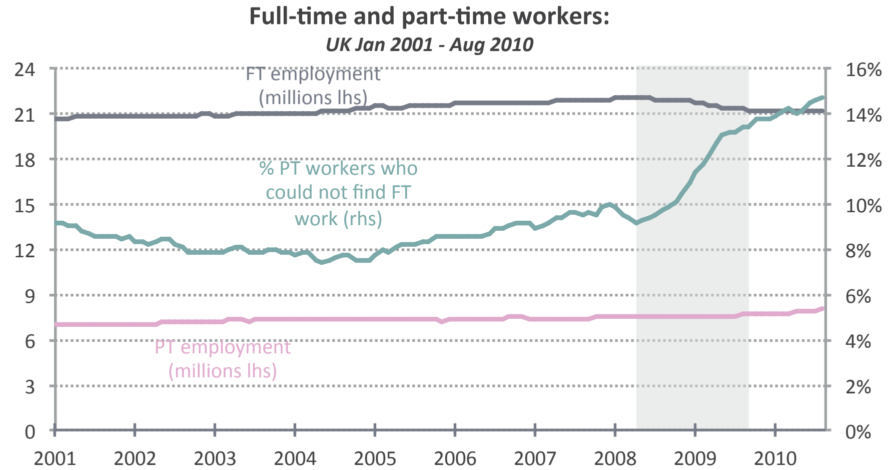



Chart 4.2: Full-time and part-time employment: UK 2001-2010
Source: ONS Labour Market Datasets YCBE, YCBH, YCDA & YCCC

16. Numbers underemployed measured as a proportion of all in employment.
17. ONS, "Underemployment in the UK labour market", *ELMR*, Vol. 4, No. 2, February 2010

*Labour market prospects*

*Recovery depends on economic growth…*

Although the economy is now technically out of recession and the labour market has shown signs of improvement in recent months, the effect of the recession on employment is likely to resonate for some years. The International Labour Organisation recently revised its employment market predictions for advanced countries and now suggests that labour markets will only recover to pre-recession levels by 2015 – instead of their previous estimate of 2013.[17]

As Chart 4.3 shows, it is an assessment with which the OBR agrees. The chart sets out OBR central case forecasts for unemployment and the claimant count and presents an expectation of gradual reductions in the measures, reflecting subdued growth in the economy.

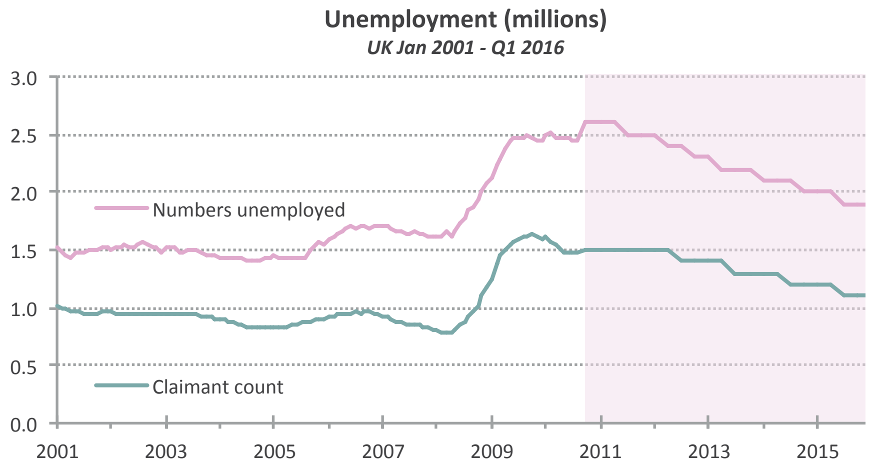



Chart 4.3: Unemployment: 2001–2016
Note: Projections represent central OBR forecast.
Sources: Outturn: ONS Time Series, BCJD & MGSC;
Projection: OBR, *Labour market forecasts*, 19 August 2010

*Spare capacity in firms may limit jobs growth…*

The flexibilities that helped to sustain employment at higher than expected levels during the downturn could potentially produce a slower rebound during recovery. Because firms have retained staff by reducing hours and limiting pay increases, they are likely to be in a position to meet a portion of any growth in demand by simply increasing hours – and therefore productivity per unit of labour. Thus new employment opportunities could be more limited than the overall growth in GDP might suggest.

*Public sector job cuts will act as drag…*

The October Spending Review confirmed that the government expects fiscal tightening to reduce public sector job numbers by around 0.5 million, representing a clear dampening effect on the labour market. The speed with which redundant staff can be re-employed will depend in part on demand in the private sector and in part on the ability of individuals to transfer their skills to different forms of activity.

Although it is not yet clear how quickly job losses will occur, nor the extent to which natural wastage will take the strain, the Chartered Institute for Personnel Development (CIPD) has argued that the overall impact will be bigger than reported, with 0.7 million jobs going in the public sector and a further 0.9 million being lost from the private sector.[18]

17. ILO Economic and Labour Market Analysis Department, *Global Employment Trends*
18. CIPD Press Release, "CIPD estimates 1.6 million extra private sector jobs needed by 2015-16 simply to offset full impact of Coalition Government's spending cuts and VAT rise", 1 November 2010



*Hitting some regions harder than others…*

Regional considerations will also be important, with the withdrawal of public sector jobs having the potential to exacerbate regional imbalances. Chart 4.4 shows that the public sector accounts for larger proportions of overall employment in Northern Ireland, Wales, Scotland and the North East than it does elsewhere in the country.

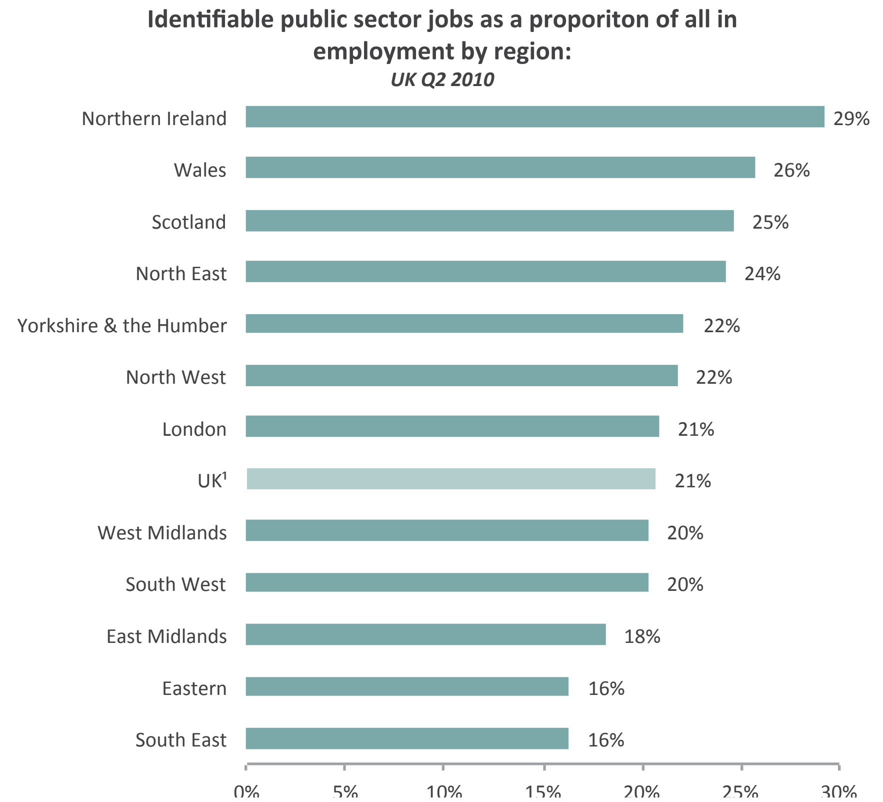



Chart 4.4: Public sector employment by region: UK Q2 2010
Note: ¹UK figure includes around 30,000 employees that cannot be allocated to a region.
Sources: ONS, *Public Sector Employment Statistical Bulletin*;
ONS, *Regional Labour Market Summary*

*Particularly those that already have weak labour markets…*

However, even before job cuts in the public sector start to bite, it is many of these same regions that have the highest levels of unemployment and lowest levels of employment in the country. For example, in July 2010, Northern Ireland had the lowest employment rate in the UK; 66.4 per cent, compared with 70.7 per cent in the South East. Unemployment was highest in Yorkshire and the Humber; 9.3 per cent, compared with 5.7 per cent in the South West.

The Centre for Economic and Business Research (CEBR) has forecast that these imbalances will result in Wales and the North East experiencing rates of unemployment 3 percentage points higher than those in the South East and South West of England.[19]

Outcomes will depend on the extent to which any growth in the private sector is concentrated in these areas, as well as the extent to which workers are willing and able to relocate. Policies such as the NIC holiday for new businesses outside of London, the South East and East of England, and increased funds for the Regional Growth Fund are likely to prove helpful, but prospects remain highly uncertain.

19. CEBR Press Release, "Unemployment to breach 10% in half of UK regions over next 5 years", 31 August 2010

*Pay prospects*

**Pay will be frozen in the public sector...**

The Spending Review also built on the public sector pay freezes introduced at the time of the June 2010 Budget, by calling on departments to limit redundancies by negotiating reductions in hours and pay. More broadly, the slow pace of labour market improvement discussed above is expected to feed through into subdued pay increases.

**And sluggish in the private...**

Chart 4.5 details the OBR's central case projections for average earnings in the period to 2015. It shows that increases are expected to remain below-trend during the early part of the period, before returning to pre-crisis levels towards the end. Comparison of earnings with RPI inflation shows that prices have outstripped earnings by some margin in 2010. The OBR's projections suggest that this situation will continue until 2013, putting significant pressure on households' finances.

**So wages will fall in real terms until 2013...**

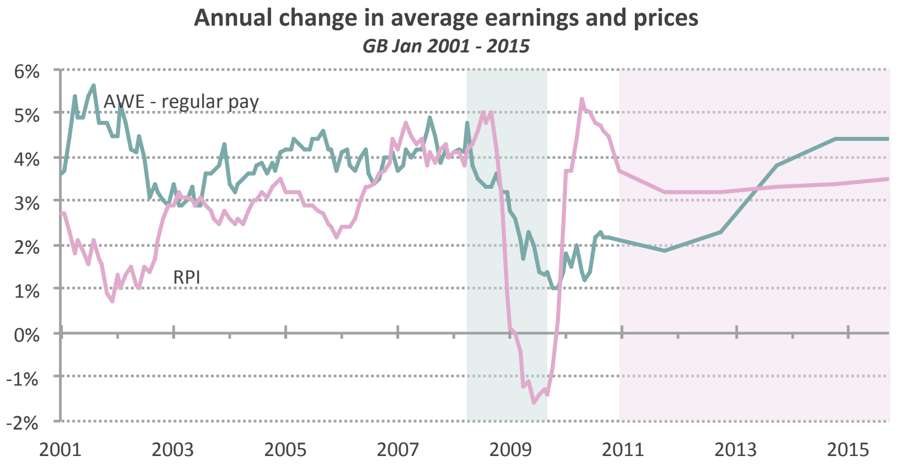



Chart 4.5: Average earnings index and RPI: 2001–2015
Notes: AWE represents whole economy earnings excluding bonuses in Great Britain. Projections represent central OBR forecast.
Sources: Outturn: ONS Time Series KA18 & CZBH;
Projection: OBR, *Budget forecast*, June 2010, Table C2

## 4.2 LMEs' experiences of work and skills

*Economic activity*

**55 per cent of LMEs work full-time and 21 per cent part-time...**

Table 4.1 compares economic activity among adults in 2008/09 in each of the income groups we define. It shows that LMEs (80 per cent) were twice as likely to be economically active as members of the benefit-reliant (40 per cent) group and only slightly less likely to be economically active than higher earners (92 per cent).

**4 per cent unemployed...**

Compared to higher earners (78 per cent), however, LMEs (55 per cent) were considerably less likely to be in full-time employment and more likely to be unemployed (4 per cent of LMEs, compared with 1 per cent of higher earners). LMEs (21 per cent) were much more likely than members of either of the other two income groups (11 per cent of benefit-reliant adults and 13 per cent of higher earners) to be in part-time employment.

LMEs (10 per cent) were also marginally more likely than others (7 per cent and 8 per cent) to be self-employed.



Table 4.1: Economic activity among adults by income group: *UK 2008-09*

| | Benefit-reliant | | LMEs | | Higher earners | | All adults | |
|---|---|---|---|---|---|---|---|---|
| | 000s | % | 000s | % | 000s | % | 000s | % |
| Economically active | 1,900 | 40% | 8,800 | 80% | 16,800 | 92% | 27,500 | 81% |
| *Full-time employee* | *400* | *8%* | *5,200* | *47%* | *13,100* | *72%* | *18,700* | *55%* |
| *Full-time self-employed* | *300* | *5%* | *900* | *8%* | *1,200* | *6%* | *2,300* | *7%* |
| *Part-time employee* | *400* | *9%* | *2,000* | *19%* | *2,000* | *11%* | *4,500* | *13%* |
| *Part-time self-employed* | *100* | *2%* | *200* | *2%* | *300* | *2%* | *600* | *2%* |
| *Unemployed* | *700* | *15%* | *500* | *4%* | *200* | *1%* | *1,400* | *4%* |
| Economically inactive | 2,800 | 60% | 2,300 | 20% | 1,400 | 8% | 6,500 | 19% |
| *Looking after family/home* | *700* | *14%* | *700* | *6%* | *400* | *2%* | *1,700* | *5%* |
| *Permanently sick/disabled* | *1,300* | *28%* | *600* | *6%* | *200* | *1%* | *2,200* | *6%* |
| *Retired* | *300* | *5%* | *500* | *5%* | *500* | *3%* | *1,300* | *4%* |
| *Full-time education* | *100* | *1%* | *100* | *1%* | *100* | *0%* | *200* | *1%* |
| *Temporarily sick/disabled* | *100* | *2%* | *0* | *0%* | *0* | *0%* | *200* | *0%* |
| *Other* | *400* | *9%* | *300* | *3%* | *200* | *1%* | *900* | *3%* |
| All adults | 4,700 | 100% | 11,100 | 100% | 18,200 | 100% | 34,000 | 100% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

**Faced bigger increase in unemployment than higher earners at start of recession...**

Due to the data collection period for the *Family Resources Survey*, the full impact of the recession on LMEs' employment cannot yet be gauged. However, the data suggests that LMEs were already beginning to feel the effects of the downturn in the 2008-09 period.

Chart 4.6 summarises the changes in economic activity rates between the 2007-08 and 2008-09 surveys. The proportion of LMEs who were unemployed increased by 1.2 percentage points over the period, compared with 0.3 percentage points among higher earners.

**Large fall in full-time work partially offset by increase in part-time ...**

The proportion of LMEs who were working full-time fell by 1.2 percentage points, compared to a drop of 0.3 percentage points in the higher earner group. However, the proportion of LMEs working part-time *increased* – by 1.1 percentage points – compared to a fall of 0.2 percentage points among higher earners.

Given the finding discussed in Chapter 4.1 about the shift from full-time to involuntary part-time work over the course of the recession, it is likely that the increase in part-time work in the LME group reflected in part a reduction in hours for previously full-time working low and higher earners (whose reduced incomes pushed them into the LME group in 2008-09). It could also be a product of some previously non-working LME adults moving into work as a means of replacing lost incomes from elsewhere in the household.

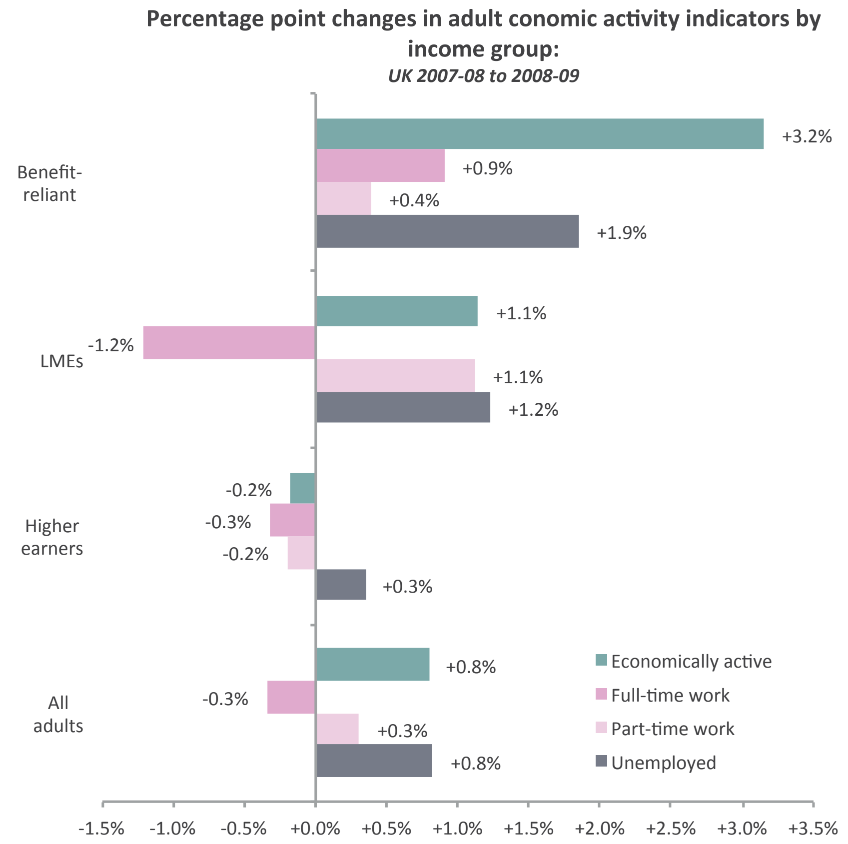



Chart 4.6: Changes in economic activity by income group: UK 2007-08 to 2008-09
Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey* 2008-09 & 2007-08

This second possibility is supported by consideration of the gender split in activity. Table 4.2 details activity rates among males and females in each of the income groups in 2008-09. In all groups, males were more likely to be active than females, more likely to be working full-time and be self-employed, but less likely to be working part-time.

*Three-quarters of LME men work full-time; one-third of women...*

Among LMEs, three-quarters (74 per cent) of men were working full-time, compared with just over one-third (37 per cent) of women. In contrast, just 8 per cent of men were working part-time, compared with 33 per cent of women. LME men (6 per cent) were twice as likely as women (3 per cent) to be unemployed, though women (28 per cent) were much more likely than men (13 per cent) to be inactive.

Table 4.2: Economic activity among adults by income group and sex: *UK 2008-09*

| | Benefit-reliant | | LMEs | | Higher earners | | All adults | |
|---|---|---|---|---|---|---|---|---|
| | Male | Female | Male | Female | Male | Female | Male | Female |
| Economically active | 48% | 32% | 87% | 72% | 95% | 89% | 87% | 75% |
| *Full-time employee* | *11%* | *6%* | *60%* | *34%* | *81%* | *61%* | *66%* | *44%* |
| *Full-time self-employed* | *9%* | *2%* | *13%* | *3%* | *10%* | *3%* | *11%* | *3%* |
| *Part-time employee* | *6%* | *13%* | *6%* | *30%* | *3%* | *21%* | *4%* | *23%* |
| *Part-time self-employed* | *2%* | *2%* | *2%* | *3%* | *1%* | *2%* | *1%* | *2%* |
| *Unemployed* | *20%* | *11%* | *6%* | *3%* | *1%* | *1%* | *5%* | *3%* |
| Economically inactive | 52% | 68% | 13% | 28% | 5% | 11% | 13% | 25% |
| *Looking after family/home* | *2%* | *25%* | *0%* | *12%* | *0%* | *4%* | *1%* | *10%* |
| *Permanently sick/disabled* | *31%* | *25%* | *5%* | *6%* | *1%* | *2%* | *6%* | *7%* |
| *Retired* | *6%* | *5%* | *4%* | *5%* | *2%* | *4%* | *3%* | *4%* |
| *Full-time education* | *0%* | *2%* | *1%* | *1%* | *0%* | *0%* | *0%* | *1%* |
| *Temporarily sick/disabled* | *3%* | *2%* | *0%* | *1%* | *0%* | *0%* | *0%* | *1%* |
| *Other* | *9%* | *9%* | *2%* | *3%* | *1%* | *2%* | *2%* | *3%* |
| All adults | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*LME men more affected by early stages of recession than women...*

Chart 4.7 compares changes in male and female activity rates between 2007-08 and 2008-09 in the LME group with those taking place in the population as a whole.

Among men, LME trends appear to be in the same direction, but of a bigger magnitude, than those occurring in the overall population. That is, full-time employment fell further (-2.9 percentage points, compared with -1.3 percentage points) and unemployment rose higher (+2.4 percentage points, compared with +1.2 percentage points), but part-time working also increased by more (+1.8 percentage points, compared with +0.7 percentage points).

*Shift from full-time to unemployment and under-employment...*

Among women, changes among LMEs were similar to those in the population as a whole and were much smaller on all counts than those experienced by men. Unemployment increased by just 0.1 percentage points, compared with 0.4 percentage points among all females.

Increases in both full-time and part-time employment among LME women add weight to the theory that some households responded to the downturn by shifting work balances. That is, job losses and cuts in hours experienced by many men were partly compensated by increased female working.

*While LME women increased part-time and full-time working...*

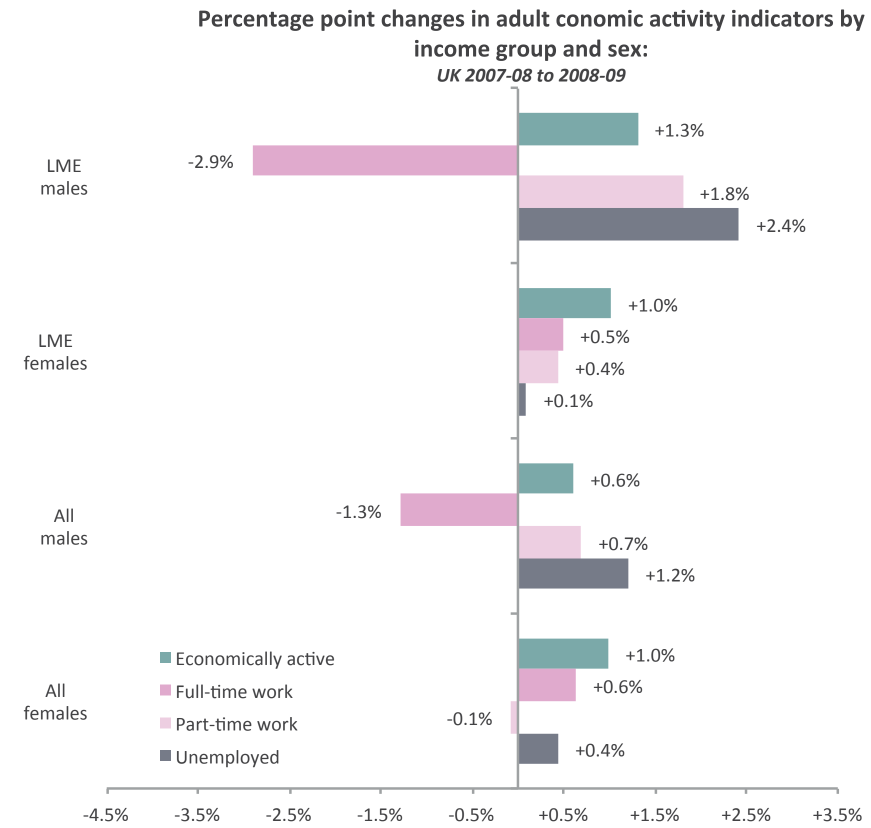



Chart 4.7: Changes in LME economic activity by sex: UK 2007-08 to 2008-09

Note: LMEs based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09 & 2007-08*

*Full-time working among LMEs highest in Northern Ireland and lowest in London...*

*Unemployment highest in West Midlands and lowest in East Midlands...*

Table 4.3 highlights significant regional variation in economic activity among LMEs in 2008-09: the proportion working full-time was highest in Northern Ireland (60 per cent) and lowest in London (50 per cent); the proportion working part-time was highest in the South West (26 per cent) and lowest in Northern Ireland (15 per cent); and the proportion unemployed was highest in the West Midlands (6 per cent) and lowest in the East Midlands (2 per cent).

It is worth noting that these figures do not necessarily reflect more general activity rates in these areas. They may instead simply be products of our definition of LMEs. For example, the relatively low level of full-time work among LMEs in London may simply reflect the high level of wages there, which mean that a higher proportion of those working full-time have salaries above the national median and are therefore part of the higher earner group. To qualify for LME status, individuals are more likely to need to be working part-time than they are in other parts of the country, and couples are more likely to need to include one non-working member. The variances highlight the situations faced by LMEs in different localities however.

Table 4.3: Economic activity among LME adults by Government Office Region: *UK 2008-09*

| | East Midlands | Eastern | London | North East | North West & Merseyside | Northern Ireland |
|---|---|---|---|---|---|---|
| Economically active | 83% | 80% | 74% | 75% | 79% | 78% |
| *Full-time employee* | *52%* | *44%* | *40%* | *47%* | *48%* | *51%* |
| *Full-time self-employed* | *7%* | *8%* | *10%* | *5%* | *7%* | *9%* |
| *Part-time employee* | *21%* | *19%* | *16%* | *18%* | *18%* | *14%* |
| *Part-time self-employed* | *2%* | *3%* | *4%* | *2%* | *2%* | *1%* |
| *Unemployed* | *2%* | *5%* | *4%* | *4%* | *4%* | *2%* |
| Economically inactive | 17% | 20% | 26% | 25% | 21% | 22% |
| *Looking after family/home* | *5%* | *7%* | *11%* | *5%* | *4%* | *6%* |
| *Permanently sick/disabled* | *4%* | *3%* | *5%* | *9%* | *9%* | *9%* |
| *Retired* | *5%* | *5%* | *3%* | *7%* | *5%* | *4%* |
| *Full-time education* | *0%* | *0%* | *2%* | *1%* | *0%* | *0%* |
| *Temporarily sick/disabled* | *0%* | *0%* | *1%* | *0%* | *0%* | *0%* |
| *Other* | *3%* | *4%* | *4%* | *3%* | *2%* | *3%* |
| Total | 100% | 100% | 100% | 100% | 100% | 100% |

| | Scotland | South East | South West | Wales | West Midlands | Yorkshire & the Humber | All low earners |
|---|---|---|---|---|---|---|---|
| Economically active | 82% | 80% | 83% | 80% | 80% | 80% | 80% |
| *Full-time employee* | *51%* | *44%* | *44%* | *53%* | *46%* | *48%* | *47%* |
| *Full-time self-employed* | *7%* | *10%* | *9%* | *7%* | *5%* | *8%* | *8%* |
| *Part-time employee* | *19%* | *18%* | *23%* | *16%* | *21%* | *17%* | *19%* |
| *Part-time self-employed* | *2%* | *3%* | *3%* | *1%* | *2%* | *2%* | *2%* |
| *Unemployed* | *4%* | *4%* | *4%* | *4%* | *6%* | *5%* | *4%* |
| Economically inactive | 18% | 20% | 17% | 20% | 20% | 20% | 20% |
| *Looking after family/home* | *5%* | *8%* | *5%* | *4%* | *7%* | *6%* | *6%* |
| *Permanently sick/disabled* | *6%* | *3%* | *3%* | *8%* | *5%* | *7%* | *6%* |
| *Retired* | *4%* | *5%* | *5%* | *4%* | *5%* | *5%* | *5%* |
| *Full-time education* | *1%* | *1%* | *1%* | *0%* | *0%* | *0%* | *1%* |
| *Temporarily sick/disabled* | *0%* | *0%* | *0%* | *1%* | *1%* | *0%* | *0%* |
| *Other* | *2%* | *3%* | *2%* | *2%* | *2%* | *2%* | *3%* |
| Total | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

Note: LMEs based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

Charts 4.8 and 4.9 show how LME outcomes varied across regions in the period between 2007-08 and 2008-09. Chart 4.8 details changes in the proportions of LMEs working full-time and part-time, while Chart 4.9 sets out the movement in unemployment.

*Biggest increase in LME unemployment at start of recession in Eastern region, West Midlands and South West...*

The data suggests that, at this relatively early stage of the downturn, job losses among LMEs were most pronounced in the Eastern (the proportion of LMEs unemployed increased by 2.8 percentage points), West Midlands (+2.3 percentage points) and South West (+1.9 percentage points) regions. In contrast, unemployment actually *fell* among LMEs in Northern Ireland (-0.5 percentage points) and the East Midlands (-0.2 percentage points).

As with the overall employment picture, it is likely LME job losses were mitigated to some extent by reduction in hours. Focusing on drops in full-time working, the worst hit areas were London (the proportion of LMEs working full-time fell by 5.8 percentage points), the West Midlands (-4.0 percentage points) and the North West & Merseyside (-3.3 percentage points).

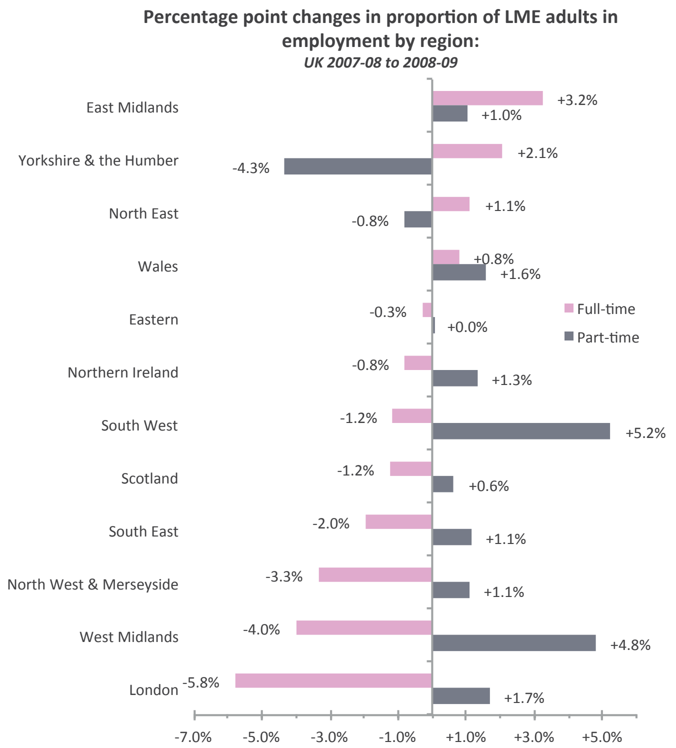



Chart 4.8: Changes in LME employment by region: UK 2007-08 to 2008-09

Note: LMEs based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09 & 2007-08*

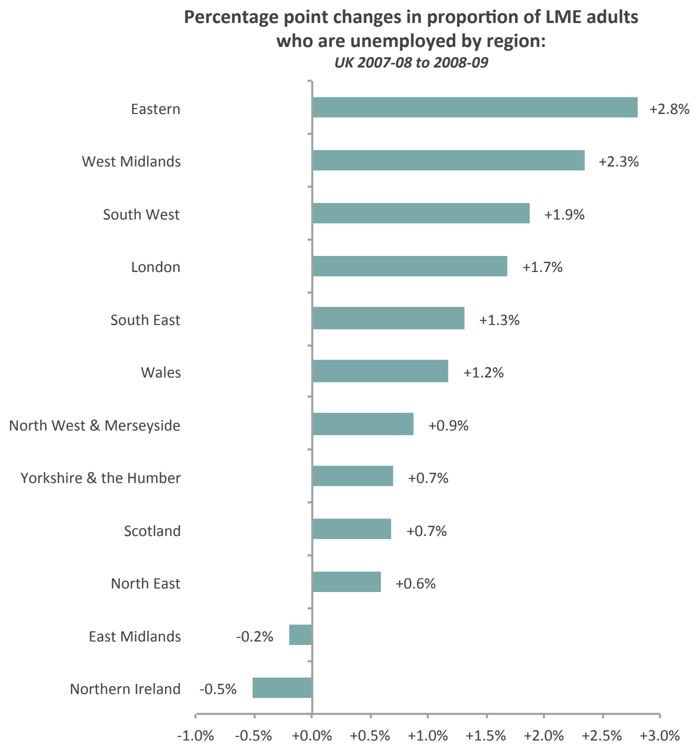



Chart 4.9: Changes in LME unemployment by region: UK 2007-08 to 2008-09

Note: LMEs based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09 & 2007-08*

While reliance on the data in the *Family Resources Survey* prevents analysis at this stage of the experiences of LMEs over the full duration of the recession and beyond, we are able to draw some conclusions about likely outcomes based on the sectors LMEs work in and their typical skill and occupational profiles.

### *Industrial sectors*

***LMEs account for one-third of all jobs…***

Table 4.4 details the number of workforce jobs held by LMEs recorded in the 2007-08 and 2008-09 *Family Resources Surveys*.

In the latter period, LMEs accounted for 32 per cent of all jobs, including 48 per cent in the *accommodation and food services sector*, 42 per cent in *retail* and 37 per cent in *construction*. In terms of the numbers working in each sector, there were 1.5 million LME jobs in *retail* (18 per cent of all LME jobs), *health and social work* accounted for 1.0 million (12 per cent) and *manufacturing* provided a further 1.0 million (12 per cent).

***Over-represented in accommodation & food, retail, construction and manufacturing sectors…***

The number of LME jobs fell by 9 per cent in the *transport and communications* sector between 2007-08 and 2008-09, and by 9 per cent in the *public administration sector.* There were also 5 per cent drops in the *health and social work* and *manufacturing sectors*.

In contrast, there were sizeable proportional increases in LME job numbers in education (up 14 per cent) – perhaps reflecting significant transfers into the profession at the start of the recession – *professional, scientific and technical activities* (11 per cent), *construction* (6 per cent) and *financial services* (4 per cent).



Table 4.4: Jobs held by LME adults by industrial sector: *UK 2007-08 & 2008-09*

| | Number (000s) | | 2008-09 LME proportion | | Change 2007-08 to 2008-09 | |
|---|---|---|---|---|---|---|
| | *2007-08* | *2008-09* | *of all jobs in industry* | *of all LME jobs* | *Number (000s)* | *Proportion (%)* |
| Retail | 1,440 | 1,470 | 42% | 18% | +30 | +2% |
| Health and social work | 1,080 | 1,030 | 31% | 12% | -50 | -5% |
| Manufacturing | 1,020 | 970 | 35% | 12% | -50 | -5% |
| Financial services | 810 | 840 | 23% | 10% | +30 | +4% |
| Construction | 780 | 830 | 37% | 10% | +50 | +6% |
| Transport and communications | 670 | 610 | 34% | 7% | -60 | -9% |
| Education | 520 | 590 | 25% | 7% | +70 | +14% |
| Accommodation and food services | 520 | 520 | 48% | 6% | +0 | -0% |
| Public administration, defence & social security | 490 | 440 | 23% | 5% | -40 | -9% |
| Arts, entertainment & recreation | 280 | 290 | 29% | 4% | +10 | +3% |
| Agriculture, forestry & fishing | 200 | 190 | 44% | 2% | -10 | -5% |
| Energy, water and mining | 120 | 120 | 25% | 2% | +0 | +1% |
| Professional scientific & technical activities | 100 | 110 | 16% | 1% | +10 | +11% |
| Other service activities | 270 | 250 | 44% | 3% | -20 | -9% |
| Total jobs[1] | 8,300 | 8,270 | 32% | 100% | -40 | -0% |

Notes: LMEs based on FRS definitions: see Chapter 8.

[1] Does not include jobs not allocated to one of the industrial categories above.

Source: RF analysis of DWP, *Family Resources Survey 2007-08 & 2008-09*

Consideration of output and employment performances across industrial sectors over a longer time period suggest that LME sectors have tended to fare worse over time.

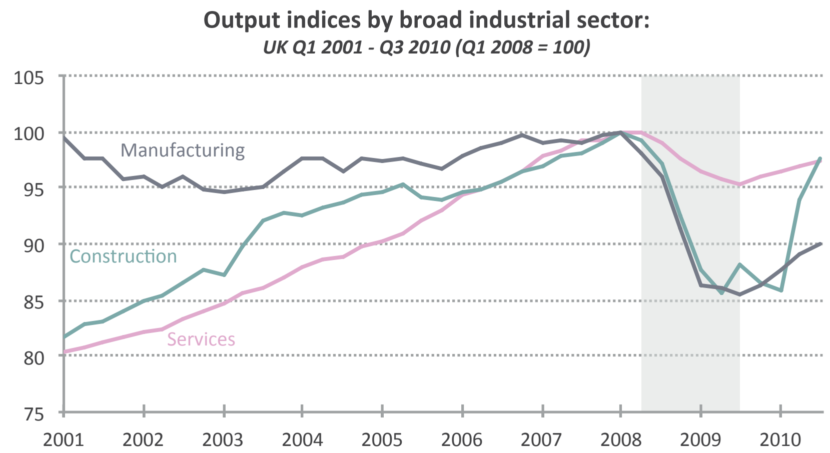
***Typical LME sectors among the worst affected during recession…***

Chart 4.10 details real-terms output indices in the three broad sectors of *manufacturing, construction and services* in the period from Q1 2001 to Q3 2010. It shows that, prior to the start of the recession, manufacturing output grew relatively slowly – heading back towards its 2001 starting position. In contrast, construction and – more linearly – services output expanded strongly.

Throughout the recession, the manufacturing and construction sectors were hit harder than services – although within this overall category, some services fared less well than others. The recovery has, however, been stronger in manufacturing and construction than in services.

Chart 4.10: Sectoral output indices: UK 2003-2010

Source: ONS Time Series, CKYY, GDQB & GDQS




***With biggest job losses taking place in manufacturing, construction and retail…***

Table 4.5 reflects these trends, and suggests that the employment picture is likely to have become more difficult for LMEs since the start of the recession, with large reductions in job numbers in typical LME industries such as *manufacturing* (job numbers down 13.3 per cent between Q1 2008 and Q2 2010), *construction* (9.1 per cent reduction) and *retail* (7.7 per cent fall).

Table 4.5: Number of workforce jobs by industry: *UK 2008-2010*

| *(seasonally adjusted, 000s)* | Total Q2 2010 | Change: Since Q1 2008 000s | % | Change: Y-on-Y 000s | % | Change: Q-on-Q 000s | % |
|---|---|---|---|---|---|---|---|
| Manufacturing | 2,515 | -386 | -13.3% | -96 | -3.7% | -17 | -0.7% |
| Construction | 2,103 | -211 | -9.1% | -72 | -3.3% | +53 | +2.6% |
| Total services | 25,408 | -389 | -1.5% | -104 | -0.4% | -7 | -0.0% |
| *Wholesale & retail trade; repair of vehicles* | *4,654* | *-387* | *-7.7%* | *-162* | *-3.4%* | *-24* | *-0.5%* |
| *Financial & insurance activities* | *1,074* | *-77* | *-6.7%* | *-74* | *-6.4%* | *+8* | *+0.8%* |
| *Information & communication* | *1,109* | *-73* | *-6.2%* | *-45* | *-3.9%* | *+3* | *+0.3%* |
| *Transport & storage* | *1,429* | *-93* | *-6.1%* | *-62* | *-4.2%* | *+2* | *+0.1%* |
| *Administrative & support service activities* | *2,359* | *-114* | *-4.6%* | *+53* | *+2.3%* | *-20* | *-0.8%* |
| *Accommodation & food service activities* | *1,904* | *-74* | *-3.7%* | *-37* | *-1.9%* | *+9* | *+0.5%* |
| *Arts, entertainment & recreation* | *847* | *-25* | *-2.9%* | *+8* | *+1.0%* | *-3* | *-0.4%* |
| *Public admin & defence; compulsory social security* | *1,740* | *-16* | *-0.9%* | *-12* | *-0.7%* | *-19* | *-1.1%* |
| *Human health & social work activities* | *3,977* | *+283* | *+7.7%* | *+139* | *+3.6%* | *+22* | *+0.6%* |
| *Real estate activities* | *455* | *+31* | *+7.3%* | *+14* | *+3.2%* | *+13* | *+2.9%* |
| *Professional scientific & technical activities* | *2,352* | *+106* | *+4.7%* | *+92* | *+4.1%* | *+27* | *+1.2%* |
| *Education* | *2,702* | *+121* | *+4.7%* | *+6* | *+0.2%* | *+* | *+0.0%* |
| *Other service activities* | *808* | *-68* | *-7.8%* | *-24* | *-2.9%* | *-21* | *-2.5%* |
| All industries | 30,801 | -929 | -2.9% | -196 | -0.6% | +71 | +0.2% |

Source: ONS labour market datasets

On a quarter-on-quarter basis, workforce jobs increased in a number of sectors, with *real estate* (+2.9 per cent), *construction* (+2.6 per cent) and *professional, scientific and technical activities* (+1.2 per cent) performing particularly well. In contrast, the number of workforce jobs in the *public administration, defence and social security* sector fell by 1.1 per cent, suggesting the beginning of a worsening of conditions in the public sector.

### *Occupational categories*

***LMEs typically in lower-level occupations...***

Within each of the sectors in which they work, LMEs are most likely to be employed in lower level jobs. Table 4.6 shows 17 per cent of working LMEs were engaged in *elementary* occupations in 2008-09 and 15 per cent were in *skilled trades*, while just 8 per cent were *managers and senior officials* and 5 per cent worked in *professional* occupations.

LMEs accounted for 32 per cent of all employees. Within each category, they were over-represented in *elementary* (54 per cent of all employees), *sales and customer services* (51 per cent) and *process, plant and machinery operatives* (48 per cent) occupations. In contrast, they were under-represented among *professionals* (11 per cent of all employees in this category), *managers and senior officials* (17 per cent) and those in *associate professional and technical occupations* (21 per cent).

***Over-represented in elementary, sales & customer service, process, plant & machinery operative, personal service and skilled trades categories...***

LME employee numbers fell most between 2007-08 and 2008-09 within the *elementary* (down 110,000), *process, plant and machinery operatives* (90,000) and *professional* (50,000) categories. However, there were increases in LME employees in *skilled trades* (up 70,000), *sales and customer services* (up 70,000) and *associate professional* (60,000) categories.

As with the industrial sector findings discussed above, these figures are likely to reflect two factors. First, the falling earnings of some higher earners in these sectors, pushing them into the LME group in 2008-09 and, secondly, the timing of the survey.



Table 4.6: LME employees by occupational category: *UK 2007-08 & 2008-09*

| | Number (000s) 2007-08 | Number (000s) 2008-09 | 2008-09 LME proportion: *of all employees in occupation* | 2008-09 LME proportion: *of all LME employees* | Change 2007-08 to 2008-09: *Number (000s)* | Change 2007-08 to 2008-09: *Proportion (%)* |
|---|---|---|---|---|---|---|
| Elementary occupations | 1,480 | 1,370 | 54% | 17% | -110 | -7% |
| Skilled trades occupations | 1,150 | 1,230 | 41% | 15% | +70 | +6% |
| Administrative and secretarial occupations | 1,030 | 1,010 | 34% | 12% | -20 | -2% |
| Personal service occupations | 940 | 980 | 45% | 12% | +30 | +4% |
| Process, plant and machinery operatives | 1,000 | 910 | 48% | 11% | -90 | -9% |
| Sales and customer service occupations | 810 | 880 | 51% | 11% | +70 | +9% |
| Associate professional and technical occupations | 770 | 830 | 21% | 10% | +60 | +8% |
| Managers and senior officials | 720 | 690 | 17% | 8% | -30 | -4% |
| Professional occupations | 460 | 410 | 11% | 5% | -50 | -11% |
| Total employees[1] | 8,350 | 8,300 | 32% | 100% | -50 | -1% |

Notes: LMEs based on FRS definitions: see Chapter 8.

[1] Does not include employees not allocated to one of the occupational categories above.

Source: RF analysis of DWP, *Family Resources Survey 2007-08 & 2008-09*

*LME occupations experienced biggest absolute increases in unemployment…*

Again, consideration of more recent data suggests that LME occupations have been worst hit over the longer-term. Table 4.7 sets out the number of Job Seekers Allowance claimants in the UK by the 'usual occupation' reported by claimants in the period from Q1 2008. In Q3 2010, JSA numbers were highest in typical LME occupational categories such as *elementary* (421,000 in Q3 2010), *sales and customer service* (275,000) and *skilled trades* (165,000).

*And form bulk of long-term unemployed…*

In September 2010, long-term unemployment was much more prevalent among people saying their usual occupation was *elementary* (176,000) than any other category: the next highest was *sales and customer service* (87,000) occupations. Just 14,000 long-term unemployed came from *professional* occupations.

Table 4.7: Number of JSA claimants by 'usual occupation' of claimant: *UK 2008-2010*

| | Quarterly average *(000s)* | Change *(%)* | | | Long-term un-employed[1] |
|---|---|---|---|---|---|
| | Q3 2010 | Since Q1 2008 | y-on-y | q-on-q | *Sep 2010 (000s)* |
| Managers and senior officials | 60 | +94% | -25% | -10% | 19 |
| Professional occupations | 50 | +140% | -18% | +9% | 14 |
| Associate professional and technical occupations | 90 | +98% | -15% | +0% | 29 |
| Administrative and secretarial occupations | 143 | +72% | -15% | -1% | 47 |
| Skilled trades occupations | 163 | +78% | -20% | -13% | 63 |
| Personal service occupations | 85 | +107% | +8% | +4% | 26 |
| Sales and customer service occupations | 277 | +101% | +11% | +3% | 87 |
| Process, plant and machine operatives | 140 | +56% | -21% | -11% | 61 |
| Elementary occupations | 420 | +43% | -8% | -6% | 176 |
| Occupation unknown | 13 | +642% | +160% | +17% | 1 |
| All | 1,441 | +73% | -9% | -4% | 523 |

Notes: [1] Unemployed for over 26 weeks.
Source: NOMIS database, 11 November 2010

### *Qualifications*

*LMEs have low-to-mid level skills profile…*

There is no definitive hierarchy to the occupational levels set out in Table 4.7: while it is clear that elementary occupations are less skilled than professional ones, it is not obvious how skilled trades compared with sales and customer service occupations. Moreover, job titles vary across companies, so there is likely to be some inconsistency in the categories recorded for each worker.

Nationally recognised qualifications therefore give a much better sense of the skills profile of workers. On this measure, LMEs can be seen to be concentrated in the low-to-mid level of the range. That is, members of LME households tend to have lower levels of qualifications than those in higher earner households and higher levels than those in benefit-reliant ones.

Table 4.8 shows that 44 per cent of LME adults had no qualification beyond GCSE/O-level in 2008-09, compared with 51 per cent among those from the benefit-reliant group and 26 per cent of higher earners. Just 16 per cent of LMEs had some form of university qualification, compared with 12 per cent of benefit-reliant adults and 39 per cent of higher earners.



Table 4.8: Highest level of educational qualification of adults by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All individuals |
|---|---|---|---|---|
| No formal qualifications | 7% | 5% | 2% | 3% |
| GCSE grade D-G | 15% | 10% | 4% | 7% |
| O/GCSE equiv. (A-C) | 29% | 29% | 20% | 24% |
| ONC/National Level BTEC | 6% | 8% | 6% | 7% |
| A-Levels; Highers | 9% | 11% | 11% | 11% |
| Higher educational qual (below degree) | 6% | 9% | 11% | 10% |
| Degree level qual (or equivalent) | 12% | 16% | 39% | 29% |
| Other qualifications | 16% | 12% | 7% | 10% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*Low-to-mid skilled have suffered the biggest employment effects since the start of the recession…*

Table 4.9 and Chart 4.11 present similar findings. They show that, in the period between Q1 2008 (immediately prior to the recession) and Q2 2010, negative changes in activity, employment and unemployment rates were bigger among those with lower levels of qualifications.

Interestingly, however, it is those with GCSEs – rather than those with no qualifications – who have faced the biggest changes, perhaps reflecting the already high levels of economic inactivity among the latter group. It is therefore those with the low-to-mid level qualifications profiles of LMEs who appear to have suffered the biggest employment effects of the recession.

Table 4.9: Economic activity among working-age adults by highest qualification held: *UK 2008-09*

| | Employment rate | | Unemployment | | Inactivity rate | |
|---|---|---|---|---|---|---|
| | Q1 2008 | Q2 2010 | Q1 2008 | Q2 2010 | Q1 2008 | Q2 2010 |
| Degree or equivalent | 85% | 83% | 2% | 3% | 13% | 14% |
| Higher education (diploma & below degree) | 78% | 75% | 2% | 3% | 20% | 22% |
| A Level or equivalent | 74% | 70% | 3% | 5% | 23% | 25% |
| GCSE grades A-C or equivalent | 70% | 65% | 5% | 7% | 25% | 28% |
| Other qualifications | 66% | 60% | 5% | 7% | 29% | 32% |
| No qualification | 38% | 35% | 4% | 6% | 58% | 60% |

Source: ONS, *Labour Force Survey*

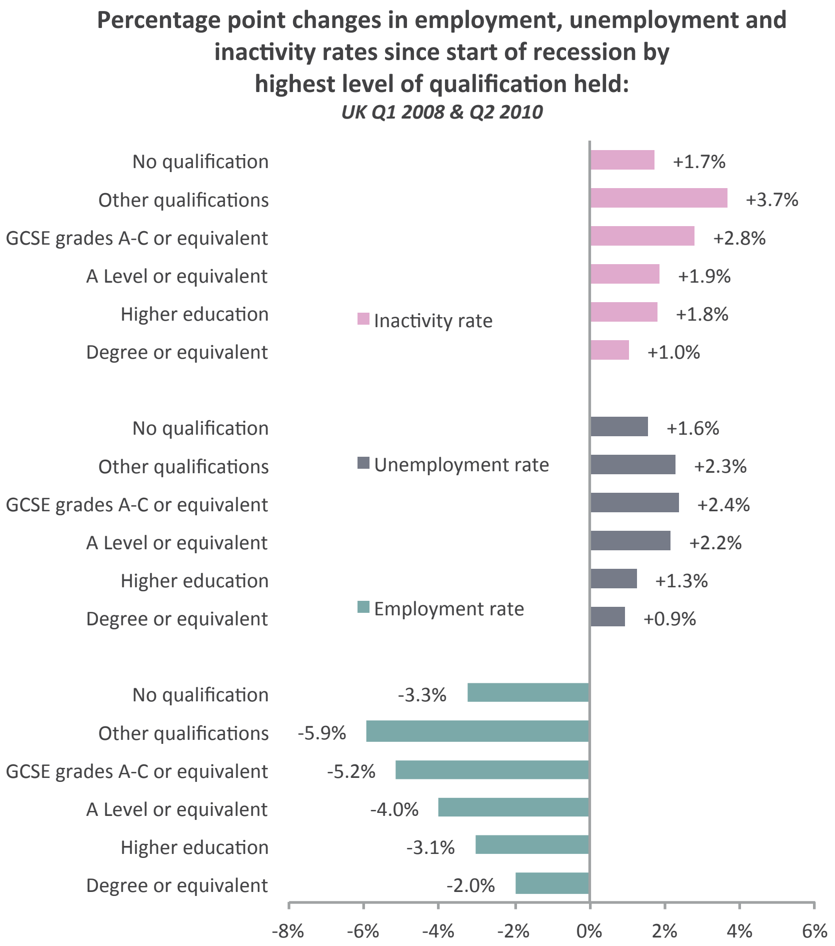



Chart 4.11: Changes in economic activity by level of qualification: UK 2008 to 2010
Source: ONS, *Labour Force Survey*

*Getting on in work*

***LMEs more likely than higher earners to have difficulties getting on in work...***

Research has shown that LMEs are more likely than higher earners – both outside and within the same firms – to experience difficulties with job retention and career progression.

For example, a 2009 ippr study noted that just 74 per cent of employees who were low-paid[20] in 2000 were in employment in 2005, compared with 83 per cent of higher earners. Workers recorded as low-paid in 2000 were twice as likely as higher earners to be unemployed and three times as likely to be economically inactive in 2005. On progression, over half of low-paid workers experienced no significant improvement in income from 2002 to 2005: moves out of low pay were found to be particularly infrequent among workers who start out in skilled trades, customer service, semi-skilled manual occupations and in entry-level jobs.[21]

The report cited findings from previous studies that showed that low pay was little better than unemployment in helping people move into higher paid work, even where other factors such as age, gender and qualification were discounted. Explanations for this effect included the 'signal' low pay experience sends to prospective employers and the detrimental effect low pay may have on workers' motivation and self-confidence.[22]

20. Earning less than 60 per cent of median full-time earnings and more than £3 per hour
21. ippr, *Nice Work If You Can Get It: achieving a sustainable solution to low pay and in-work poverty,* January 2009, Tables 2.2 & 2.3
22. Ibid.



***Face time pressures, job insecurity and a lack of opportunities to change course...***

A National Consumer Council (NCC) qualitative study of a sub-set of LMEs[23] in January and February 2008 identified a number of labour market concerns and barriers to progression.[24] Almost all participants in the review felt their jobs were insecure. This was a particular problem in areas with a weak local job market or an abundance of cheap labour, because respondents said they were restricted in their ability to travel or relocate for work by their lack of resources. Members of the focus groups also said that they typically worked long hours, with some doing so because they were pressured to take shifts by their employers. They also had little access to flexible working opportunities and had difficulties booking annual leave at short notice. The NCC concluded that the group was exposed because of a lack of information and understanding about employment rights, variations in those rights and differences in enforcement.

Some of the younger LMEs involved in the study said that they wanted to change occupation in order to secure better working hours and improved prospects but they found their lack of experience to be a barrier. Financial realities meant that these individuals could not consider retraining in their spare time, particularly because of the irregular and limited nature of their time off.

***Often pessimistic and lack confidence...***

A more recent study commissioned by the Joseph Rowntree Foundation found that the notion of progression in work did not resonate with low-skilled workers. Low confidence and pessimism about future prospects were identified as key barriers to progression but others also made positive choices to not pursue career goals as a trade-off with other aspirations and considerations such as having children or the necessity of moving into a line of work that is higher paid but less enjoyable.[25]

A further potential barrier to progression among LMEs is the declining relative supply of intermediate jobs. Research has suggested that the UK labour market has become polarised over recent years, with technological change facilitating automation of many mid-level occupations, such as semi-skilled manufacturing.[26] Low level jobs – such as cleaning and security – and highly-skilled technical occupations – such as IT and accountancy – are generally not suitable for such automation, and have therefore grown by comparison.

***Reduction in intermediate level 'bridging professions' make route out of low pay harder to navigate...***

Chart 4.12 shows that, in the period since 1982, the proportion of jobs in the UK in 'higher occupations' (managers and senior officials, professional occupations) has increased significantly, while the proportion in 'lower occupations' (personal services, sales and customer services, process, plant and machine operatives, elementary occupations) has fallen only slightly.

23. Low-income workers (single people earning between £10,000 and £18,500; couples earning under £29,000 with neither of them earning above £18,500 individually) not living with dependent children and or claiming welfare benefits including tax credits.
24. NCC (2008), *More snakes than ladders? an insight into the lives of the forgotten working poor,*
25. JRF, Better off working? Work, poverty and benefit cycling, 2010
26. Goos, M. and Manning, A., "Lousy and Lovely Jobs: The Rising Polarization of Work in Britain", *Review of Economics and Statistics*, 89 (1), pp. 118-133, 2007

The biggest decline has therefore taken place in the 'intermediate occupations' (associate professional and technical, administrative and secretarial, skilled trades occupation), meaning that it is likely to have become more difficult for LMEs to progress towards the highest occupations due to the lack of "bridging professions".[27]

The study behind this data projected that this trend will continue, with intermediate occupations representing just over one-fifth of all jobs by 2012.

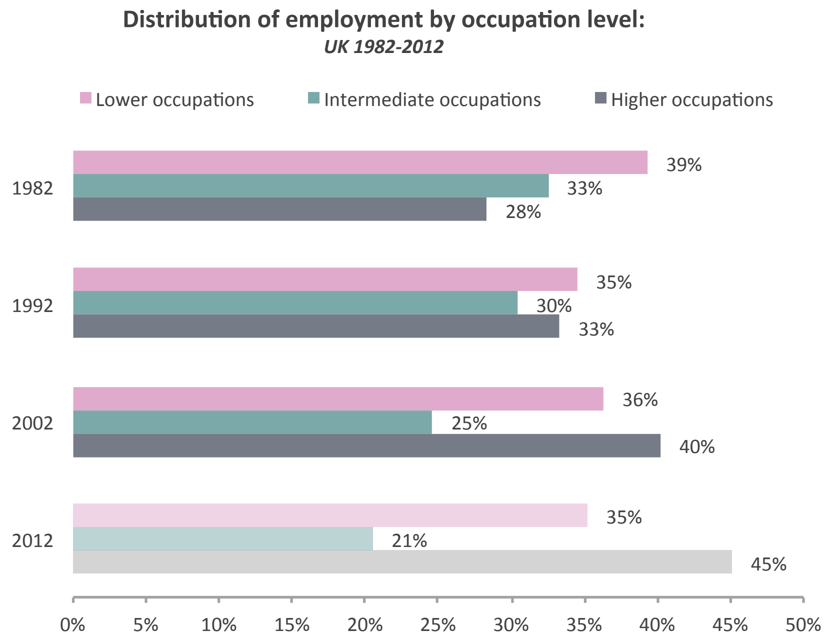



Chart 4.12: Distribution of employment by occupation level: UK 1982-2012

Notes: 'Higher occupations': *managers & senior officials and professional occupations;*
Intermediate occupations': *associate professional & technical, administrative & secretarial and skilled trade occupations*;
'Lower occupations': *personal services, sales & customer services, process, plant & machine operatives and elementary occupations.*

Source: ippr, *Choosing to Learn, Improving participation after compulsory education, December 2005*

Training helps with job retention and progression both through the direct effect of increasing skills levels and via the more indirect impact on employee confidence.[28] It is likely to be of particular importance in the current climate in which opportunities associated with economic recovery remain limited.

***Often excluded from in-work training because of skills profile…***

However, employers tend to focus training on the higher skilled members of their workforces. Chart 4.13 presents Labour Force Survey data showing that 68 per cent of employees in Q2 2010 that were educated to degree level had been offered training by their employer in the last year, compared with 56 per cent of those with qualifications no higher than GCSE.

27. The categorisation of occupations into three hierarchical levels is unavoidably arbitrary. Arguments could be made for changing the compositions of the groups. For example, the relatively high number of graduates working in *associate professional & technical* occupations could argue for its inclusion in the 'higher occupation' category. Similarly, consideration of more detailed occupational codes could provide a more nuanced approach. In the absence of major reorganisation of the categories, however, the trends shown in Chart 4.12 are likely to hold.

28. See for example JRF, *Better off working? Work, poverty and benefit cycling*, 2010.



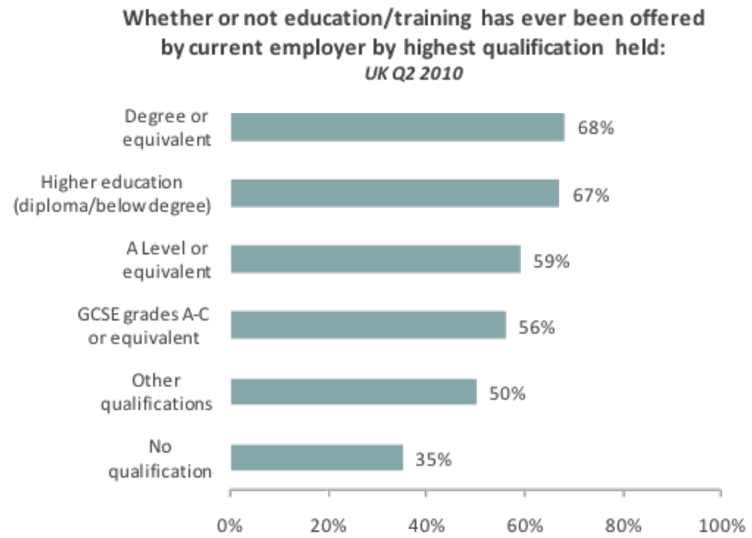



Chart 4.13: Employer provision of training by qualification of employee: UK 2010

Source: ONS, *Labour Force Survey*

Analysis of the National Employer Skills Survey similarly reveals that employees in higher level occupations are more likely to be offered skills training. Chart 4.14 shows that in 2009, 32 per cent of *managers and senior officials* undertook employer-provided training, compared with just 9 per cent of those in *elementary* occupations.

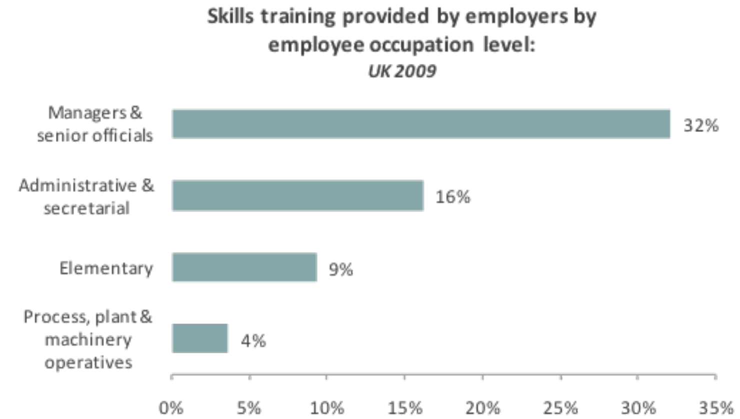



Chart 4.14: Skills training provided by employers: UK 2007

Source: Learning & Skills Council, *National Employer Skills Survey 2009*

Table 4.10 highlights the potential benefits of earning a new qualification, especially at the lower end of the income scale. It analyses National Child Development Study (NCDS) cohort data[29] and shows that, among those lowest earning and low-to-middle earning members of the cohort who earned a new qualification between 1991 and 2000, the proportions experiencing upward mobility were 63 per cent and 35 per cent. In contrast, among those members of these groups not gaining a new qualification, mobility was restricted to 43 per cent and 23 per cent respectively.

29. The NCDS is a national cohort study that started in 1958 and surveyed all the children born in one week in that year in England, Scotland and Wales. Periodic follow-ups have captured the cohort at different periods in their lives. In relation to analysis of this dataset, we have created four income groups – based on distributions of individual gross weekly earnings from employment – rather than our usual three, in order to add a degree of nuance to estimates of mobility. Details are provided in Chapter 8.

Table 4.10: Proportion of NCDS cohort members who moved up the income scale in period by whether or not they gained a new qualification: *1991-2000 & 2000-2004*

| | Lowest earners | LMEs | Middle-to-high earners |
|---|---|---|---|
| New qualification | | | |
| 1991-2000 | 63% | 35% | 18% |
| 2000-2004 | 40% | 24% | 17% |
| No new qualification | | | |
| 1991-2000 | 43% | 23% | 17% |
| 2000-2004 | 31% | 20% | 15% |

Notes: Qualification obtained refers to both academic and vocational qualifications.
Income groups based on NCDS definition: see Chapter 8.

Source: RF analysis of *National Child Development Study*, Waves 5 to 7

***Been undermined by skills focus on high- and low-end…***

LMEs have not been helped by the direction of successive governments' skills policies. The polarisation of jobs in the UK economy has driven a focus on improving skills at the high and low ends, with insufficient concern for those in the middle. Hence, university places were expanded significantly between 1997 and 2010, increasing the number of highly skilled people in the workforce. At the lower end of the skills spectrum, the emphasis under the previous government was initially on increasing basic skills in the workforce such as literacy and numeracy.

Following the Leitch Review,[30] the focus shifted towards educating employees to Level 2, with most investment going to provision of relatively low-level skills training. This occurred despite Leitch's report in fact recommending moving the balance of intermediate skills from Level 2 to Level 3, in order to realise the greater benefits associated with Level 3 education for both individual employees and the wider UK skills base.

### *Resilience*

***Redundant LMEs take longer than higher earners to leave claimant count…***

In addition to being more likely than higher-skilled, higher-earning members of the workforce to lose their jobs, LMEs are also more likely to take longer to return to work.

Chart 4.15 details JSA off-flows in August 2010 by length of time on the benefit for both *managers and elementary workers*. Of those exiting JSA in August 2010, 74 per cent of *managers and senior officials* had been on the count for 26 weeks or less, compared with 68 per cent of those who work in *elementary* occupations.

30. HM Treasury, *Leitch Review of Skills: Prosperity for all in the global economy – world class skills, 2006*



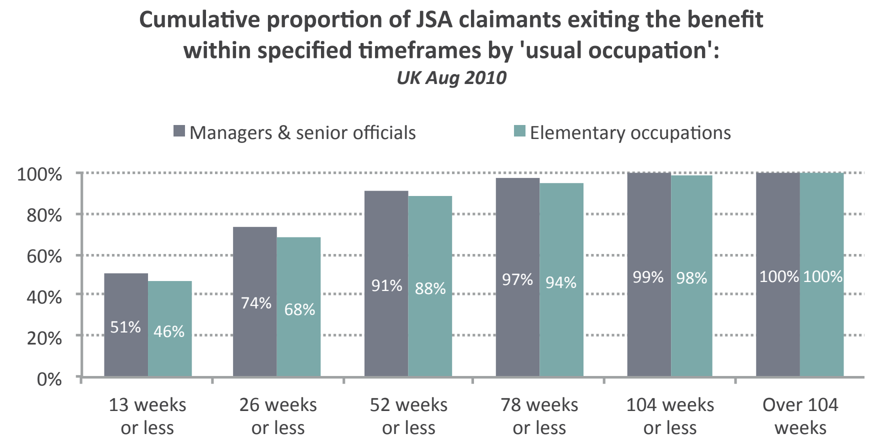



Chart 4.15: JSA claimants exiting the count within specified timeframes by selected 'usual occupation': UK 2010

Source: ONS, *NOMIS* database

Not only are those from elementary occupations likely to be on JSA for longer than managers, they are also less likely when they do exit the benefit to be doing so because of a return to work. Chart 4.16 shows that, in August 2010, 32 per cent of those from elementary occupations who left the count had simply failed to sign on, compared with 22 per cent of managers. DWP research suggests that people who leave the count in this way frequently return in the medium-term.

***And less likely to leave unemployment to return to work or training…***

In contrast, just 30 per cent found employment of at least 16 hours a week, compared with 52 cent of managers. Including those who exited onto training schemes or into education, managers and senior officials (55 per cent) remained more likely to leave for job-related activity than those from elementary occupations (44 per cent).

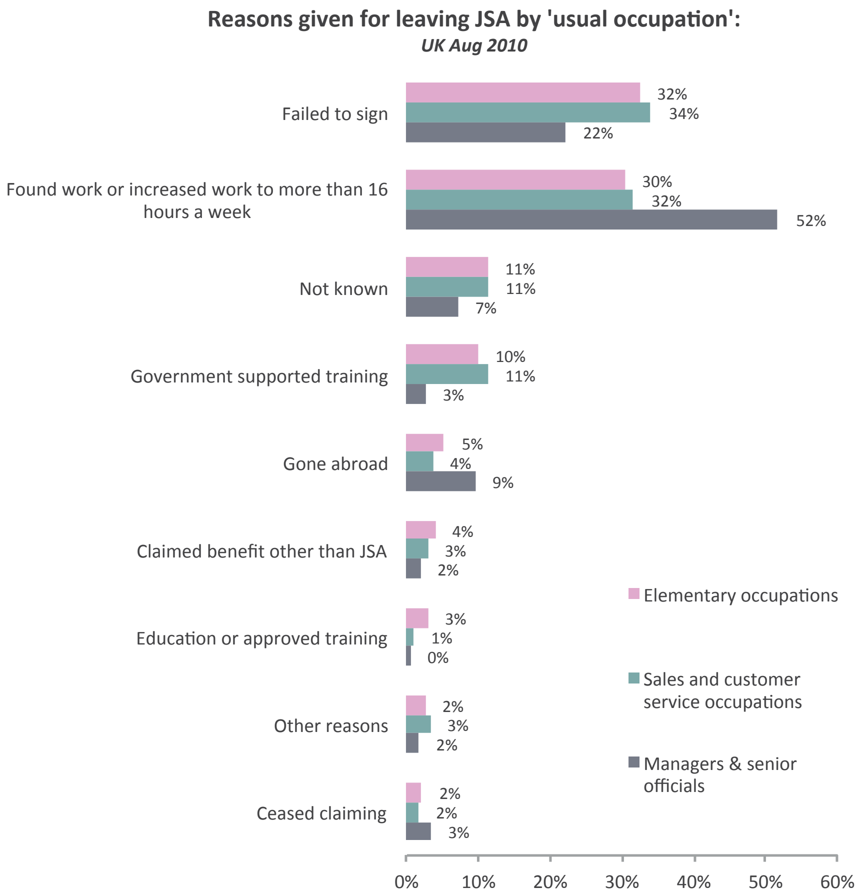



Chart 4.16: Reasons for exiting JSA claimant count by selected 'usual occupation': UK 2010
Source: ONS, *NOMIS* database

The length of time spent outside the workforce is particularly important for younger workers with low skill levels. Chart 4.17 uses evidence from the NCDS cohort to show that, for those with the intermediate skill levels typical of LMEs, a period of 12 months' unemployment between the ages of 16 and 23 can produce a wage scar of 28 per cent later in life.

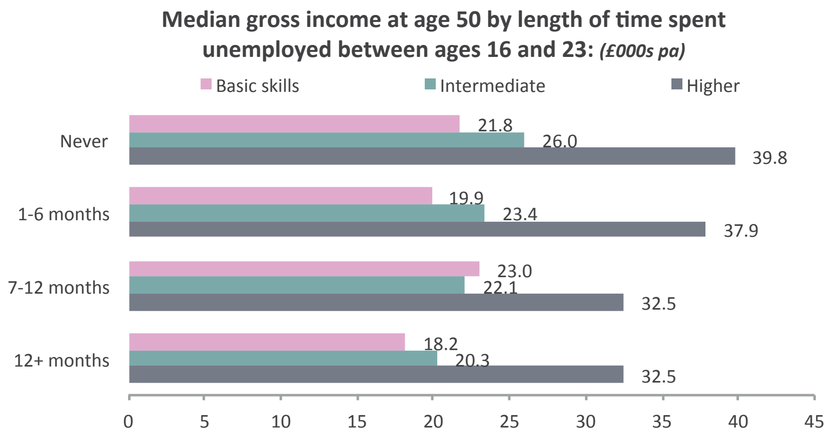



Chart 4.17: Median income at age 50 by skill levels and experience of youth unemployment
Notes: Full-time employees only. Basic skills are defined as no qualifications or Level 1; Intermediate skills are Levels 2 and 3; Higher skills are Levels 4-6.
Source: RF analysis of National Child Development Study, Waves 4 and 8

### *Carers*

*One-in-ten LMEs have informal caring responsibilities...*

LME employment prospects – particularly at a time of weak labour market activity – may be further hindered by caring responsibilities. Table 4.11 shows the proportion of adults in each income group who undertook such activity in 2008-09. The difference between LMEs (10 per cent of all adults) and higher earners (8 per cent) was small but important. Moreover, the gap was much bigger among younger members of the groups than among those close to retirement, potentially affecting long-term employment prospects for some LMEs.

Table 4.11: Proportion of adults who are informal carers by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All adults |
|---|---|---|---|---|
| All individuals | 13% | 10% | 8% | 9% |
| Sex | | | | |
| Male | 11% | 9% | 6% | 7% |
| Female | 16% | 12% | 10% | 11% |
| Age | | | | |
| 16-24 | 7% | 5% | 3% | 5% |
| 25-34 | 13% | 7% | 3% | 5% |
| 35-44 | 15% | 10% | 6% | 9% |
| 45-54 | 17% | 14% | 12% | 13% |
| 55-64 | 13% | 15% | 14% | 14% |
| 65+ | 12% | 7% | 6% | 7% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

### *Redundancy payments*

In addition to being more susceptible to unemployment and less likely to return to work quickly, LMEs have been more vulnerable to the *consequences* of labour market weakness than higher earners. This is partly due to the lower levels of protection enjoyed by LMEs in the form of savings and insurance (see Chapter 5), but it is also because of the levels of redundancy payments received by the group

*Received smaller redundancy payouts, reinforcing retraining difficulties...*

Table 4.12 sets out the distribution of awards received by adults who were made redundant in 2008-09, by their income group at the time of the survey. Among LMEs, the average payout received in 2008-09 was £8,260. This is lower than the averages within both the benefit-reliant (£9,220) and higher earner (£10,360) groups.

Table 4.12: Distribution of awards to adults receiving redundancy payments in past year by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Distribution by award | | | | |
| <£1,000 | 16% | 8% | 18% | 14% |
| £1,000 < £5,000 | 36% | 49% | 39% | 42% |
| £5,000 < £10,000 | 20% | 19% | 15% | 17% |
| £10,000 < £50,000 | 27% | 23% | 25% | 25% |
| £50,000 < £100,000 | 0% | 1% | 4% | 2% |
| Average award | £9,220 | £8,260 | £10,360 | £9,410 |

Note: LMEs based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

While perhaps surprising, the higher average awards recorded by benefit-reliant adults might reflect the fact that some who received sizeable payouts (27 per cent received awards in excess of £10,000) subsequently decided to take some time out from the labour market, and therefore had incomes at the times of the survey that put them in the benefit-reliant group.

Relatively low redundancy payment receipts are likely to compound the difficulties LMEs who lose their jobs have with retraining and re-entering sustainable employment. It will also exacerbate problems in other areas of LMEs' lives, in particular, household finances.

### *LMEs' experiences of recession*

***Employment pressure was biggest cause of concern during recession...***

Taken together, this picture of LMEs as being more vulnerable to job loss than higher earners (because of the sectors they work in and because of their relative expendability), less likely to bounce back quickly (because of their lower skill profiles and wider barriers to progression) and less able to cope with the financial implications of job loss (because of the exacerbation of generally lower levels of financial resilience by limited redundancy payment receipt), makes clear the heightened exposure faced by LMEs during the recession.

In June 2009 we commissioned OPM to conduct a focus group with 21 members of LME households, to determine their experiences of the downturn.[17] Participants described job insecurity and lack of employment opportuni[31]es as being their biggest concerns during the recession.

Most group members were in paid employment – either on a permanent or temporary basis – and a small number were self-employed. The type of employment varied and included cleaning, retail, administration, transport and garden maintenance across the private, public and third sectors. A minority were not working due to being retired, seeking employment or having other responsibilities such as caring for children or other relatives.

A number of participants said that their companies had made cutbacks since the start of the recession, both in the form of reduced employment and via wider cost-cutting measures.

> *I've noticed that they are cutting back at my job... I can't claim expenses anymore for outreach work. Sometimes I think it's just a matter of time until I get made redundant.*

> *They've started trying to cut down my hours at work because of the credit crunch.*

31. Details are provided in Chapter 8.



Several group members had friends, family members or neighbours who had recently lost their jobs. The precarious position of LMEs was reflected in participants' responses to the statement: *My number one concern about the recession is*:

> *Unemployment and not knowing if I still would have my job by the end of the year.*

> *Losing my job at the age of 52. Also what would happen if my husband lost his job?*

> *The lack of work out there at the moment and how the cost of everything's going up and there's no help.*

> *Losing my job and not being able to pay the bills and the mortgage, my biggest fear is losing my house.*

***Long hours and second jobs cause stress and resentment...***

Participants spoke about the impact that living in a LME household through the recession was having on their emotional, physical and psychological health. As well as being 'cash poor', participants often stated they were 'time poor', due to the long hours they worked or the necessity of taking on two jobs to make ends meet. Working two jobs was a cause of resentment and meant people were often tired and their relationships suffered.

> *Having to take on a second job made me feel angry; it's something you don't want to do – you want to be able to relax in the evening and watch the telly – you don't want to go straight back out and work again. You feel constantly tired.*

> *My salary wasn't covering all the bills and as it was coming up to Christmas we didn't have any money to celebrate it for the kids. My partner started working weekends and I took on a second job. We never saw each other.*

***Being on cusp of benefits is demoralising...***

There were several examples of 'work not paying'. Certain members of the group reported having net incomes from employment that were only marginally higher than what would be available to them in state support if they were unemployed. In a smaller number of cases, participants argued that they were less well-off compared to benefit-reliant households because of their ineligibility for council tax rebates and housing support. One woman who worked in a school as an administrative assistant reflected:

> *I'm £5 better off a week from working, and I get up at 5 a.m. every day. How can that be right?*

This situation was considered to be demoralising for people who felt they were working hard and contributing to society but seeing little benefit as a result.

> *You fall out of the catchment [for benefits] if you earn more than the threshold. With my wage I earn £11 more than the threshold for benefits so I'm not entitled to anything. I want to say to my employer 'well you can keep your £11 so that I can get a bit of extra help with benefits' but they say that's illegal.*

The lack of a secure, guaranteed, income each week that a permanent contract can offer was felt to be a particular disadvantage and made budgeting more difficult for those that were self-employed. For example, a couple of participants who were self-employed faced particular challenges relating to irregular income and budgeting.

> *I'm a cab driver but before that I used to be a bus driver… I wanted the control of being self-employed so that's why I became a cab driver. I tried to better my life but I was stupid to think that I could be self-employed. Some weeks you make a lot of money other weeks you make very little. It's less easy to budget for your life when you don't have a steady income. Now with the recession I noticed that there are fewer people taking cabs: people are walking or taking public transport because they are cutting back their costs.*

Participants who were not already in paid employment, retired or caring for someone tended to be looking for work. Since the recession, the group agreed there were fewer job opportunities available and more people competing for vacancies.

***Finding work more difficult in recession and obligations on job seekers sometimes in-appropriate…***

Participants criticised the courses job seekers are required to attend: they were felt to be of questionable quality and to provide a poor fit with their existing skills. For example, one participant's partner was a qualified electrician who was out of work and was sent on a 13-week course on business skills which they felt was irrelevant. There were also examples of people being made to go on courses just a few weeks before they reached statutory retirement age.

Participants commented on the negative effect the courses had on people who felt degraded by having to go on poor quality training with the threat of benefits being withdrawn through non-attendance. The group expressed doubt as to whether the courses led to better employment prospects.

> *You're a statistic: the courses get you off their books.*

> *It gives you hopes and dreams of a job, but no job at the end of it.*

The high cost of transport was also identified as a further barrier to finding work.

> *It would be really helpful if people on low incomes could get some form of subsidised support: such as the free or subsidised travel cards that people on benefits get.*

***Age seen as barrier to regaining employment…***

Apart from a lack of jobs, a number of older participants felt that ageism played a large barrier in seeking employment with one person stating:

> *Employers don't want to know if you're over 50.*

There was widespread agreement from the group on this point. Older members of the group felt that employers could tell how old they were from their education and employment history on their CV and that this was a big disadvantage. This prejudice had also been experienced at the job centre where a number of older participants had been asked how old they were and, on stating that they were in their 50s, were told that they would find it difficult looking for work and should start thinking about retirement.

# 5. Household finances

*Average net low-to-middle earner household income in 2008-09 was £19,600. Compared to 2007-08, average incomes grew more slowly among LMEs than among others, reflecting the labour market pressures faced by the group. Within the overall average, one-quarter experienced rising incomes and one-quarter faced falls. Nearly one million LME households were in relative poverty*

*LMEs have been more acutely affected than higher earners by price increases driven by fuel and food costs, because they spend more of their disposable income on these areas of spending. Half of the group had some difficulty keeping up with household bills in 2008-09 and one-quarter had no coping strategy in place.*

*Their ability to cope with the income and employment pressures of recession has been undermined by a lack of safety nets and by the credit crunch. Half had less than one month's net income in savings in 2008-09 and two-fifths said they couldn't afford to save £10 a month. Two-thirds didn't save in a pension. Nearly one-third experienced actual or perceived credit constraint.*

## 5.1 Household budgets in recession and recovery

*Spending, borrowing and saving*

***Consumer retrenchment has reduced spending and increased saving...***

As discussed in Chapter 3.3, one consequence of the conditions in place at the start of the recent recession is that UK households quickly retrenched. Consumer spending fell much more sharply than it did during previous periods of contraction, and has recovered little subsequently: total household consumption in Q2 2010 remained 3.6 per cent lower than in Q1 2008.

Falls in employment and nominal wage growth reduced nominal labour income. However, this effect was more than offset by higher government benefit payments and reduced taxes. Therefore, while falling income reduced spending in some households, the aggregate fall was primarily associated with an increase in the savings ratio: that is, households chose to rein in spending in favour of saving. The increase in the household saving ratio of 7.7 percentage points between Q3 2008 and Q3 2009 was the biggest four-quarter rise since records began in 1955. However, the ratio had reversed around half of its gain by Q2 2010, reflecting the slight increase in consumer spending and weaker incomes.

There has also been a significant slowing in the rate of growth of household borrowing since the start of the recession. This is likely to reflect in part reduced demand associated with household retrenchment, but has also been driven by supply-side factors. Both secured and unsecured lending conditions have been weak since the onset of the credit crunch, with banks increasing their capital ratios in response to concerns over increased defaults, lower asset prices and associated losses. As such, access to credit, even for credit-worthy consumers, has been restricted.

Moreover, even where credit remains available, it is often at a higher relative cost. While the official Bank of England Bank Rate has been reduced to a historic low in response to the recession, rates on a range of consumer credit products have failed to follow suit.

As discussed in Chapter 3.4, prospects for household spending and saving are subject to significant uncertainty. Fiscal consolidation, labour market conditions, ongoing credit tightness, concerns over debt levels and potential further house price falls are all likely to dampen consumer demand, but continued monetary stimulus will pull in the opposite direction.

Chart 5.1 sets out the OBR's central case projections for consumer spending and saving in the period to 2015. It shows an expectation of gradual growth in expenditure – with annual increases of 2.2 per cent by the end of the period – and a correspondingly gradual decline in the savings ratio, such that it reaches 5.4 per cent by 2015.

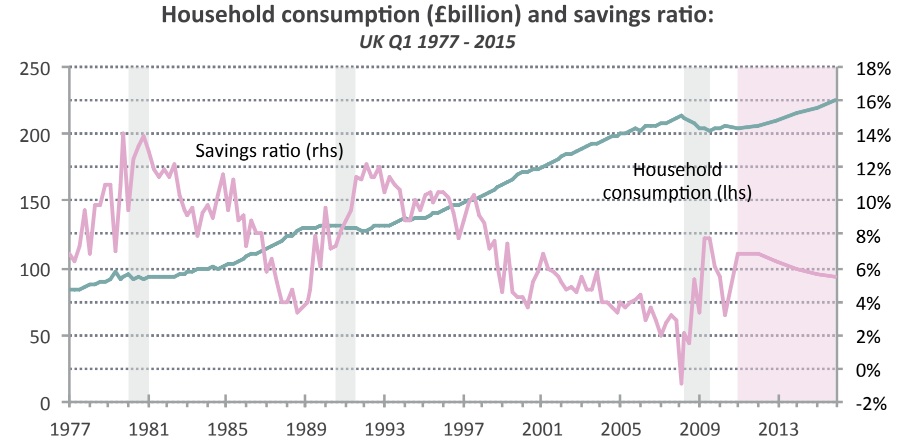



Chart 5.1: Household consumption and savings: 1977-2015
Note: Projections represent central OBR forecast.
Sources: ONS Time Series ABJR & NRJS; OBR, Budget Forecast, June 2010, Table C2

*Cost of living*

***Despite being relatively low, inflation has been above target for some time...***

The effects of economic slowdown have been made worse for many by rises in the cost of living. Chart 4.5 showed that, following a decade in which the annual increase remained primarily below 3.0 per cent, RPI inflation reached a high of 5.0 per cent in September 2008, despite the fall in demand associated with a recession.

While the level subsequently fell, and is relatively low by historical standards, CPI inflation remains above target and prices continue to rise more rapidly than earnings. Both the OBR and Bank of England have projected that the VAT increase in January 2011, further oil price rises and increased import costs associated with the depreciation of sterling will mean that this situation will persist until 2013. Ongoing spare capacity in the economy is expected to return inflation to target after that point.

## 5.2 LMEs' household finances

*Incomes and compositions*

***After benefits and taxes, average LME household income is £20,300...***

Table 5.1 details average (mean) non-equivalised household incomes in the UK in 2008-09, by income group, along with a breakdown of sources of income. On average, gross LME household income in 2008-09 was £25,700 and net household income was £20,300. These figures compare with overall UK average figures of £43,500 and £31,500.

LME households received £20,800 from non-benefit sources, with £19,500 coming from employment. In contrast, non-benefit income among benefit-reliant households was just £2,200 on average, with £1,900 coming from employment.

*Year-on-year growth in income smaller than for other income groups…*

Benefits were worth £2,200 on average to LME households, compared with £8,300 to benefit-reliant households. LME households were, however, the biggest recipients of tax credits. They received an annual average of £1,500, compared with £1,300 among benefit-reliant households and £200 among higher earners.

The LME net average household income was 2.5 per cent higher than in 2007-08, representing smaller year-on-year growth than among benefit-reliant (4.7 per cent) and higher earner (3.5 percent) households.

*900,000 LME households in relative poverty…*

While most LME households are not in crisis, around 930,000 (16 per cent of the total) had net incomes before housing costs in 2008-09 of less than 60 per cent of the national median, meaning that they were considered to be living in relative poverty.

### Table 5.1: Average annual income among households by income group: *UK 2008-09*

| £ | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Original (non-benefit) income | 2,200 | 20,800 | 63,700 | 39,100 |
| Gross earnings | 1,900 | 19,500 | 59,500 | 36,500 |
| *Gross income from employment* | *1,600* | *17,400* | *52,900* | *32,500* |
| *Gross self-employment earnings* | *300* | *2,100* | *6,600* | *4,100* |
| Investment income | 200 | 500 | 2,600 | 1,500 |
| Non-state pension income | 100 | 800 | 1,500 | 1,100 |
| + Benefit income | 8,300 | 2,200 | 1,000 | 2,700 |
| State pension, income support + pension credit | 100 | 300 | 200 | 200 |
| Disability benefits | 900 | 300 | 100 | 300 |
| Other benefits | 7,400 | 1,600 | 700 | 2,200 |
| Non-income-related benefit income | 2,700 | 1,900 | 1,000 | 1,600 |
| Income-related benefit income | 5,600 | 200 | 0 | 1,100 |
| + Tax credits | 1,300 | 1,500 | 200 | 800 |
| + Remaining income¹ | 600 | 1,300 | 1,100 | 1,100 |
| = Gross household income | 12,500 | 25,700 | 65,800 | 43,500 |
| - Direct taxes and other deductions² | 1,300 | 5,400 | 20,100 | 12,100 |
| = Net household income | 11,300 | 20,300 | 45,700 | 31,500 |
| *Change from 2007-08* | *+4.7%* | *+2.5%* | *+3.5%* | *+3.3%* |

Notes: Income groups based on FRS definitions: see Chapter 8.

¹ Includes income derived from sub-tenants, odd-jobs, free school milk and/or meals, private benefits (such as personal health insurance, trade union strike pay and government training allowances), student/school grants, royalties, allowances from friends, relatives or an organisation and allowances from local authorities for foster and adopted children.

² Income is net of: income tax payments; NICs; domestic rates/council tax; contributions to occupational pension schemes; maintenance and child support payments; parental contributions to students living away from home; and student loan repayments.

Sources: RF analysis of DWP, *Family Resources Survey 2008-09 & 2007-08;*
RF analysis of DWP, *Households Below Average Income 2008-09 & 2007-08*

As identified above, LMEs are the main recipients of tax credits. Table 5.2 shows that 30 per cent of LME family units[32] received credits in 2008-09, compared with 25 per cent of benefit-reliant units and 10 per cent of higher earner ones. Levels of receipt were particularly high in the 35-44 age group, with 57 per cent of LME families receiving some form of tax credit award. Among all those LME units in receipt of tax credits, the average award was £75.28 per week.

32. i.e. benefit units



*LMEs are main recipients of tax credits…*

### Table 5.2: Tax credit receipt among families by income group and age of unit head: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| Proportion in receipt of tax credits | | | | |
| 16-24 | 23% | 8% | 1% | 8% |
| 25-34 | 44% | 44% | 10% | 26% |
| 35-44 | 37% | 57% | 22% | 36% |
| 45-54 | 18% | 32% | 11% | 18% |
| 55-64 | 4% | 8% | 2% | 4% |
| All | 25% | 30% | 10% | 19% |
| Average tax credit award per week among all benefit units | | | | |
| 16-24 | £15.44 | £6.89 | £1.33 | £6.37 |
| 25-34 | £37.92 | £33.77 | £7.21 | £19.92 |
| 35-44 | £31.92 | £44.79 | £5.49 | £22.63 |
| 45-54 | £13.33 | £20.24 | £2.40 | £9.58 |
| 55-64 | £2.05 | £4.44 | £0.62 | £2.15 |
| All | £19.99 | £22.29 | £3.74 | £12.73 |
| Average tax credit award per week among all benefit units in receipt of tax credits | | | | |
| 16-24 | £66.10 | £88.66 | £115.11 | £77.49 |
| 25-34 | £87.07 | £76.72 | £69.55 | £77.74 |
| 35-44 | £85.18 | £79.18 | £25.18 | £63.28 |
| 45-54 | £73.27 | £64.05 | £22.69 | £52.52 |
| 55-64 | £56.91 | £57.60 | £31.48 | £51.62 |
| All | £79.17 | £75.28 | £36.58 | £66.00 |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

While Child Tax Credit (CTC) is paid to all families with children that have incomes below a qualifying threshold, Working Tax Credit (WTC) is restricted to working households. LMEs' position as the main beneficiaries of tax credits is therefore driven by their qualification for WTC.

*Particularly Working Tax Credit…*

Table 5.3 shows that eligibility for CTC in 2008-09 was similar among LME (20 per cent) and benefit-reliant (20 per cent) adults, but that LMEs (11 per cent) were much more likely than benefit-reliant adults (5 per cent) to be in receipt of WTC.

### Table 5.3: Tax credit receipt among adults by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All benefit units |
|---|---|---|---|---|
| WTC only | 2% | 3% | 0% | 1% |
| CTC only | 17% | 12% | 5% | 9% |
| CTC & WTC | 3% | 8% | 1% | 4% |
| Total in receipt | 22% | 23% | 7% | 14% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, Family Resources Survey 2008-09

*Income stability*

***Often have erratic incomes requiring careful budget management...***

A study by the Centre for Analysis of Social Exclusion published in March 2006 measured the income stability over the course of 12 months among low-to-middle income households in receipt of working tax credits.[33] Families taking part in the research had average net income of £17,000 a year, with most falling in the bracket £12,000-£22,000. Therefore, while the study excluded households without children, it provided a good description of the income volatility experienced by many LME households.

The research described the income of one-third of families as being 'stable with blips': that is, with income in at least ten of the 13 four-week periods considered within 15 per cent of their annual mean, but varying by 25 per cent or more from it in other periods. A further one-quarter had income described as 'erratic' or 'highly erratic': that is, having income in at least four of the 13 periods that was more than 15 per cent outside of their annual mean.

When interviewed, participants who reported their income as being unpredictable said that they just had to deal with whatever income turned out to be. Overall, most respondents described themselves as organised in managing their finances – sometimes on a daily basis. However, over one-half said that their income just covered their outgoings in the previous six months, with nothing left over for savings, while a further one-quarter said that their outgoings had exceeded their income. The study concluded that the group managed by tailoring spending to match variable incomes, "often with little margin for error".[34]

***Made worse by recession...***

The recession is likely to have increased the instability of income within many LME households, particularly those in which labour market pressures have resulted in members losing their jobs, working fewer hours or entering into non-standard (for example, zero-hours) contracts. Many LMEs moving in and out of work in this period will have encountered transitional difficulties associated with delays in processing certain benefit payments such as Housing Benefit and Council Tax Benefit. However, others may actually have benefited – from reduced mortgage payments or the temporary cut in VAT for example.

***One-quarter experienced year-on-year fall in income ...***

Chart 5.2 details findings from 2008-09. It shows that 25 per cent of families in the LME group experienced a fall in weekly income compared with 12 months earlier, while 27 per cent experienced increases. Although this is a positive balance, outcomes for higher earners were better, with 45 per cent reporting increased incomes and just 15 per cent detailing falls.

Moreover, among those experiencing increases, higher earner families were more likely than LMEs to have gained more than £50 a week.

33. Centre for Analysis of Social Exclusion, *Tracking Income: How working families' incomes vary through the year,* March 2006
34. Ibid. p7



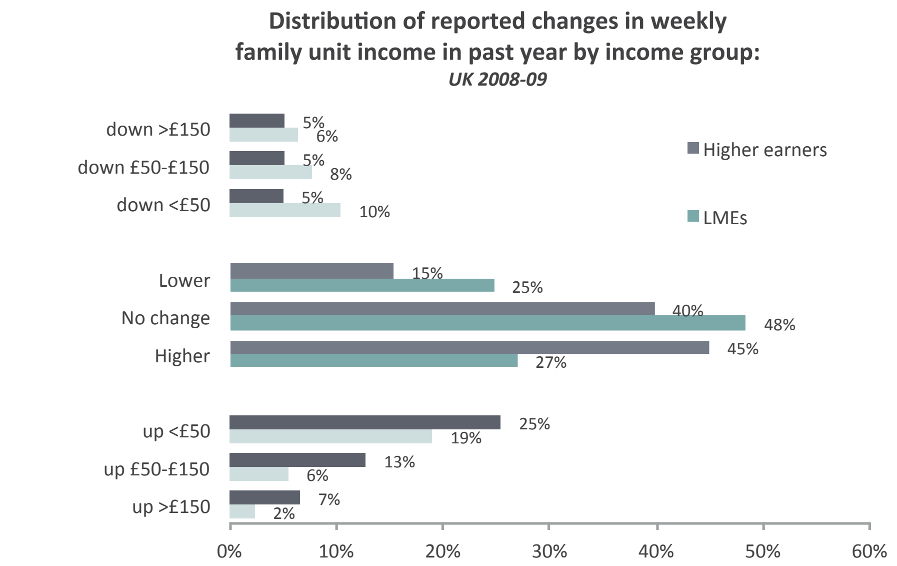



Chart 5.2: Changes in income by income group: UK 2008-09
Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008/09*

*Spending and cost of living*

***Live close to the edge of their means...***

A large number of LME households live at or beyond their means each week. Table 5.4 provides a breakdown of spending on different commodities within each of the income groups as proportions of both total consumption spending and disposable household income

The figures relate to consumption spending only.[35] The table shows that, on average, LME households spent 85 per cent of their disposable income on consumption each week in 2008-09.

***Spend a large share of their income on transport, food, housing and fuel...***

The table also shows that LMEs were particularly likely to spend more of their income than higher earners on commodities that are difficult to cut back on. Taken together, spending on the four categories of *transport*, *food and non-alcoholic drinks, housing and fuel, light and power*, accounted for around 40 per cent of LME disposable income on average in 2008, compared with 26 per cent among higher earner households.

35. That is, the element of household expenditure that is allocated to consumption rather than interest payments, taxes, savings or investments, as defined under the internationally-agreed COICOP classification system.

## Table 5.4: Weekly household expenditure by income group: UK 2008[1]

| | As proportion of average total consumption expenditure | | | As proportion of average disposable household income | | |
|---|---|---|---|---|---|---|
| | Benefit-reliant | LMEs | Higher earners | Benefit-reliant | LMEs | Higher earners |
| Transport | 11% | 15% | 19% | 12% | 13% | 12% |
| Food & non-alcoholic drinks | 18% | 14% | 11% | 19% | 12% | 7% |
| Recreation & culture | 13% | 14% | 16% | 14% | 12% | 10% |
| Housing (net)² | 13% | 12% | 7% | 13% | 10% | 4% |
| Restaurants & hotels | 8% | 9% | 11% | 8% | 8% | 7% |
| Miscellaneous goods & services | 7% | 9% | 10% | 8% | 7% | 6% |
| Household goods & services | 7% | 7% | 8% | 7% | 6% | 5% |
| Clothing & footwear | 6% | 6% | 6% | 7% | 5% | 4% |
| Fuel, light & power | 7% | 5% | 4% | 7% | 4% | 3% |
| Communication | 4% | 4% | 3% | 4% | 3% | 2% |
| Alcoholic drinks, tobacco & narcotics | 5% | 3% | 2% | 5% | 3% | 2% |
| Health | 1% | 1% | 1% | 1% | 1% | 1% |
| Education | 1% | 1% | 2% | 1% | 1% | 2% |
| All consumption expenditure³ | 100% | 100% | 100% | 106% | 85% | 64% |

Notes: ¹ Based on weighted data and including children's expenditure.

² Excluding mortgage interest payments, capital repayment of mortgages, council tax, Northern Ireland rates, housing alterations and improvements and moving and purchase costs. Rent is net of rebates and benefits.

³ Spending on consumption as defined under COICOP. Excludes spending on taxes, fines, money spent abroad, gifts, pension contributions, gambling receipts, savings and investments.

Income groups based on LCF definition: see Chapter 8.

Source: RF analysis of ONS, *Family Spending: A report on the 2008 Living Costs and Food Survey*

*The same goods that have driven price increases in recent years...*

This spending profile means that LMEs have been disproportionately affected by many of the recent cost of living increases experienced in recent years.

Table 5.5 sets out annual changes in the various components of the CPI in the period from October 2008 to October 2010. By looking at the CPI rather than the RPI, we avoid the volatility in the latter measure over the period associated with sharp interest rate cuts and therefore mortgage costs.

## Table 5.5: Annual percentage changes in components of consumer prices index: UK 2008-2010

| | Oct-08 | Oct-09 | Oct-10 |
|---|---|---|---|
| Education | +8.6% | +5.2% | +5.3% |
| Transport | +4.3% | +3.5% | +5.8% |
| *passenger transport by railway* | *+4.1%* | *+5.3%* | *+8.2%* |
| *fuels & lubricants* | *+9.2%* | *-1.1%* | *+11.4%* |
| *passenger transport by road* | *+5.4%* | *+2.9%* | *+3.5%* |
| Alcoholic beverages, tobacco & narcotics | +4.4% | +4.3% | +6.3% |
| Food & non-alcoholic beverages | +10.1% | +2.2% | +4.5% |
| Communication | -2.2% | +2.6% | +3.9% |
| Hotels, cafes & restaurants | +4.2% | +1.6% | +3.1% |
| Furniture, household equipment & repair of the house | +3.1% | +3.3% | +2.7% |
| Health | +2.6% | +3.4% | +2.9% |
| Miscellaneous goods & services | +3.0% | +1.3% | +3.0% |
| Recreation & culture | -0.2% | +2.0% | +1.5% |
| Clothing & footwear | -6.7% | -6.8% | +0.7% |
| Housing, water & fuels | +15.2% | -1.3% | +0.5% |
| *electricity, gas & other fuels* | *+39.3%* | *-7.1%* | *-2.3%* |
| All items | +4.5% | +1.5% | +3.2% |

Source: ONS Time Series

In October 2008, sharp oil price inflation meant that by far the biggest year-on-year increases in prices occurred in the *domestic electricity, gas & other fuels* (+39.3 per cent), *food* (+10.1 per cent) and transport *fuels & lubricants* (+9.2 per cent) components.



In October 2009, annual inflation for both electricity gas & other fuels (-7.1 per cent) and fuels & lubricants (-1.1 per cent) was negative, reflecting the high base from the previous year, and declining demand for fuels worldwide in response to global recession. Food inflation also dropped although, at +2.2 per cent, it remained above the weighted average for all items (+1.5 per cent).

Increased global economic activity in 2010 has again increased demand for, and therefore the cost of, oil, although prices have fallen a little in the most recent months amid concerns about the sustainability of global recovery. While housing fuel inflation was again negative (-2.3 per cent) in October 2010, the transport fuels & lubricants (+11.4 per cent) component was one of the main drivers of overall inflation of 3.2 per cent. Food price increases (+4.5 per cent) were again above this weighted average.

Chart 5.3 shows that, despite some reduction from the peak in late-2008, domestic fuel costs remain high by historical standards.

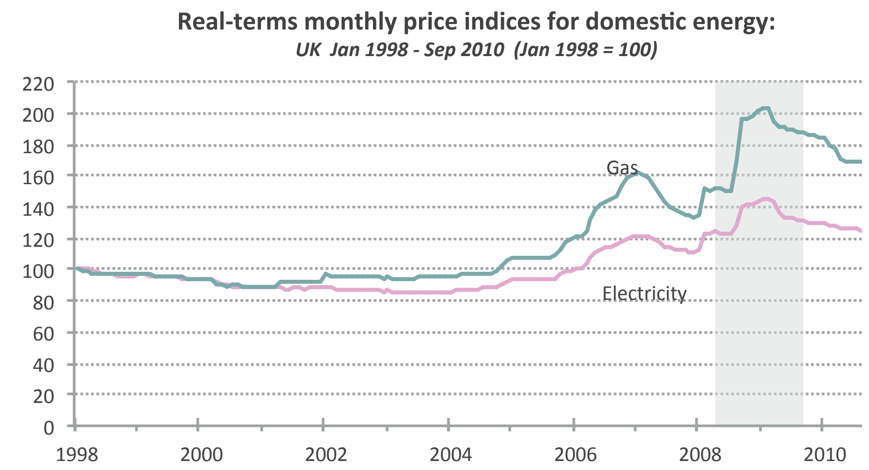



Chart 5.3: Domestic energy price indices: UK 1998-2010
Sources: DECC, *Quarterly Energy Prices*, Tables 2.2.1 & 2.3.1; ONS Time Series CHAW

*Therefore faced higher levels of inflation than higher earners...*

Because food and fuel make up a higher proportion of total expenditure among LMEs than among higher earners, the group has been more affected by these trends in prices.

Chart 5.4 compares CPI indices for LME and higher earner households between January 2000 and October 2010. The indices are weighted for the typical basket of goods bought each year by households within the two income groups (as recorded in the *Living Costs and Food Survey*), thereby offering a better indication of the actual levels of price rises faced by these households than the overall CPI rate does.

The first section of the chart details movement in the two weighted indices. The second uses the gap between these two indices to calculate the cumulative effect on LMEs' spending power. It does this by comparing average annual expenditure among LME households at each point in time, with the cost of the equivalent basket of shopping under a scenario in which LME households had experienced the same level of inflation as higher earners. The third section shows differences in the annual rates of CPI inflation faced by LME and higher earner households, as implied by the index numbers.

Relative to 2000, price rises were broadly in line across the two groups in the period to 2006 (indicated by the similarity of the two weighted-CPI lines) but, following a slight divergence in that year, a much bigger split in inflation levels occurred in 2008 and 2009.

*Reducing spending power by around £300 a year...*

At its peak, in January 2009, the difference between LME and higher earner annual inflation was 1.1 percentage points. At that time, the cost of the typical LME basket had increased by 20 per cent since January 2000, while the cost of higher earner basket was 18 per cent higher. In cash terms, this means that LME households' purchasing power was reduced by around £300 a year on average relative to the purchasing power of higher earners.[36]

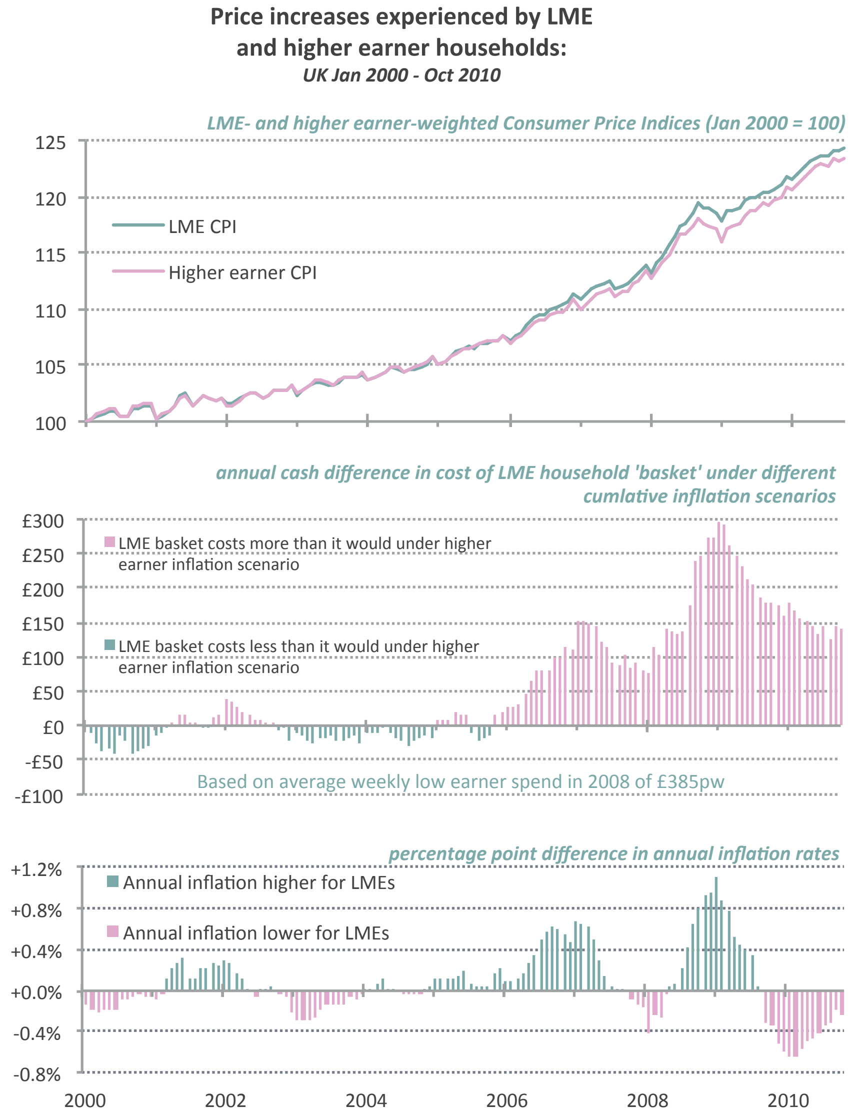



Chart 5.4: LME and higher earner inflation: UK 2000-2010

Notes: LME and higher earner CPI weights based on proportion of total consumption expenditure spent on various CPI components in 2001-08. Income groups based on LCF definition: see Chapter 8.

Sources: ONS CPI Indices; RF analysis of ONS, *Family Spending: A report on the 2008 Living Costs and Food Survey* (and earlier)

36. This figure is calculated on the basis that LME households' average consumption expenditure was £386 a week in 2008. Deflating by the LME-weighted CPI suggests that the cost of an equivalent basket in January 2000 would have been £330. Applying the LME-weighted index to this figure, gives a basket cost of £389 a week in January 2009. If the higher earner-weighted CPI is used instead, the equivalent basket value in January 2009 would have been £383 a week. The difference in purchasing power is therefore approaching £6 a week, or £300 a year.



*Situation is unlikely to get any better in coming years...*

While the two weighted-indices converged somewhat in 2010, as a result of the reduced fuel price pressures detailed in Table 5.5, the LME index was still above the higher earner one at the end of the period. This indicates that, overall, LMEs have faced higher cost pressures – and therefore bigger reductions in purchasing power – than higher earners. Over the period as a whole, the cost of the LME basket rose by 24.3 per cent, compared with an increase of 23.5 per cent in the higher earner basket.

Chart 5.5 details IMF projections of global food and fuel prices for the period to 2015. It shows that, while global demand for both commodities is likely to continue growing as emerging markets develop, industrialise and produce a new middle class of consumers, higher prices are expected to drive supply – via exploration of potential new oil deposits for example – and therefore modify further price increases.

As such, once the 2010 oil rebound is over, the prices of both commodities are projected to remain relatively flat in real terms. It is noticeable, however, that oil prices are forecast to stabilise at a much higher level than the average for the last decade, with the IMF acknowledging that the tension between rapid commodity demand and sluggish capacity growth is likely to re-emerge once the global recovery matures into a sustained expansion.

*And could get worse...*

Others have argued that the increasing cost of energy extraction around the globe – due to the fact that the most accessible sources were the first to be exploited – is likely to push up the cost of fuel steadily.[37]
While investment in new technologies and energy sources may reduce pressures in the longer-term, the transition period is likely to prove difficult for many households. The latest round of domestic fuel price rises in the UK suggests that the situation will get worse before it gets better.

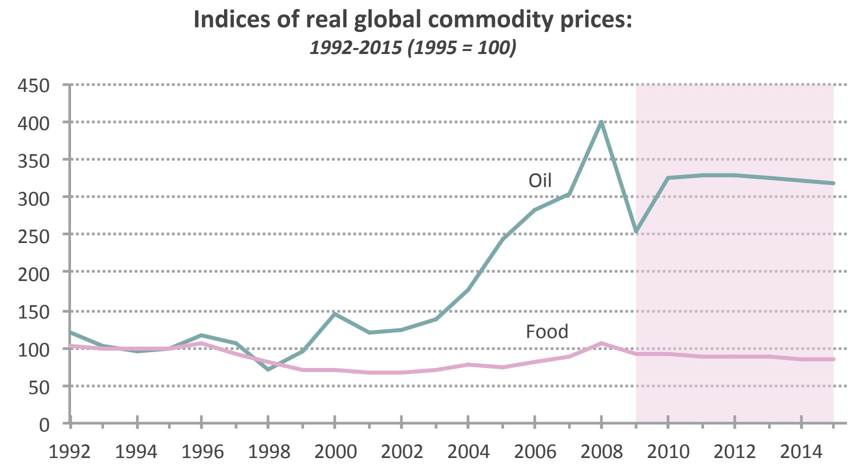



Chart 5.5: Indices of global commodity prices: 1992-2015

Source: IMF, *World Economic Outlook Update*, April 2010, Chart 1.2

*Highlighting the importance of investment in energy efficiency...*

Despite being less able to cope with fuel price rises than higher earners, LME households are unlikely to qualify for any form of financial assistance because social tariffs – cheaper energy deals which all utility companies must provide – are targeted at firms' most vulnerable customers. For example, EOn's StayWarm tariff is only available to those households containing someone aged over 60 in them, while EDF Energy's *Energy Assist* package is aimed at those customers experiencing fuel poverty – that is, those households which spend at least 10 per cent of their income on domestic fuel. Few LME's fall into this catagory. Eligibility for other social tariffs depends on benefit receipt.

37 See, "Engine trouble", *The Economist*, 23 October 2010, p89

In addition, LMEs have been less able than members of other income groups to invest in reducing their future domestic fuel consumption. While higher earners have been better placed to improve the efficiency of their home from their own funds, benefit-reliant households have been more likely to qualify for grants such as Warm Front and Warm Deal which are primarily available to benefit-recipients. A National Audit Office (NAO) review of Warm Front highlighted the lack of focus of this approach, concluding that:

> Applicants are assessed on a 'first come first served' basis, with eligibility based on receipt of benefits used as a proxy for those most likely to be in fuel poverty... 57 per cent of vulnerable households in fuel poverty do not claim the relevant benefits to qualify for the Scheme. Yet nearly 75 per cent of households who would qualify were not necessarily in fuel poverty.[38]

The government announced in the October Spending Review that Warm Front grants will be phased out by 2013, to be replaced by a system of Green Deal loans that will allow home owners to meet the upfront costs of installing energy efficiency measures, with repayments taken from future energy bill savings. Private rented sector tenants will also be given powers, from 2015, to ensure that their landlords use the Green Deal to meet their requests for 'reasonable energy efficiency improvements'. Similarly, local authorities will to be able to insist that landlords improve the worst performing homes.

Because it will be available to all householders, the Green Deal has the potential to offer greater support to LME's than existing schemes.

### *Deprivation measures*

***Income and spending pressures mean some go without...***

Respondents to the *Family Resources Survey* are asked questions relating to their family unit's ability to achieve a series of outcomes, which together form a picture of their relative level of deprivation.

Table 5.6 details the distribution of answers given to the adult deprivation questions by each of the income groups. In all instances, LMEs scored less well than higher earners, but better than benefit-reliant units. For example, 40 per cent of LME units said they would like to take a holiday away from home for at least one week a year, but could not afford it, compared with 14 per cent of higher earners and 68 per cent of benefit-reliant families.

Around one-third (32 per cent) of LMEs similarly wanted, but could not afford, to replace worn-out furniture; around one-quarter (23 per cent) could not repair broken electrical goods and one-fifth (20 per cent) did not have enough money to keep their home in a decent state of decoration. A sizeable minority (12 per cent) said they were unable to keep their accommodation warm enough, contrasting with just 3 per cent of higher earner families.

Table 5.7 sets out responses to similar questions on child deprivation. Again, LME family units scored less well than higher earners but better than benefit-reliant units. Generally speaking, the proportion expressing inability to achieve desired outcomes was lower across all of the income groups in relation to the children questions than in relation to the adult questions, perhaps reflecting the priority given to children's needs within families.

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



***One-fifth of LME households considered 'materially deprived'...***

Among LME family units, 13 per cent said they would like to have enough bedrooms for every child over the age of 10 to be able to have their own, but could not afford it. On other measures, very few LMEs reported deprivation, although 14 per cent said that there were no outdoor facilities nearby where their children could play in safety.

The DWP produces a weighted measure of *material deprivation* based on responses to all the adult and child deprivation questions asked in the *Family Resources Survey*. Households with a score of 25 or more are considered to be materially deprived. In 2008-09, 18 per cent of LME households were in this position, compared with 49 per cent of benefit-reliant households and 2 per cent of higher earners.[39]

39. Analysis of DWP, *Family Resources Survey* 2008-09

## Table 5.6: Family responses to adult deprivation indicators by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| *Holidays away from home at least one week a year* | | | | |
| Does this | 23% | 52% | 80% | 61% |
| Would like, but cannot afford | 68% | 40% | 14% | 32% |
| Does not want/need this | 9% | 8% | 7% | 8% |
| *Replace any worn out furniture* | | | | |
| Does this | 27% | 53% | 79% | 62% |
| Would like, but cannot afford | 60% | 32% | 10% | 26% |
| Does not want/need this | 13% | 14% | 11% | 13% |
| *Money to spend each week on self, not family* | | | | |
| Does this | 49% | 72% | 91% | 77% |
| Would like, but cannot afford | 49% | 26% | 8% | 21% |
| Does not want/need this | 2% | 2% | 1% | 2% |
| *Replace or repair broken electrical goods* | | | | |
| Does this | 37% | 67% | 88% | 72% |
| Would like, but cannot afford | 52% | 23% | 6% | 19% |
| Does not want/need this | 11% | 10% | 7% | 9% |
| *Enough money to keep home in decent state of decoration* | | | | |
| Does this | 54% | 77% | 94% | 82% |
| Would like, but cannot afford | 42% | 20% | 5% | 16% |
| Does not want/need this | 4% | 4% | 2% | 3% |
| *Friends/family around for a drink or meal at least once a month* | | | | |
| Does this | 43% | 59% | 74% | 64% |
| Would like, but cannot afford | 34% | 17% | 5% | 14% |
| Does not want/need this | 22% | 24% | 21% | 22% |
| *Hobby or leisure activity* | | | | |
| Does this | 51% | 66% | 82% | 72% |
| Would like, but cannot afford | 27% | 15% | 4% | 12% |
| Does not want/need this | 21% | 19% | 14% | 17% |
| *Two pairs of all weather shoes for each adult* | | | | |
| Does this | 75% | 91% | 97% | 91% |
| Would like, but cannot afford | 22% | 7% | 1% | 7% |
| Does not want/need this | 3% | 2% | 1% | 2% |
| *Are you able to keep accommodation warm enough?* | | | | |
| No | 31% | 12% | 3% | 11% |
| Yes | 69% | 88% | 97% | 89% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

## Table 5.7: Family responses to child deprivation indicators by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| *A holiday away from home at least one week a year with family* | | | | |
| Does this | 26% | 57% | 86% | 63% |
| Would like, but cannot afford | 68% | 37% | 11% | 33% |
| Does not want/need this | 5% | 6% | 4% | 5% |
| *Enough bedrooms for every child over 10* | | | | |
| Does this | 68% | 85% | 97% | 86% |
| Would like, but cannot afford | 29% | 13% | 3% | 12% |
| Does not want/need this | 3% | 2% | 0% | 2% |
| *Swimming at least once a month* | | | | |
| Does this | 43% | 54% | 64% | 56% |
| Would like, but cannot afford | 24% | 10% | 2% | 10% |
| Does not want/need this | 33% | 35% | 34% | 34% |
| *Go to a playgroup at least once a week* | | | | |
| Does this | 51% | 68% | 80% | 69% |
| Would like, but cannot afford | 16% | 5% | 1% | 6% |
| Does not want/need this | 32% | 27% | 20% | 25% |
| *Have friends round for tea/snack once a fortnight or more* | | | | |
| Does this | 53% | 66% | 77% | 68% |
| Would like, but cannot afford | 21% | 7% | 1% | 7% |
| Does not want/need this | 26% | 26% | 22% | 25% |
| *Leisure equipment such as sports equipment or a bicycle* | | | | |
| Does this | 75% | 87% | 94% | 88% |
| Would like, but cannot afford | 18% | 6% | 1% | 6% |
| Does not want/need this | 7% | 6% | 5% | 6% |
| *Go on a school trip at least once a term* | | | | |
| Does this | 80% | 88% | 96% | 90% |
| Would like, but cannot afford | 14% | 6% | 1% | 5% |
| Does not want/need this | 6% | 6% | 4% | 5% |
| *A hobby or leisure activity* | | | | |
| Does this | 61% | 76% | 86% | 77% |
| Would like, but cannot afford | 18% | 6% | 1% | 6% |
| Does not want/need this | 21% | 18% | 14% | 17% |
| *Celebrations on special occasions* | | | | |
| Does this | 88% | 96% | 98% | 95% |
| Would like, but cannot afford | 10% | 2% | 0% | 3% |
| Does not want/need this | 2% | 2% | 1% | 2% |
| *Outdoor space/facilities nearby where kids play in safety* | | | | |
| No | 25% | 14% | 6% | 13% |
| Yes | 75% | 86% | 94% | 87% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

### *Financial inclusion*

***Not typically financially excluded…***

In general, LMEs are less likely to be financially excluded than members of the benefit-reliant group. For example, Table 5.8 shows that just 2 per cent of LME households had no form of financial account or asset in 2008-09, compared with 4 per cent of benefit-reliant ones, and that 94 per cent of LME households held a current account, compared with 76 per cent of those in the benefit-reliant group.

*But less likely than higher earners to own key financial products…*

### Table 5.8: Household ownership of savings and assets by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Current account | 76% | 94% | 97% | 92% |
| Other bank/building society account | 19% | 40% | 64% | 48% |
| ISAs | 10% | 30% | 52% | 38% |
| Premium bonds | 7% | 15% | 27% | 20% |
| Stocks and shares | 4% | 11% | 26% | 17% |
| Basic bank account | 12% | 8% | 6% | 8% |
| Post Office Card Account | 15% | 4% | 2% | 5% |
| Post Office account | 2% | 3% | 6% | 4% |
| Company share scheme | 0% | 2% | 8% | 5% |
| Unit trusts | 1% | 1% | 5% | 3% |
| PEPs | 1% | 1% | 3% | 2% |
| Credit union | 1% | 1% | 1% | 1% |
| National Savings | 1% | 1% | 2% | 2% |
| SAYE | 0% | 1% | 1% | 1% |
| Any other type of account | 1% | 1% | 2% | 1% |
| No account | 4% | 2% | 2% | 2% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

However, while members of LME households tend to engage in the same financial service markets as higher earners, their ownership of products such as ISAs, stocks and shares and investment products is substantially lower. This, combined with the spending and income stability pressures described above – and a lack of access to financial advice – means that many LME's face significant financial insecurity.

*Low levels of savings…*

### *Safety nets: savings and insurance*

Table 5.9 sets out savings within each income group in absolute terms, and shows that around two-thirds (66 per cent) of LME families had total savings and assets of less than £1,500 in 2008-09, compared with around one-third (36 per cent) of higher earners.

### Table 5.9: Value of savings/assets in family by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| < £1,500 | 84% | 66% | 36% | 54% |
| £1,500 < £3,000 | 5% | 10% | 11% | 10% |
| £3,000 < £8,000 | 4% | 9% | 14% | 11% |
| £8,000 < £20,000 | 3% | 6% | 13% | 9% |
| £20,000 < £25,000 | 1% | 2% | 4% | 3% |
| £25,000 < £30,000 | 1% | 1% | 3% | 2% |
| £30,000 < £35,000 | 0% | 1% | 2% | 1% |
| £35,000 < £40,000 | 0% | 1% | 2% | 1% |
| £40,000+ | 3% | 5% | 15% | 10% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*



*Half have less than one month's net income in savings…*

Tables 5.10 and 5.11 compare family units' total savings with their monthly net incomes. Table 5.10 shows that half (52 per cent) of LME units recorded savings equivalent to less than one month's net income in 2008-09, a higher proportion than recorded in either the higher earner (39 per cent) or benefit-reliant (48 per cent) groups. The higher level of savings adequacy among the benefit-reliant group is likely to reflect the fact that monthly incomes in this group are so much smaller, meaning that relatively low levels of savings are sufficient to provide cover.

### Table 5.10: Number of months' net income held by family in savings by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| Savings equivalent to | | | | |
| <1 month | 48% | 52% | 39% | 45% |
| 1<2 months | 24% | 15% | 13% | 15% |
| 2<6 months | 16% | 15% | 21% | 18% |
| 6+ months | 12% | 18% | 28% | 22% |

Notes: Income groups based on FRS definitions: see Chapter 8.
Value of savings/assets based on mid-point in range provided by respondent.

*Rising to two-thirds of those aged 25-44…*

Table 5.11 shows that savings inadequacy (less than one month's income) among LME units tended to fall with age, although it was at its highest among those units with a head aged 25-34. Among this group, two-thirds (67 per cent) had less than one month's income saved.

### Table 5.11: Number of months' net income held in savings by LME families by age of head of unit: *UK 2008-09*

| | 16-24 | 25-34 | 35-44 | 45-54 | 55-64 | All ages |
|---|---|---|---|---|---|---|
| Savings equivalent to | | | | | | |
| <1 month | 41% | 67% | 67% | 52% | 29% | 52% |
| 1<2 months | 30% | 13% | 8% | 12% | 10% | 15% |
| 2<6 months | 20% | 13% | 12% | 13% | 15% | 15% |
| 6+ months | 9% | 8% | 12% | 22% | 46% | 18% |

Notes: LMEs based on FRS definitions: see Chapter 8.
Savings/assets based on mid-point in range provided by respondent.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*Due to lack of income rather than lack of desire to save…*

Given that weekly expenditure in LME households accounts for such a large share of income on average, it is perhaps not surprising that some members of the group lack savings. Table 5.12 appears to suggest that most LMEs who are not making savings do so because of a perceived lack of income, rather than a perceived lack of need.

*Two-fifths unable to afford to save £10 a month…*

It shows the proportions of family units in each income group reporting in 2008-09 that they were saving at least £10 a month. Overall, half (48 per cent) of LME units were doing so, compared with three-quarters (77 per cent) of higher earners. While just 8 per cent of LMEs said they did not want or did not need to make such savings, 43 per cent said they would like to but could not afford it, compared with just 16 per cent of higher earners.

This proportion rose as high as 48 per cent among LME units in the 35-44 age group, perhaps reflecting the costs associated with raising a family.

## Table 5.12: Families' attitudes to making savings of £10 a month or more by income group and age of unit head: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| Age 16-24 | | | | |
| Does this | 21% | 42% | 63% | 46% |
| Would like, but cannot afford | 69% | 43% | 24% | 41% |
| Does not want/need this | 10% | 15% | 13% | 13% |
| Age 25-34 | | | | |
| Does this | 19% | 47% | 76% | 59% |
| Would like, but cannot afford | 77% | 46% | 17% | 35% |
| Does not want/need this | 5% | 7% | 6% | 6% |
| Age 35-44 | | | | |
| Does this | 22% | 48% | 81% | 61% |
| Would like, but cannot afford | 73% | 48% | 14% | 34% |
| Does not want/need this | 5% | 5% | 5% | 5% |
| Age 45-54 | | | | |
| Does this | 23% | 50% | 79% | 61% |
| Would like, but cannot afford | 70% | 46% | 15% | 33% |
| Does not want/need this | 7% | 4% | 6% | 6% |
| Age 55-64 | | | | |
| Does this | 28% | 59% | 81% | 63% |
| Would like, but cannot afford | 63% | 31% | 11% | 28% |
| Does not want/need this | 9% | 10% | 8% | 9% |
| All ages | | | | |
| Does this | 23% | 48% | 77% | 58% |
| Would like, but cannot afford | 70% | 43% | 16% | 34% |
| Does not want/need this | 7% | 8% | 7% | 7% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

As discussed in Chapter 3.1, UK households have, in aggregate, reduced consumption and increased saving since the start of recession.
Asked in late-2009, 24 per cent of LME households said they were planning, or had already started, to save more. However, Table 5.13 shows that just 7 per cent intended a "significant increase", and 37 per cent of the group said that they would "definitely not" be increasing saving.

## Table 5.13: Proportion of households planning to/already started saving more by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Yes | 13% | 24% | 40% | 31% |
| *Significiantly increase* | *2%* | *7%* | *8%* | *7%* |
| *Slightly increase* | *11%* | *18%* | *32%* | *24%* |
| No | 87% | 76% | 60% | 69% |
| *Not particularly* | *33%* | *39%* | *39%* | *38%* |
| *Definitely not* | *53%* | *37%* | *21%* | *31%* |

Notes: Weighted base = 912.
Income groups based on NMG definition: see Chapter 8.

Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

***Attempts to save driven by fear of redundancy and desire to pay down debts...***

Among those LMEs saying they would be, or were, saving more, Table 5.14 shows that 15 per cent cited fear of redundancy as the primary reason and a further 6 per cent pointed to less guaranteed monthly income, highlighting the employment and income vulnerability felt by some members of the group.

In contrast, higher earners most frequently pointed to apparently more positive reasons, with 15 per cent saying they were increasing saving because they had extra cash from falls in mortgage payments and 10 per cent citing falls in other bills.

## Table 5.14: Main reason for saving more among those households doing so/planning to do so by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Fear of redundancy/job insecurity | 20% | 15% | 9% | 12% |
| Trying to reduce debts | 36% | 14% | 8% | 12% |
| Saving for deposit on house/flat | 0% | 8% | 4% | 5% |
| Additional personal commitments | 7% | 7% | 16% | 13% |
| Less guaranteed monthly income | 8% | 6% | 4% | 5% |
| Extra cash from fall in other bills | 9% | 6% | 10% | 9% |
| Value of existing investments fallen | 0% | 4% | 5% | 5% |
| Extra cash from decrease in mortgage payments | 0% | 3% | 15% | 11% |
| Worried about future tax increases | 0% | 2% | 1% | 1% |
| Other | 20% | 34% | 28% | 29% |

Notes: Weighted base = 264.
Income groups based on NMG definition: see Chapter 8.

Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

***Less likely to have insurance than higher earners...***

The findings above highlight differences within the LME group. While some members want to and are able to put money aside, many do not or cannot. Similarly, Table 5.15 shows that, although nearly three-quarters (73 per cent) of LME families reported having contents insurance in 2008-09, a sizeable minority (15 per cent) said that they could not afford it. In contrast, just 3 per cent of higher earner family units said that they were unable to get cover.

Table 5.15: Families' attitudes to having contents insurance by income group and age of unit head: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| **Age 16-24** | | | | |
| Does this | 19% | 44% | 65% | 44% |
| Would like, but cannot afford | 57% | 22% | 5% | 25% |
| Does not want/need this | 24% | 34% | 30% | 30% |
| **Age 25-34** | | | | |
| Does this | 21% | 61% | 83% | 67% |
| Would like, but cannot afford | 59% | 21% | 4% | 17% |
| Does not want/need this | 19% | 18% | 14% | 16% |
| **Age 35-44** | | | | |
| Does this | 35% | 79% | 93% | 79% |
| Would like, but cannot afford | 53% | 14% | 2% | 14% |
| Does not want/need this | 12% | 7% | 5% | 6% |
| **Age 45-54** | | | | |
| Does this | 43% | 81% | 95% | 83% |
| Would like, but cannot afford | 46% | 12% | 2% | 12% |
| Does not want/need this | 11% | 7% | 3% | 6% |
| **Age 55-64** | | | | |
| Does this | 55% | 89% | 96% | 86% |
| Would like, but cannot afford | 30% | 6% | 2% | 9% |
| Does not want/need this | 14% | 5% | 2% | 6% |
| **All ages** | | | | |
| Does this | 36% | 73% | 90% | 75% |
| Would like, but cannot afford | 48% | 15% | 3% | 14% |
| Does not want/need this | 15% | 12% | 8% | 10% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

***Two-thirds not contributing to a pension…***

In addition to having relatively low levels of short- and medium-term saving and insurance cover, LMEs are also less likely than higher earners to be saving for retirement. Chart 5.6 shows that two-thirds (66 per cent) of working-age LMEs were not contributing to any form of pension in 2008-09, compared with 41 per cent of higher earners.

Just 29 per cent of the group were members of occupational schemes, compared with 56 per cent of higher earner adults. This difference is in part due to lower levels of availability, with just 46 per cent of LME employees being eligible for a workplace scheme, compared with 69 per cent of higher earners. However, the difference is also in part due to lower levels of take-up, with just 64 per cent of those LME employees who *were* eligible for a scheme being members, compared with 81 per cent of higher earners.

LMEs are also less likely to contribute to a private pension, with just 10 per cent reporting membership in 2008-09, compared with 14 per cent of higher earners.



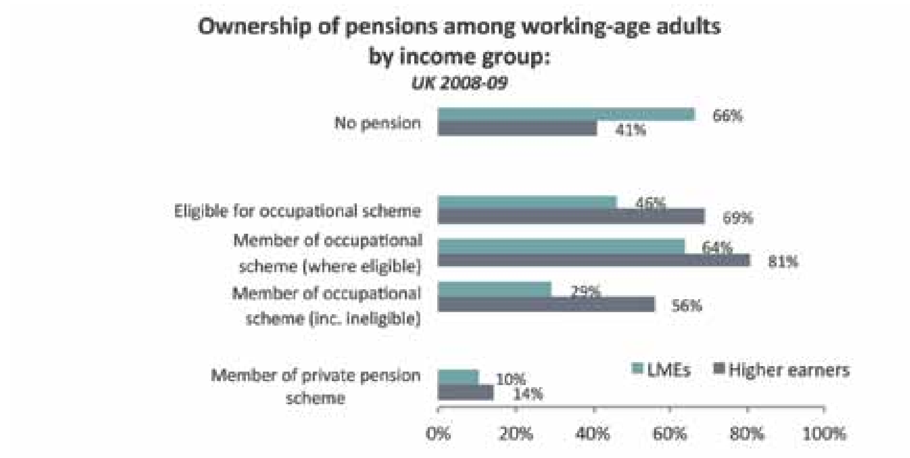



Chart 5.6: Ownership of pensions among working-age adults by income group: UK 2008-09
Note: Income groups based on FRS definitions: see Chapter 8.
Sources: RF analysis of DWP, *Family Resources Survey 2008-09*

***Auto-enrolment should improve situation…***

The National Employment Savings Trust (NEST) is a new workplace scheme, developed following legislation in the Pensions Act 2008, which is designed specifically to meet the pension needs of low-to-moderate earners.

Under the scheme – which will be phased in from 2012, with limited voluntary schemes starting sooner – employers will be obliged to enrol their workers into a workplace pension scheme that meets or exceeds certain legal standards. Some of these workers will be enrolled automatically, with the opportunity to opt out, and others will need to request enrolment. Jobholders will be automatically enrolled if they are between 22 and State Pension Age, work or ordinarily work in Great Britain or Northern Ireland and earn more than the income tax threshold of £7,475 a year.

By 2017, employers will have to make a minimum contribution of 3 per cent of a jobholder's qualifying earnings which, when added to tax relief and the jobholder's contribution, will produce a total minimum contribution of 8 per cent of qualifying earnings.

While the focus on LMEs is welcome, there is some concern that auto-enrolment will disadvantage some individuals because the amount they save might provide a retirement income smaller than the means-tested benefit that would have been available to them in the absence of a pension,[40] although the prospect of a new flat rate state pension for all by 2015 has the potential to negate this risk.

### *Credit and debt*

***LME credit and debt profiles largely commensurate to income levels…***

The proportion of LME households with outstanding secured and unsecured debts[41] is similar to the overall profile of the UK population. Table 5.16 shows that, in late-2009, 71 per cent of LME households reported having an outstanding debt: 38 per cent had secured[42] and 59 per cent had unsecured debts. Total debts among all LME households averaged £30,960, rising to £43,760 if those without any debts are excluded.

40. See for example, PPI, *Are Personal Accounts suitable for all?* November 2006
41. Secured loans are those which rely on the provision by the borrower of some form of collateral, which can be seized in the event of the borrower defaulting; mortgages for example. Unsecured loans are made without; credit cards for example.
42. This figure is smaller than the number recorded in Table 6.2 as buying their home with a mortgage (44 per cent). The difference is due to the different samples and definitions used.

## Table 5.16: Debt position of households by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Secured debt | | | | |
| Proportion with outstanding debts *(weighted base = 919)* | 30% | 38% | 63% | 49% |
| Mean outstanding debt among all answering question *(w. base = 866)* | £18,960 | £27,740 | £62,590 | £44,200 |
| Mean outstanding debt among all with secured debt *(w.base = 402)* | £75,590 | £80,400 | £103,310 | £95,320 |
| Unsecured debt | | | | |
| Proportion with outstanding debts *(w.base = 895)* | 58% | 59% | 67% | 63% |
| Mean outstanding debt among all answering question *(w. base = 862)* | £2,710 | £2,690 | £5,580 | £4,170 |
| Mean outstanding debt among all with unsecured debt *(w. base = 530)* | £4,690 | £4,640 | £8,610 | £6,790 |
| Total debt | | | | |
| Proportion with outstanding debts *(w. base = 821)* | 65% | 71% | 85% | 77% |
| Mean outstanding debt among all answering question *(w. base = 821)* | £20,890 | £30,960 | £68,010 | £48,390 |
| Mean outstanding debt among all with debt *(w. base = 632)* | £32,010 | £43,760 | £80,370 | £62,840 |

Note: Income groups based on NMG definition: see Chapter 8.

Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

Table 5.17 charts debt repayments as a proportion of monthly income within the LME group. It shows that 17 per cent of households in the group allocated more than one-quarter of their income to secured debt repayment in late 2009, and 6 per cent allocated more than one-quarter to unsecured debts. Again, these proportions do not differ markedly from those found among higher earner and benefit-reliant households.

## Table 5.17: Distribution of ratio of last monthly debt payment to monthly income among LME households: *GB Sep/Oct 2009*

| | Secured debt | Unsecured debt | Total debt |
|---|---|---|---|
| 0 | 65% | 43% | 30% |
| <0.25 | 17% | 51% | 45% |
| 0.25 < 0.50 | 13% | 4% | 18% |
| >0.50 | 4% | 2% | 6% |
| *Weighted base* | *292* | *278* | *264* |

Note: LMEs based on NMG definition: see Chapter 8.

Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

***Primarily use credit cards, overdrafts and loans***

Table 5.18 sets out the unsecured debt instruments held by LME households in late-2009. It shows that LME households were more likely than benefit-reliant households to hold credit cards and overdrafts, but less likely to have personal loans and mail order purchase agreements. LMEs' credit card ownership rate was lower than that recorded among higher earners, but the levels of overdraft use in the two groups were similar.

## Table 5.18: Unsecured debt instrument ownership in households by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| *Distribution of number of unsecured debt instruments held* | | | | |
| 0 | 42% | 41% | 33% | 37% |
| 1 | 39% | 28% | 29% | 30% |
| 2 | 11% | 20% | 20% | 19% |
| 3 | 3% | 5% | 11% | 8% |
| 4 | 3% | 3% | 5% | 4% |
| 5+ | 2% | 2% | 2% | 2% |
| *Proportion with different types of credit/loan agreements*[1] | | | | |
| Credit card | 16% | 29% | 44% | 35% |
| Overdraft | 9% | 21% | 22% | 20% |
| Personal loan | 20% | 18% | 26% | 22% |
| Hire purchase | 12% | 14% | 16% | 15% |
| Mail order purchase | 11% | 9% | 3% | 6% |
| Store card | 6% | 9% | 9% | 9% |
| Student loan | 4% | 5% | 9% | 7% |
| DSS social fund loan | 10% | 3% | 0% | 3% |
| Something else | 3% | 1% | 2% | 2% |

Notes: Weighted base = 895.

[1] Figures do not sum to 100% because respondents can own any number of debt instruments.

Income groups based on NMG definition: see Chapter 8.

Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

***More likely to find unsecured debt repayments a financial burden…***

Although the profile set out above suggests that LMEs' use of credit is broadly in line with the overall population, Chart 5.7 shows that in late 2009, one-half (49 per cent) of LME households reported that repayment of unsecured loans represented a financial burden: 16 per cent of the group described this burden as 'heavy', compared with 8 per cent in the higher earner group.

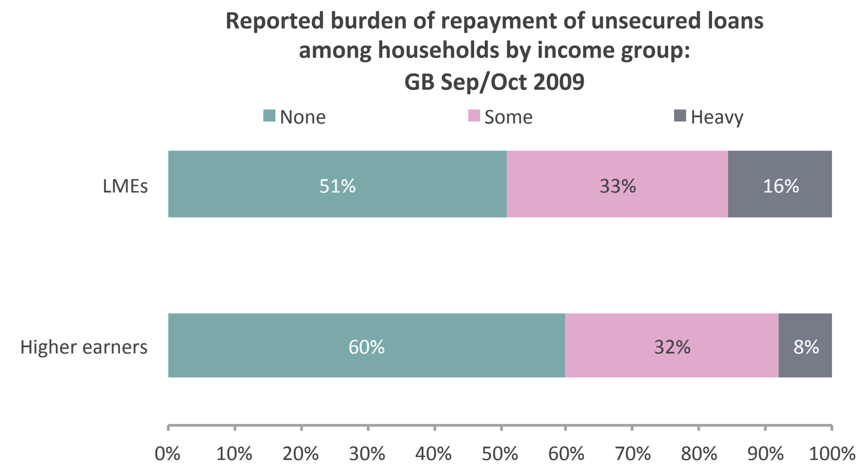



Chart 5.7: Reported burden of unsecured loan repayments by income group: GB 2009

Notes: Weighted base = 574. Income bands based on NMG definition: see Chapter 8.

Source: RF analysis of Bank of England, *2009 NMG survey,* Sep/Oct 2009

*More likely to be accessing debt counselling services...*

This tendency towards finding repayments burdensome is perhaps reflected in data on the income profiles of those households receiving help with problem unsecured debts. Chart 5.8 details the distribution of incomes among clients of the Consumer Credit Counselling Service – the UK's largest debt charity.

Although it is not possible to equivalise the incomes of these clients or determine levels of state support they receive, around 60 per cent of those helped in 2009 had incomes in the low-to-middle range of £10,000 to £30,000.

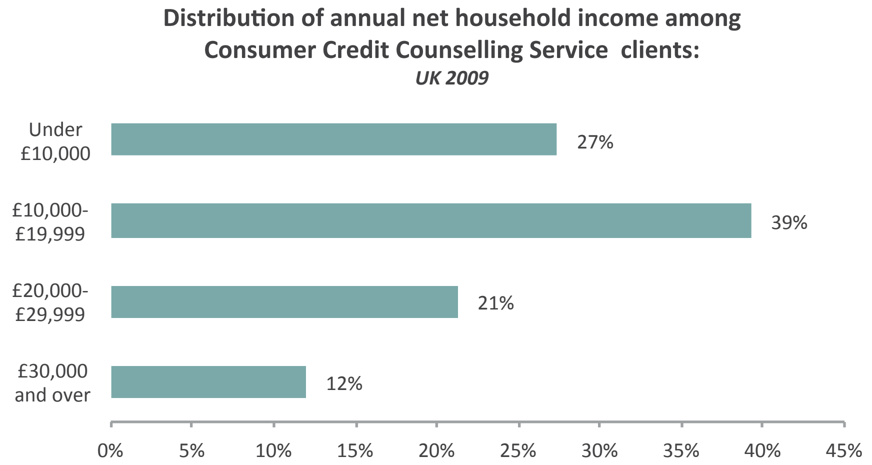



Chart 5.8: Distribution of household income among debt counselling clients: UK 2009
Note: Data cover 175,000 CCCS clients receiving full counselling session in 2009.
Source: CCCS Research, *CCCS Statistical Yearbook 2009*, Chart 2.6.3

*Half have some difficulty keeping up with bill and debt payments...*

Chart 5.9 provides further evidence of the apparent financial difficulty felt by some LME households. It shows the reported positions of LME and higher earner households in relation to household bills and credit commitments in late-2009. More than half (52 per cent) of LME households reported some form of problem keeping up with payments, compared with just 29 per cent of higher earner households. For 14 per cent of LME households, keeping up represented a "constant struggle", and 6 per cent said they were behind with payments. In contrast, just 6 per cent of higher earners spoke of a constant struggle and 2 per cent were behind.

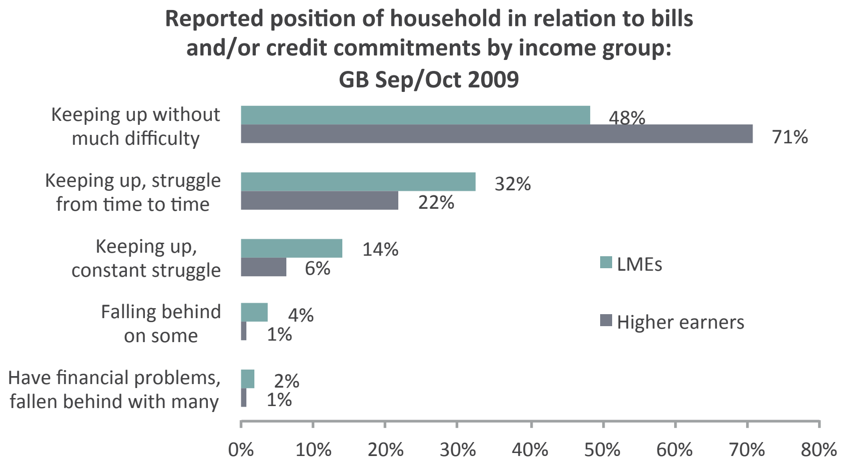



Chart 5.9: Reported position of household in relation to bills by income group: GB 2009
Notes: Weighted base = 910. Income groups based on *NMG definition*: see Chapter 8.
Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009



*Relatively few in housing arrears...*

Despite this, LMEs are only slightly more likely than higher earners to be in arrears on housing payments. Chart 5.10 shows that just 4 per cent of LME households were behind with mortgages or rent in late-2009, compared with 3 per cent of higher earners.

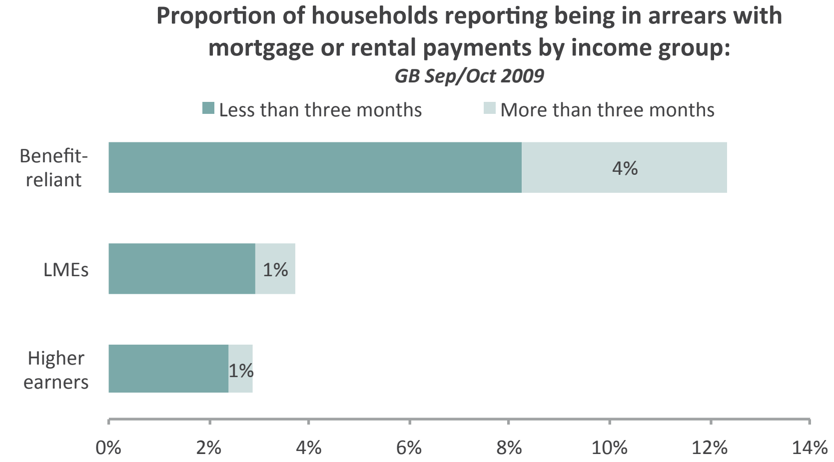



Chart 5.10: Reported arrears position of household in relation mortgage and rental payments by income group: GB 2009
Notes: Weighted base = 924. Income groups based on NMG definition: see Chapter 8.
Source: RF analysis of Bank of England, 2009 *NMG survey*, Sep/Oct 2009

*But more likely to be behind on utility bills...*

However, in relation to other household bills, LMEs are much more likely to be behind with payments. Table 5.19 shows that in 2008-09, 5.6 per cent of LME family units reported being behind on council tax payments, 4.0 per cent were behind on their electricity bills, 3.8 per cent with gas and 3.5 per cent with water. In contrast, fewer than 1 per cent of higher earners were behind on any of these bills.

### Table 5.19: Families behind with household bills by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All family units |
|---|---|---|---|---|
| Council tax | 8.0% | 5.6% | 0.9% | 3.7% |
| Electricity bill | 11.4% | 4.0% | 0.9% | 3.8% |
| Gas bill | 11.0% | 3.8% | 0.8% | 3.5% |
| Water rates/Rates (NI) | 13.0% | 3.5% | 0.6% | 3.7% |
| Telephone bill | 5.8% | 1.9% | 0.5% | 1.9% |
| Other HP payments | 3.8% | 1.3% | 0.3% | 1.2% |
| Television/video rental or HP | 3.1% | 0.6% | 0.1% | 0.8% |
| Insurance policies | 0.8% | 0.2% | 0.1% | 0.3% |
| Other fuel bills | 0.5% | 0.2% | 0.0% | 0.2% |

Note: Income groups based on FRS definitions: see Chapter 8
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*Some evidence that situation has got worse in last year...*

Moreover, there is some evidence of a worsening in the position of LMEs in relation to household bills. Chart 5.11 shows that proportions of LME families behind with payments were higher in 2008-09 than in 2007-08 in relation to most of the bills shown. Particularly large increases in relation to gas and electricity bills might be a reflection of increasing domestic fuel costs over the period.

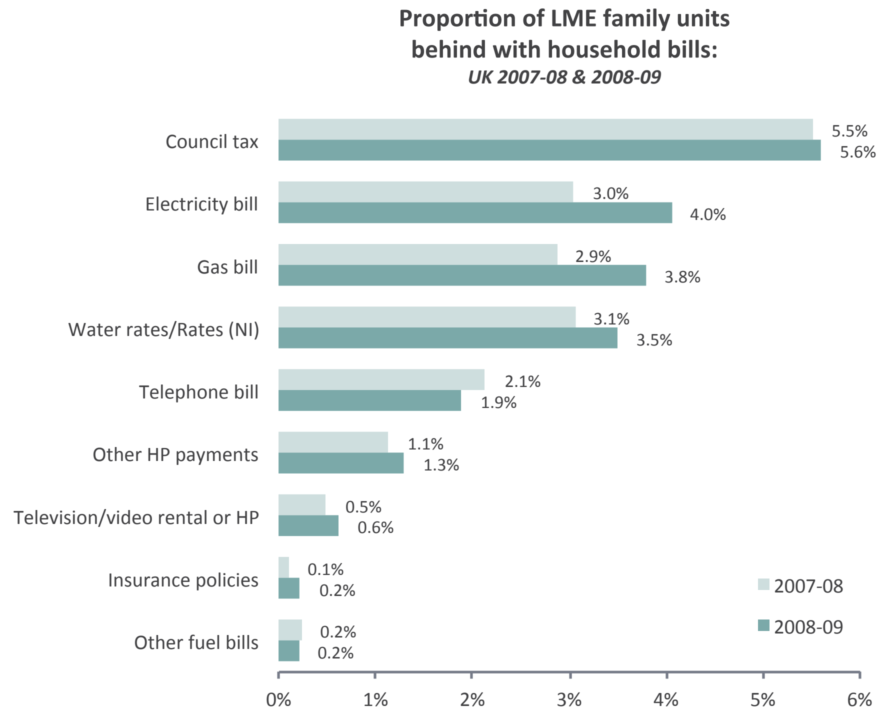



Chart 5.11: Bill arrears among LME family units: UK 2007-08 & 2008-09
Note: LMEs groups based on FRS definition: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2007-08 and 2008-09*

***Blame lack of cash flow, unexpected bills and loss of overtime income…***

Among LME households saying that they faced difficulties with keeping up with bills and credit commitments in late-2009, Table 5.20 shows that 32 per cent said that a temporary lack of cash flow was one cause and 25 per cent cited unexpected bills. Loss of overtime income (21 per cent) was another significant factor, reflecting labour market weakness, as was general overspending (14 per cent).

Unemployment and redundancy were much larger problems in the benefit-reliant group, reflecting the fact that those who had suffered such outcomes in the past year were more likely to have low incomes at the time of the survey.

Table 5.20: Reasons for difficulty in keeping up with bills and credit commitments by income group: *GB Sep/Oct 2009*

| *Proportion menitioning:* | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Lack of cash flow (temporary position) | 27% | 32% | 27% | 29% |
| Unexpected bills | 18% | 25% | 16% | 20% |
| Loss of/reduction in overtime income | 10% | 21% | 19% | 18% |
| Overspending | 15% | 14% | 18% | 16% |
| Debt legacy from being a student | 3% | 9% | 17% | 10% |
| Unemployment | 21% | 9% | 2% | 9% |
| Higher than expected interest rates | 11% | 4% | 4% | 6% |
| Credit cards too tempting | 2% | 3% | 6% | 4% |
| Illness | 6% | 2% | 1% | 3% |
| Divorce or separation | 3% | 2% | 4% | 3% |
| Redundancy | 7% | 1% | 2% | 3% |
| Had a child | 3% | 1% | 2% | 2% |
| School or university tuition fees | 1% | 0% | 0% | 0% |
| Other specified reason | 2% | 6% | 8% | 6% |

Notes: Weighted base = 374. Figures do not sum to 100% because respondents can give more than one answer.
Income groups based on NMG definition: see Chapter 8.
Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009
http://www.bankofengland.co.uk/publications/quarterlybulletin/n08.htm

***Half of those in difficulty hoped to deal with the situation by cutting back…***

When those households surveyed in late-2009 were asked what actions they were considering for dealing with their repayment difficulties, LMEs were much more likely to suggest cutbacks (49 per cent of the group) than any other course. Table 5.21 shows that the overall pattern of responses among LMEs was similar to that displayed in both benefit-reliant and higher earner households, although LMEs (4 per cent) were less likely than higher earners (8 per cent) to use cash from savings and assets.

***But one-quarter had no coping strategy…***

Perhaps most tellingly, one-quarter (24 per cent) of the LME group said that they would not follow any of the courses offered (including the 'other' choice), suggesting that a sizeable proportion had no coping strategy in place.

Table 5.21: Actions considered by those reporting having had difficulty repaying debts by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Cutbacks | 33% | 49% | 51% | 47% |
| Sell house | 4% | 5% | 5% | 4% |
| Borrowing unsecured | 3% | 5% | 8% | 6% |
| Use cash in savings/other assets | 2% | 4% | 8% | 5% |
| Enter into another debt solution e.g. DMP | 6% | 3% | 6% | 5% |
| Insolvency | 2% | 2% | 0% | 1% |
| Borrowing secured | 0% | 2% | 1% | 1% |
| Other | 16% | 18% | 17% | 17% |
| None of these | 39% | 24% | 19% | 26% |

Notes: Weighted base = 360. Figures do not sum to 100% because respondents can give more than one answer.
Income groups based on NMG definition: see Chapter 8.
Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

***Almost one-third suffer from perceived or actual credit constraint…***

As discussed in Section 5.1, the credit crunch has reduced availability of credit across the economy. Table 5.22 shows that, among LME households, 30 per cent reported actual or perceived credit constraint in late-2009: 25 per cent suffered from perceived (discouraged from applying for credit) constraint and 12 per cent experienced actual (prevented from borrowing either by the unavailability of credit or its high price) constraint. Unsurprisingly given its relationship to income, constraint was higher among LMEs than among higher earners, but lower than among members of the benefit-reliant group.

Table 5.22: Credit constraint reported by households by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Put off spending because concerned would not be able to get credit when needed *(weighted base = 908)* | 29% | 25% | 17% | 21% |
| Would like to borrow more but find it too expensive or difficult to do so *(w. base = 915)* | 19% | 12% | 7% | 11% |
| Actual or perceived credit constraint *(w. base = 907)* | 39% | 30% | 21% | 27% |
| Finding it harder than last year to borrow to finance spending *(w. base = 470)* | 57% | 43% | 34% | 41% |

Note: Income groups based on NMG definition: see Chapter 8.
Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

The situation in 2009 was little changed from that in 2008. Instead, Chart 5.12 shows that the jump in constraint took place between 2007 and 2008. Credit constraint (perceived or actual) among LME households thus increased from 22 per cent in 2007, to 28 per cent in 2008 and 30 per cent in 2010.

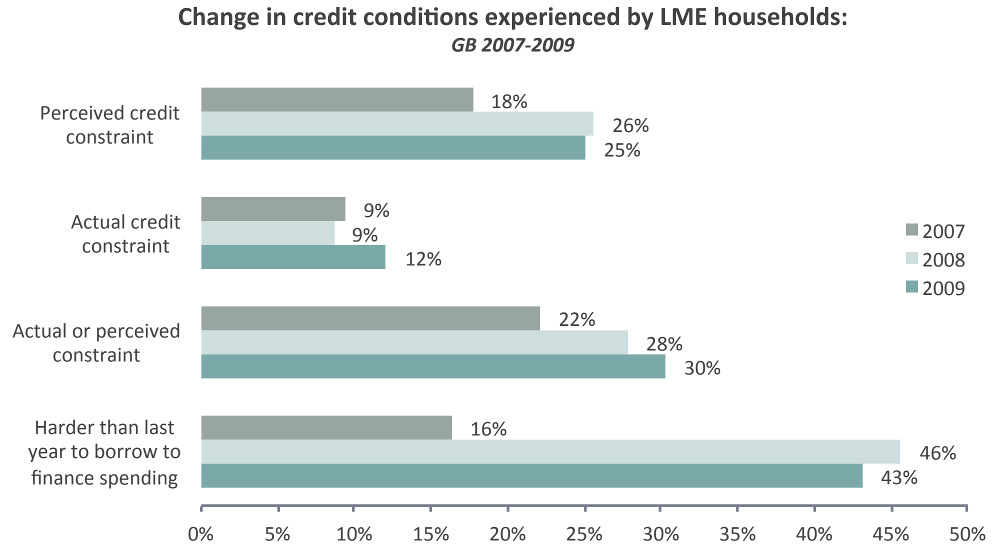



Chart 5.12: Credit constraint among LME households: GB 2007-2009
Notes: Weighted bases range from 145 to 302 across the years and questions asked. Income bands based on NMG definition: see Chapter 8.
Source: RF analysis of Bank of England, *NMG survey*, various

### *Which impacts on ability to get through difficult economic periods…*

Chart 5.13 shows that, when asked whether they found it easier or harder to borrow specifically to finance spending in 2009 compared with 2008, 43 per cent of LME households said that it was harder and 8 per cent that it was easier. While higher earner households also record a negative balance, the figures for LMEs are bigger. This suggests that, while all households have been affected in some way by the credit crunch, LMEs have faced more of a tightening than higher earners.

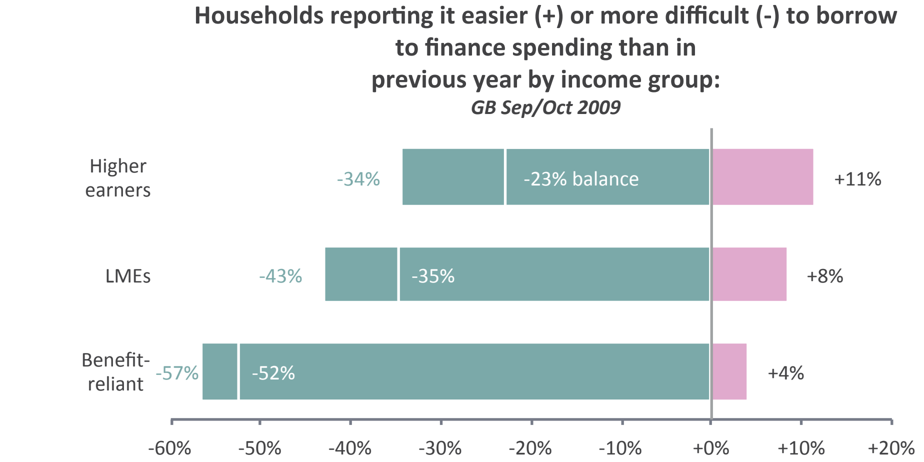



Chart 5.13: Changes in household credit conditions by income group: GB 2009
Notes: Weighted base = 480. Income groups based on *NMG definition*: see Chapter 8.
Source: RF analysis of Bank of England, 2009 *NMG survey*, Sep/Oct 2009



Moreover, the implications of finding it harder to borrow to finance spending are likely to be more severe for LME households, because of their lower levels of savings, lower weekly buffers between incomes and spending and less certain incomes. Ongoing credit constraint is therefore likely to be pushing some LMEs towards more expensive credit products.

### *May push some towards more expensive mainstream and non-mainstream products…*

While for some this might mean sub-prime borrowing, for others it may represent simply a movement towards more expensive mainstream products. Chart 5.14 shows that, while average rates of interest on 75 per cent loan-to-value mortgages and on overdrafts fell with the Bank Rate between 2008 and September 2010, the spreads between the products and the base widened over the period. Average rates on other products have actually *increased* over the same period, with the spread between personal loans and the Bank Rate becoming particularly stretched.

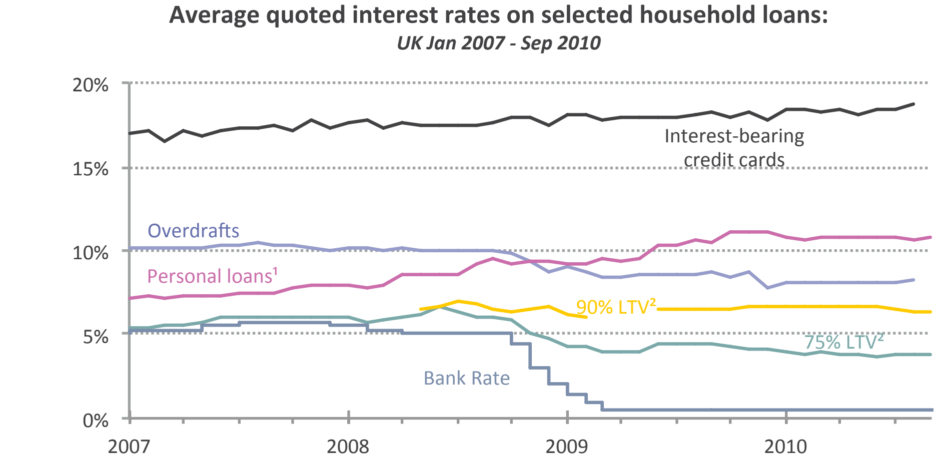



Chart 5.14: Average unsecured credit interest rates: UK 1995-2010
Note: [1] Interest rate on £10,000 personal loans.
[2] Two-year fixed rate mortgages.
Source: Bank of England, *Trends in Lending*, October 2010, Charts 2.3 & 3.1; Bank of England, *Inflation Report,* November 2010, Chart 1.16

### *Or informal arrangements…*

Another potential alternative source of credit is family and friends. Table 5.23 reports on the distribution of informal borrowing and lending arrangements in 2008-09 across the three income groups. Overall, around one-third of adults in each group had entered into some form of arrangement. Among LMEs, around one-fifth (18 per cent) had given or lent money, and one-fifth (19 per cent) had received or borrowed money.

Table 5.23: Adults entering into informal financial arrangements with friends/family in last 12 months by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| All who have given/lent money | 12% | 18% | 23% | 20% |
| Given money | 7% | 10% | 16% | 13% |
| *Regularly* | *1%* | *2%* | *4%* | *3%* |
| *Sometimes* | *6%* | *8%* | *12%* | *10%* |
| Lent money | 6% | 8% | 8% | 8% |
| All who have received/borrowed money | 27% | 19% | 13% | 17% |
| Received money | 16% | 12% | 9% | 11% |
| *Regularly* | *4%* | *2%* | *1%* | *2%* |
| *Sometimes* | *13%* | *10%* | *7%* | *9%* |
| Borrowed money | 13% | 9% | 5% | 8% |
| All who have entered into informal arrangements | 34% | 31% | 31% | 31% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*LMEs' experiences of the recession*

Many of the above findings regarding changes in LMEs' household finances during the period of recession were reflected in the focus group we commissioned OPM to conduct in June 2009.[43]

***Financial pressures built up during 2008 and 2009 because rising costs were not matched by pay increases...***

Participants were asked to talk about how they felt they had fared over the two years prior to the event, assess their current situation and talk about their hopes and concerns for the future. The picture presented was one of a rising cost of living and worsening employment situation, with the situation deteriorating particularly in the past year. This decline had resulted in a subsequent rise in worry and stress and a perceived lower quality of life for most.

Group members stated that two years previously their money went further and they had money left at the end of the week after paying for basics such as rent, food and utility bills. This meant they could afford non-essentials such as going on holiday or having a drink in the pub.

Timelines revealed that many participants became increasingly worried and unhappy during the first six months of 2009. Some were facing rent rises and struggling with loan repayments, but the main financial concern of the group was the rising cost of living and the fact that this had not been matched by rises in wages. Rises in council tax, utilities, food and fuel were all thought to have been significant. Consequently, participants felt they had less money left at the end of each week and their quality of life had declined.

> *My work offered me a 0.5 per cent pay rise but that doesn't cover the rising costs of transport. I actually feel like I'm losing money each year.*

> *Wages haven't gone up to meet the cost of utilities which means you're out of pocket.*

> *Even the cost of basic things such as food, water and electricity has risen; I feel that practically all my income goes on this basic stuff.*

> *No life, not living just existing. No change left after bills, no holiday and no quality of life.*

Participants had a number of strategies for reducing their household outgoings and increasing income. As discussed in Chapter 4.2, some were taking on a second job. Others were relying on other family members to support and top up their income; a cause of guilt for recipients, and an additional financial burden for those who supported family members.

> *My poor son helps me, but he shouldn't have to.*

Participants were unsure whether such support could continue indefinitely during the economic downturn.

***Attempts to cut expenditure and increase income lead to stress and relationship problems...***

Several participants described cutting back on non-essentials. For example, a number of people said they were no longer able to go on holiday or socialise as much due to the lack of disposable income. The social links and networks forged through clubs, pubs and seeing friends and family were jeopardised in some cases through a lack of time as well as a lack of money.

> *I think the recession has impacted on people's social lives. I've noticed people haven't been going out as much as they used to; they're going to the off-license and taking drink back home.*

43. Details of the methodology used are provided in Appendix 4.



A number of group members said they used their heating less, to save money. One participant related that they went to bed early to keep warm and save on heating bills, stating that it was a case of *either heating or eating*.

Other members of the group highlighted short-term savings that had potential long-term costs.

> *We had to sell one of our cars to reduce costs – we used to have two – and now my partner has to drop me off an hour early for work because we begin work at different times. It used to be much easier when we had two cars.*

Reduced household income was perceived as having a negative consequence on people's health, due to the cost of healthy food. A number of participants felt that healthy food was more expensive than cheaper food and that financial necessity was forcing them to adopt a less healthy diet.

Several group members said that managing their household budget was stressful and highly pressurised. A number mentioned that they felt depressed, stressed and worried about how they would survive on a day-to-day basis.

> *My marriage broke up because of the money troubles we were having.*

While most group members were managing to 'stay afloat' a smaller number felt unable to cope with the pressures of bills and opted to bury their heads in the sand, suggesting the storing up of financial troubles for the future,

> *I file my bills in the bin now.*

***Interactions with service providers and financial institutions cause difficulties and resentment...***

Several participants related that low income and irregular cash flow put them at a disadvantage with service providers because of difficulties paying bills. One group member had tried to guard against increasing gas prices by taking out a fixed tariff plan. However, because prices had fallen since they set up the plan and because the individual couldn't get out of the contract without paying a fee, they were now worse off than they would have been if they hadn't taken action.

> *What really annoys me is the ability of utility companies to put up their prices willy-nilly, especially when you think about how much profit they make. There's a cap on wages in some jobs so why can't there be a cap on the amount that those companies charge?*

Another participant, who was self-employed, had contacted the council to negotiate a repayment plan for his outstanding council tax but was instead taken to court and sent a series of letters about the balance. Another was unable to pay their gas bill but received a letter adding £14 to their bill and demanding immediate payment.

> *They just want to get more money out of you.*

This perception of being penalised for having little or no money chimed with a number of group members. Bank charges were another cost that participants felt were disproportionate.

*Bank charges are a nightmare – if you go over your overdraft the charges cost a fortune. But banks are to blame for this recession.*

Automated bill payment systems, such as direct debits, were not popular with the group. Some members said they did not want to use direct debit (which is usually more cost effective) because they found it harder to keep track of their finances and were worried about there not being enough money in their account.

These different factors combined to impact negatively on quality of life. Several participants described their lives as 'not living but surviving' with little other than work and money worries to think about.

*It feels hand to mouth . . . . Right now I feel like I'm just existing; I don't feel like I'm living.*

*I feel like I'm in limbo. We're just surviving. It's like Groundhog Day where every day you wake up and it's the same thing... you go to work, you worry, you go to sleep and then you go back to work. There's nothing to look forward to.*

***Financial pressures increase resentment about ineligibility for state support...***

A number of participants made reference to the relative situation of people who rely predominantly on state support, underlining participants' views that work does not pay. Several members of the group expressed resentment in relation to the perceived better lifestyle that people on benefits enjoy, for minimum effort.

*I've got a neighbour on benefits who lives a better life than I do. I'm not bitter but I do get a bit resentful. I've got all the worry from work, I'm working, my husband's working, but my neighbour's fine.*

Some participants felt that having a job was a higher risk than relying on benefits because paid employment did not always guarantee a minimum level of income, especially in uncertain economic times. Being in paid work also opened a household up to increased outgoings such as housing costs, council tax and dental treatment associated with the loss of state support.

*I have to pay £40 for my dental treatment: if I was on benefits this would be free.*

*I've got two children at school and before I was able to apply for a grant to cover the costs of their school uniform. But now that I have a job I'm not able to get that grant anymore: those uniforms cost £80 each. It feels like a lot of money.*

# 6 Housing

*A long-term decline in home ownership among low-to-middle earners has been exacerbated by the credit crunch. Increased deposit requirements pose major difficulties for LMEs because of their low level of saving. Prior to the crash, 30 per cent of LME first time buyers had relied on 100 per cent mortgages.*

*Because they had to stretch themselves to get on the housing ladder, those LMEs who did manage to buy in recent years are more likely than higher earners to have fallen into arrears and negative equity since the start of the recession. Falling interest rates have protected many mortgagors, but the proportion benefiting is smaller among LMEs than among higher earners because of higher reliance on fixed-rate mortgages within the group.*

*Restricted access to social housing is likely to increase as supply shrinks during a period of spending cuts, pushing growing numbers of LMEs into the private rented sector. LMEs in this sector are typically less happy with their accommodation than LMEs in other tenures.*

## 6.1 Housing market in recession and recovery

*Access to home ownership*

***House prices fell 23 per cent peak-to trough, but remain high by historic standards...***

Despite a 23 per cent drop in house prices from peak (2007) to trough (2009), the prolonged boom from 1997 means that affordability remains an issue for many would-be buyers.

Table 6.1 shows that the ratio of median house prices to median annual earnings in England increased from 3.5 in 1997 to 7.2 in 2007. It fell slightly in 2008 and 2009, but remained at a historically high level of 6.3. The ratio is even bigger in some regions, with the median house price in London amounting to nearly eight times median earnings.

Table 6.1: Ratio of median house prices to median earnings: England 1997-2009

| | 1997 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|
| London | 4.0 | 7.9 | 8.1 | 8.2 | 8.3 | 7.6 |
| South East | 4.1 | 8.1 | 8.0 | 8.5 | 8.4 | 7.3 |
| South West | 3.8 | 8.1 | 8.0 | 8.3 | 8.1 | 7.2 |
| East | 3.6 | 7.5 | 7.5 | 7.9 | 7.8 | 6.8 |
| West Midlands | 3.4 | 6.2 | 6.4 | 6.5 | 6.1 | 5.7 |
| East Midlands | 3.1 | 6.2 | 6.1 | 6.5 | 6.0 | 5.5 |
| Yorkshire & the Humber | 3.1 | 5.6 | 5.9 | 6.0 | 5.7 | 5.2 |
| North West | 3.0 | 5.4 | 5.7 | 5.8 | 5.5 | 5.2 |
| North East | 2.9 | 5.0 | 5.6 | 5.7 | 5.5 | 5.1 |
| England | 3.5 | 6.8 | 7.0 | 7.2 | 6.9 | 6.3 |

Source: CLG, *Live Table 577*

***Home ownership fallen among younger households in last decade; exacerbated by credit crunch...***

These increases in prices combined with a number of other factors – for instance, increases in student debt, labour mobility requirements and the growth of the private rented sector – to make home ownership either more difficult or less attractive for younger households in recent years. As such, the proportion of English households headed by someone aged under-30 that were buying a property with a mortgage declined from 43 per cent in 1999, to 32 per cent in 2008.[44]

While a movement away from home buying may already have been in evidence, the trend has accelerated more recently: the 12-month average number of loans approved for house purchase in Great Britain dropped from 69,000 in November 2006 to just 24,000 in April 2009.[45] Despite some subsequent improvement, numbers have not approached pre-crisis levels, and appear to be falling once again.

***Prices expected to remain subdued, but lack of supply will push them back up...***

Chart 6.1 details the OBR's central case projection for the period to 2015, and suggests that prices will stagnate in the near term, due to an ongoing lack of demand and tightness in the credit market. However, insufficient housing supply is expected to push prices up again from 2012 onwards. By 2013, house prices are forecast to be 4.5 per cent higher year-on-year.


Chart 6.1: House price inflation: 1976–2015
Note: Projections represent central OBR forecast.
Sources: Outturn: Lloyds Banking Group, *Halifax House Price Index;* CLG, *Live Table 502*
Projection: OBR, *Budget forecast*, June 2010, Table C2

*Sustainability of home ownership*

While the credit crunch has amplified the difficulties faced by some in accessing home ownership, the crash – and, more generally, the impact of the recession on household incomes – has had implications for those who *did* enter the housing market in the past decade.

***Many home owners have benefited from falling mortgage rates...***

Many existing home owners have benefited from the sharp fall in the Bank of England's official Bank Rate since mid-2007 (although lower mortgage rates have not fully reflected the extent of the drop in the base rate). Others, however, have experienced difficulties in maintaining payments during a recession. The growing affordability problem in the period prior to the financial crisis, and the relatively easy access to credit, meant that first time buyers tended to rely on securing mortgages that were larger relative to their incomes than in previous decades, leaving them more vulnerable to changes in circumstances.

***But some have had difficulties, particularly those who stretched themselves during the boom...***

Chart 6.2 highlights the fact that trends in both arrears and possessions showed signs of increasing in the period prior to the start of the downturn, from lows in 2004. Following the onset of the credit crunch, rates increased steeply. The proportion of mortgaged properties in arrears grew from 1.0 per cent in the first half of 2007 to 2.5 per cent in Q2 2009. The proportion of mortgaged properties in possession grew from 0.08 per cent at the end of the first half of 2007, to 0.21 per cent at the end of Q1 2009.

44 CLG, *Survey of English Housing Preliminary Report: 2007-08*, Chart 2
45. BBA, *High street banking: monthly statistics release*, Table 5

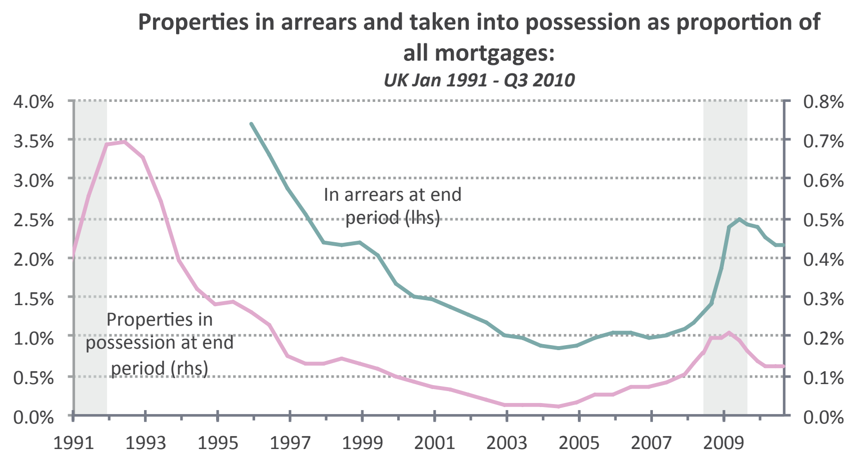



Chart 6.2: Arrears and repossessions: UK 1991-2010
Source: CML, *Tables AP1 & AP4*

Although significant, the increases were lower than many experts had predicted given the size of the GDP correction.[46] As with unemployment, rates have also fallen sooner than after the last recession. In Q2 2010, the proportion of mortgaged properties in arrears stood at 2.2 per cent and the proportion in possession was 0.12 per cent.

Low interest rates undoubtedly contributed to the better than expected performance, while the relative resilience of the labour market, lender forbearance and government support policies also helped.

### *Housing supply*

***Housing supply failed to meet government targets in past decade...***

Despite a prolonged housing boom, building supply flat-lined during the decade prior to the credit crunch. Chart 6.3 shows that a surge in private enterprise dwelling completions between 2001 and 2006 was abruptly reversed from 2007/08. Completions by Registered Social Landlords altered little over the period, while local authority house building ground to a halt.

The previous government set an overall target in England for 240,000 new homes a year up to 2016. However the chart shows that this level has not been reached in any year in the period since 2000/01. In 2009-10, net supply[47] totalled just 128,680, a 23 per cent decrease on the previous year and the lowest annual level since the series began in 2000/01.

46. See for example, CML, *Market commentary*, 12 November 2009.
47. Net additions measure the absolute increase in stock between one year and the next, including other losses and gains (such as conversions, changes of use and demolitions).



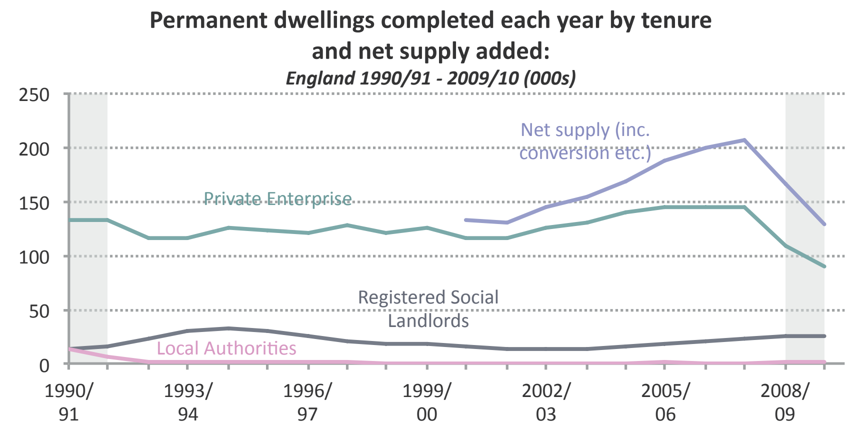



Chart 6.3: New housing supply: England 1990/91 – 2009/10
Sources: CLG, *Live Table 209*;
CLG, *Net supply of housing 2009-10*, England, October 2010, Table 1

***Spending cuts risk undermining supply in coming years...***

The October Spending Review included details of a 74 per cent reduction in the Communities and Local Government capital spending budget between 2010-11 and 2014-15.

While it claimed that 150,000 new affordable homes would still be delivered over the spending review period, direct government funding will be much reduced. Instead, housing association investment is expected to be driven by the revenues associated with the introduction of intermediate rent levels for some social sector tenants. It is not clear at this stage how the 150,000 figure has been arrived at, however, with the Chartered Institute of Housing calculating that the borrowing capacity generated by the introduction of intermediate rents is only enough to fund 15,000 new homes over the period.[48]

***Unclear whether private sector will fill the gap...***

The adequate provision of suitable accommodation in the private rented tenure will similarly depend on increased large-scale investment. In May 2009, the Homes and Communities Agency launched its Private Rental Sector Initiative, designed to attract institutional investors such as UK pension and overseas funds that had not traditionally been involved in residential letting into the market at scale for the first time. The call for expressions of interest received a positive response, suggesting that there is appetite for institutional investment – and therefore potential for growth in house building. However, the focus appears to be on the higher end of the market: extending this model to the lower end of the market should now be a priority.

## 6.2 LMEs' experiences of housing

***LMEs have similar tenure profile to national average...***

Table 6.2 shows that LME tenure largely reflects national averages, with two thirds (64 per cent) of LME households living in properties they owned in 2008-09, 17 per cent living in social rented property and 19 per cent in private rented properties.

While the proportion of households in home ownership increases with income (from 25 per cent among benefit-reliant households, to 83 per cent among higher earner households) and the proportion in the social rented sector decreases (from 51 per cent to 3 per cent), the proportions living in the private rented sector are relatively even across the income bands.

48. Figure reported in "Grant freeze marks death of social housing", *Inside Housing*, 29 October 2010

Table 6.2: Household housing tenure by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Owners | 25% | 64% | 83% | 67% |
| *Owned with mortgage* | *12%* | *44%* | *63%* | *48%* |
| *Owned outright* | *13%* | *20%* | *20%* | *19%* |
| Social rented sector tenants | 51% | 17% | 3% | 16% |
| *Rented from housing association* | *24%* | *9%* | *2%* | *8%* |
| *Rented from council* | *27%* | *8%* | *1%* | *8%* |
| Rented privately | 24% | 19% | 13% | 17% |
| *Rented privately - unfurnished* | *18%* | *13%* | *9%* | *12%* |
| *Rented privately - furnished* | *6%* | *5%* | *4%* | *5%* |
| All households | 100% | 100% | 100% | 100% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

***But varies significantly with age...***

Within the LME group, tenure distribution varies considerably by age. Table 6.3 shows that rates of ownership in 2008-09 increased from 17 per cent among those households with a head aged 16 to 24, to 85 per cent among households with a 60 to 64 year-old head. In contrast, proportions living in both the social rented sector and, more dramatically, the private rented sector declined with age.

Table 6.3: Housing tenure among LME households by age of head of household: *UK 2008-09*

| | 16 to 24 | 25 to 34 | 35 to 44 | 45 to 54 | 55 to 59 | 60 to 64 | All ages |
|---|---|---|---|---|---|---|---|
| Owners | 17% | 47% | 69% | 73% | 80% | 85% | 64% |
| *Owned with mortgage* | *16%* | *44%* | *60%* | *50%* | *32%* | *18%* | *44%* |
| *Owned outright* | *1%* | *4%* | *8%* | *23%* | *49%* | *67%* | *20%* |
| Social rented sector tenants | 20% | 20% | 19% | 17% | 12% | 10% | 17% |
| *Rented from housing association* | *12%* | *10%* | *10%* | *8%* | *8%* | *4%* | *9%* |
| *Rented from council* | *8%* | *10%* | *9%* | *9%* | *5%* | *6%* | *8%* |
| Rented privately | 63% | 33% | 13% | 10% | 7% | 5% | 19% |
| *Rented privately - unfurnished* | *34%* | *22%* | *10%* | *9%* | *7%* | *5%* | *13%* |
| *Rented privately - furnished* | *28%* | *10%* | *2%* | *1%* | *1%* | *0%* | *5%* |
| All households | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

***Tend to move for positive reasons...***

Table 6.4 details the reasons given for moving by those households that did so in 2007-08. In the main, LMEs moved for apparently positive reasons: one-quarter (26 per cent) said they had moved in order to live in a larger or better home, 19 per cent said they had wanted to move to a better area, 16 per cent wanted to live independently and 12 per cent moved for job-related reasons.

***But also more likely than higher earners to move for negative ones...***

Fewer households cited negative reasons, although proportions were higher among LMEs than among higher earners: 5 per cent of LMEs moved because they were required to by their previous landlord, compared with 3 per cent of higher earners; and inability to afford previous housing costs accounted for 2 per cent of LME movers compared with 1 per cent of higher earners.



Table 6.4: Reasons given for moving by households doing so in past 12 months by income group: *England 2007-08*

| | Benefit-reliant | LMEs | Highers earners | All households |
|---|---|---|---|---|
| To a larger/better home | 20% | 26% | 30% | 26% |
| To move to a better area | 14% | 19% | 22% | 19% |
| To live independently | 16% | 16% | 16% | 15% |
| Job related reasons | 2% | 12% | 16% | 12% |
| Other family/personal reasons | 18% | 10% | 7% | 10% |
| Divorce/separation | 7% | 9% | 8% | 8% |
| Wanted to buy | 1% | 8% | 17% | 11% |
| Marriage/cohabitation | 3% | 8% | 12% | 9% |
| To a smaller/cheaper home | 4% | 8% | 4% | 6% |
| To get children into a better school | 3% | 5% | 4% | 4% |
| Landlord required tenant to move out/end of tied letting[1] | 11% | 5% | 3% | 5% |
| Could not afford previous housing costs | 4% | 2% | 1% | 2% |
| Other reason | 25% | 12% | 10% | 13% |

Notes: Figures do not sum to 100% because more than one reason could be given. Income groups based on SEH definition: see Chapter 8.

[1] Answer refers to both social and private landlords.

Source: RF analysis of CLG, *Survey of English Housing 2007-08*

*Access to home ownership*

***Two-thirds of LMEs own their own home, but rates much lower among younger members of the group...***

In part, the trends set out in Table 6.3 are likely to reflect life-cycle effects, with households tending to buy property as they age. However, there is also evidence that today's younger LMEs are less likely to access home ownership than previous generations.

Chart 6.4 compares the proportions of LME and higher earner households in each age band that were buying a home with a mortgage in 2008-09. It shows that, while higher earner households are more likely than lower earner ones to be buying property with a mortgage in each of the working-age groups, the difference is greatest in the youngest one: just 16 per cent of LME households with heads aged 16-24 are buying with a mortgage, compared with 43 per cent of higher earner households.

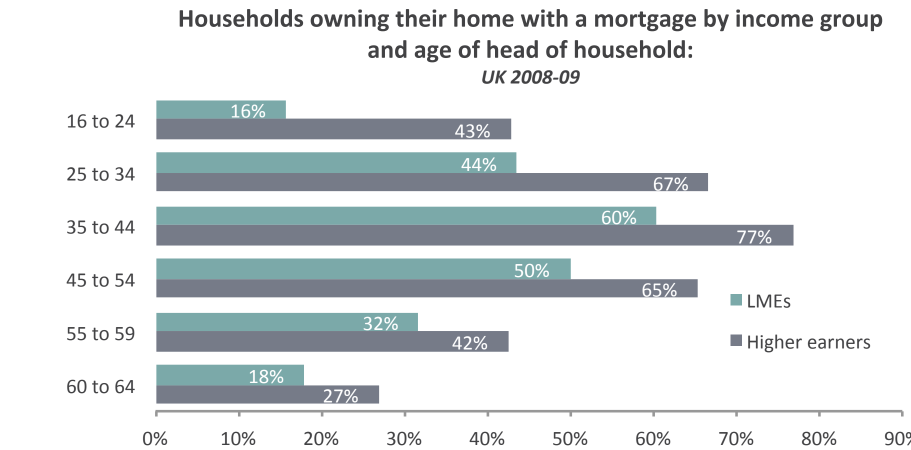



Chart 6.4: Home ownership with a mortgage by income group and age: UK 2008-09

Note: Income groups based on FRS definitions: see Chapter 8.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

***LMEs have found it increasingly difficult to get on the housing ladder...***

The steady decline in home buying among LMEs has been caused by the affordability issues discussed in Chapter 6.1. Chart 6.5 shows that, across the three income groups, indices of average first time buyer house prices to average first time buyer incomes rose only slightly between 1977 and 1998. However, they subsequently increased rapidly in the period to 2009 and remain high by historical standards.

While similar trends are apparent for each of the income groups, affordability has fallen most for members of the LME and benefit-reliant groups: in 2009, the ratio among LME first time buyers was 126 per cent higher than in 1977, compared with an 74 per cent increase among higher earners.

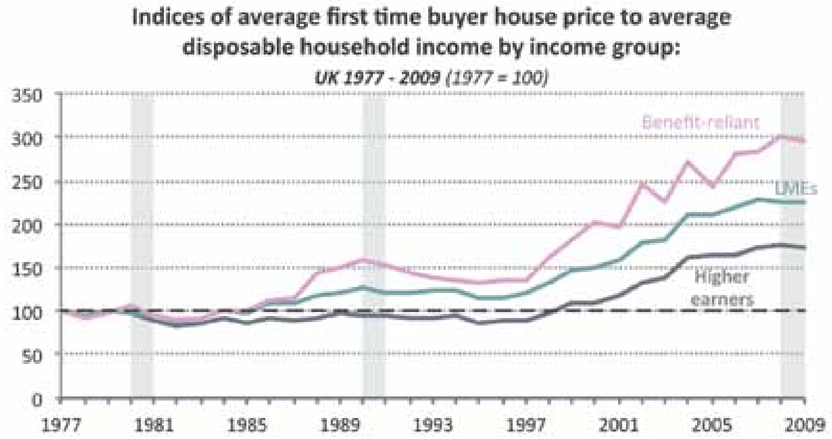



Chart 6.5: Indices of first time buyer housing affordability by income group: UK 1977-2009
Note: Income groups based on ONS definition: see Chapter 8.
Sources: ONS, *The effects of taxes and benefits on household income*, Table 14; CLG, *Live Table 505*

***And have accounted for declining proportion of first time buyers…***

Chart 6.6 shows the proportion of first time buyer transactions made each year in the period 1977 to 2007 that were accounted for by those living in LME households in 2007-08. While the measure is imperfect – because of the possibility that today's LMEs were outside of the income group at the time of house purchase – it nevertheless suggests that a decline in home buying among LMEs took place from 1997 onwards.

In 1997, 28 per cent of first-time buyer transactions were undertaken by those in LME households in 2007-08; by 2007, the proportion had fallen to 18 per cent.

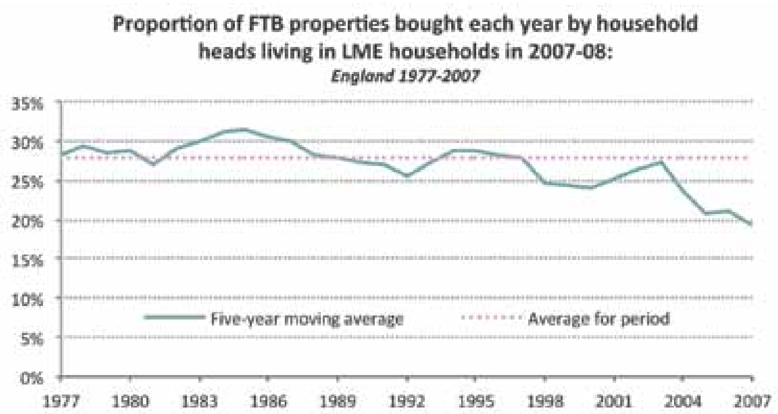



Chart 6.6: First time buyer properties bought by LMEs: UK 1977-2007
Note: Income groups based on SEH definition: see Chapter 8.
Source: RF analysis of CLG, *Survey of English Housing 2007-08*

***Despite falling prices, LME access remains restricted because of credit crunch…***

Despite house price falls from mid-2007 and significant cuts to interest rates, home ownership remains beyond the reach of many LMEs because of the lack of availability of mortgage credit. Chart 6.7 shows that the number of new mortgages advanced to borrowers with low-to-moderate incomes (£10,000 to £30,000 a year) fell from 171,000 in Q2 2006, to just 29,000 in Q2 2009.



While there was a similar drop over the period in the numbers of mortgages advanced to borrowers with incomes in excess of £50,000 a year, the decline was not as sudden, suggesting that it may have had more to do with a fall in demand for credit over time than with an immediate restriction of supply.

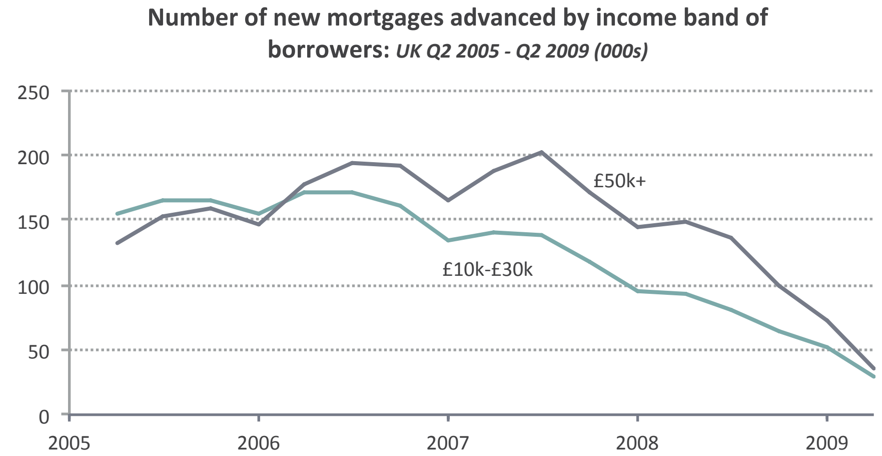



Chart 6.7: Mortgage advances by income band of borrowers: UK 2005-2009
Note: Data based on a sample of lenders – representing around 95 per cent of value of all mortgage lending – for new mortgages only. Includes regulated mortgages only - Buy-to-let and second charge lending are excluded.
Source: CML Research

***Primarily due to increased deposit requirements…***

As discussed in Chapter 6.1, reduced access to credit has primarily taken the form of higher deposit requirements from lenders. Table 6.5 describes the fall in the availability of high loan-to-value, high income-multiple and non-standard mortgage advances since the start of the credit crunch.

Mortgages at 90 per cent loan-to-value (LTV) and above accounted for 13.3 per cent of all loans for house purchase in Q4 of 2007; by Q2 2010 this proportion had fallen to 2.1 per cent (having been as low as 1.5 per cent in Q4 2009). Conversely, the share of mortgages at less than 75 per cent LTV increased from less than half (49.5 per cent) to approaching three-quarters (70.8 per cent). Similarly, the proportion of mortgages awarded to borrowers with impaired credit histories fell from 3.2 per cent in Q4 2007 to 0.3 per cent in Q2 2010.

The average loan-to-value advanced to first time buyers in Q3 2010 was 76 per cent. Applying this ratio to the average value of properties bought by first time buyers in 2009 suggests that would-be buyers needed to raise a deposit of around £51,000. Based on income figures for 2009, this would require the average LME to save 5 per cent of their net household income for 45 years.[49]

49. Income projected on basis of average growth in previous five years

Table 6.5: Residential loans to adults by type: UK 2007-2010

| *As a proportion of value of gross advances* | 2007 Q4 | 2008 Q4 | 2009 Q4 | 2010 Q2 |
|---|---|---|---|---|
| Loan to value bracket | | | | |
| ≤ 75% | 49.5% | 65.2% | 72.0% | 70.8% |
| 75 ≤ 90% | 37.1% | 28.9% | 26.5% | 27.1% |
| 90 ≤ 95% | 7.8% | 4.6% | 0.9% | 1.6% |
| Over 95% | 5.5% | 1.3% | 0.6% | 0.5% |
| Income multiple bracket | | | | |
| Single: | | | | |
| < 2.5 | 8.5% | 11.2% | 11.1% | 11.7% |
| 2.5 < 3.0 | 5.3% | 5.8% | 5.5% | 5.2% |
| 3.0 < 3.5 | 7.2% | 6.9% | 6.7% | 6.2% |
| 3.5 < 4.0 | 7.1% | 6.6% | 6.8% | 6.2% |
| 4.0 or over | 9.6% | 8.3% | 10.0% | 10.1% |
| Other | 12.4% | 8.6% | 6.2% | 7.2% |
| Total on single income | 50.1% | 47.5% | 46.3% | 46.6% |
| *of which not evidenced* | *19.1%* | *16.5%* | *12.1%* | *10.9%* |
| Joint: | | | | |
| < 2.00 | 8.5% | 11.2% | 10.3% | 10.2% |
| 2.00 < 2.50 | 6.8% | 8.6% | 8.1% | 7.8% |
| 2.50 < 2.75 | 4.5% | 5.1% | 4.9% | 4.7% |
| 2.75 < 3.00 | 5.0% | 5.1% | 5.4% | 5.1% |
| 3.00 or over | 22.5% | 21.3% | 23.9% | 24.6% |
| Other | 2.6% | 1.2% | 1.3% | 1.0% |
| Total on joint income | 49.9% | 52.5% | 53.7% | 53.4% |
| *of which not evidenced* | *19.6%* | *20.0%* | *14.0%* | *12.9%* |
| Credit history status | | | | |
| Loans with impaired credit history | 3.2% | 0.9% | 0.3% | 0.3% |
| Loans without impaired credit history | 96.8% | 99.1% | 99.7% | 99.7% |

Note: Figures cover regulated and non-regulated loans.

Source: FSA, *Statistics on Mortgage Lending*, MLAR Tables 1.31 & 1.32, September 2010

Chart 6.8 shows how the number of years' saving associated with average first time buyer deposits has changed in the period since 1977. Having fluctuated in the earlier part of the period, there has been a very steep increase in the last decade.

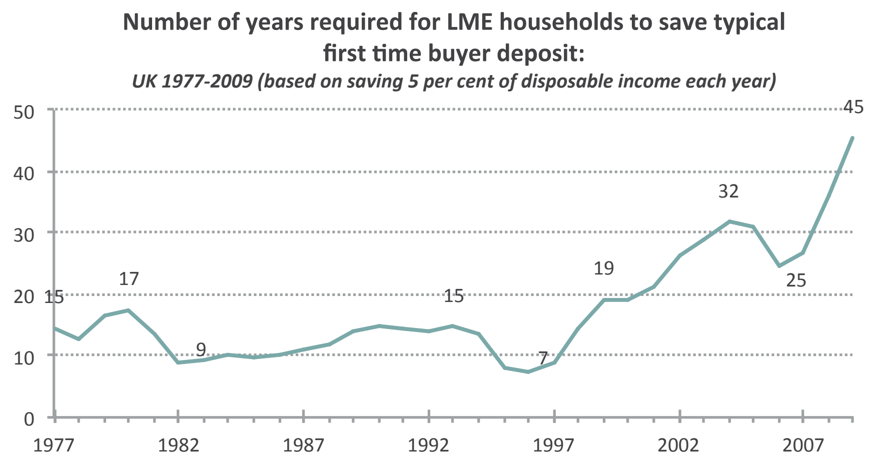



Chart 6.8: Number of years required for LME households to save for first time buyers deposit size

Note: Years are calculated by dividing average FTB advance in each year by 5 per cent of average LME household disposable income in the same period.

Sources: CLG, *Live Table 515*; RF analysis of ONS, *The effects of taxes and benefits on households income, 2008/09*

*LMEs less likely to have access to informal financial support that is becoming necessary for most first time buyers…*

Many of those who have been able to buy during this period have met lenders' higher deposit requirements by relying on money from family and friends. In 2006 it was estimated that 38 per cent of first time buyers under 30 had received help from parents and others; by the second quarter of 2009 this had increased to nearly 80 per cent.[50]

While the average age among all first time buyers has increased slightly in recent years, it has changed little since the start of the credit crunch, standing at 32 in 2009. In contrast, the average among those not receiving any help from family and friends has grown much more dramatically: CML research shows that it increased from 33 in early-2007 to 37 in mid-2009.[51] The National Housing Federation has forecast that today's 21 year-olds will be 43 on average before they are able to make unassisted purchases.[52]

*And more likely to be affected by withdrawal of high loan-to-value mortgages…*

Table 6.6 shows that LMEs are less likely than higher earners to be able to access this financial support, and therefore less likely to enter home ownership at younger ages: among those LME home owners in their first home in England in 2007-08, 11 per cent had paid part of their deposit with money from family or friends, compared with 20 per cent of higher earners. Instead, 30 per cent of these first time buyer LMEs had relied on a 100 per cent mortgage, compared with 18 per cent of higher earners.

Table 6.6: Main non-mortgage source of finance used by first time buyers by income group of household: England 2007-08

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Savings | 44% | 48% | 59% | 59% |
| No other source - 100% mortgage | 27% | 30% | 18% | 23% |
| Gift or loan from family or friend | 15% | 11% | 20% | 7% |
| Proceeds from sale of previous home | 8% | 6% | 6% | 7% |
| Inherited money | 3% | 5% | 7% | 3% |
| Windfall e.g. Insurance payment or accident compensation | 1% | 1% | 1% | 0% |
| Money paid by private landlord to encourage move | 0% | 0% | 0% | 0% |
| Loan for deposit/briding loan from elsewhere e.g. bank, employer | 0% | 0% | 0% | 0% |
| Money paid by local authority to encourage move | 0% | 0% | 0% | 0% |
| Other | 5% | 4% | 3% | 3% |

Notes: Income groups based on SEH definition: see Chapter 8.
Totals can sum to more than 100 per cent because each household can cite more than one alternative source of income.

Source: RF analysis of *CLG, Survey of English Housing 2007-08*

*Few LMEs have benefited from state-sponsored low cost home ownership schemes…*

A number of attempts have been made to extend home ownership via government-sponsored low cost home ownership (LCHO) schemes. England has had an active LCHO programme since 1980, encompassing both shared ownership (part rent/part buy), shared equity (a government equity share in the home or less common a house builder or lender) and most recently *Rent to Homebuy* (renting which can be converted to ownership). However, scale remains small, with fewer than 1 per cent of households living in these types of intermediate housing.[53]

Anyone with incomes below £60,000 can apply. Although some lower income households have taken advantage, critics have suggested that the schemes simply accelerate purchases among those who would have accessed home ownership in any event. Beneficiaries have also largely been living in London or the South East and childless.[54]

50. CML, 'First-time buyers – are they really getting older?' *CML News and Views*, Issue 15, 4 August 2009
51. Ibid.
52. NHF Press Release, "Young adults will have to wait until middle age to buy first home", 30 August 2010
53. Shelter, *The forgotten households: is intermediate housing meeting affordable housing needs?* July
54. Ibid.

LMEs are likely to have had difficulty accessing LCHO schemes because they are less able than higher earners to demonstrate that they can purchase sustainably, a requirement of the schemes. Limited awareness has been another factor; as has the tendency to promote sales of flats rather than houses (more than half of shared ownership homes are one- or two-bedroom flats), thereby reducing the attraction for families.

The only LCHO scheme from which LMEs have benefited widely is the Right-to-Buy programme. Chart 6.9 shows that, in 2007-08, more than half (59 per cent) of all home owners who bought under Right-to-Buy were living in LME households. However, sales through Right-to-Buy have decreased substantially – there were an estimated 3,100 sales in England in 2009-10, down from 84,100 in 2003-04[55] – and are less likely to be relevant to younger LMEs hoping for a way onto the housing ladder in the future.

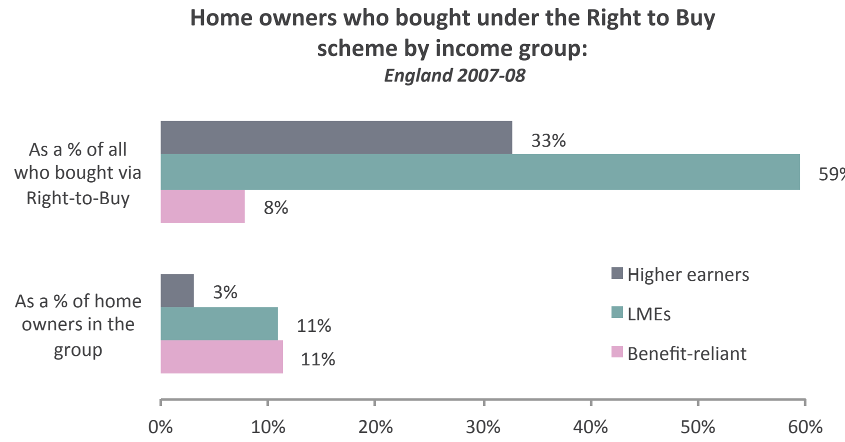



Chart 6.9: Homes bought from local authority by income group: UK 2007-08
Note: Income groups based on SEH definition: see Chapter 8.
Source: RF analysis of CLG, *Survey of English Housing 2007-08*

***Four-fifths of LMEs not planning to buy a home say it's because they can't afford it; just 9 per cent prefer the flexibility of renting…***

Affordability issues are central to some LMEs planning never to buy a home. Table 6.7 sets out the distribution across income groups of reasons given by those stating that they do not want to buy a home. It shows that LME households (79 per cent) in this position were about as likely as benefit-reliant households (82 per cent) and more likely than higher earners (63 per cent) to say that the primary reason was that they did not believe they would ever be able to afford it.

Just 13 per cent of LMEs said that their happiness with their current home was their primary motivation for not buying, and just 9 per cent cited the flexibility of renting.

55. CLG, *Social housing sales to sitting tenants, England, 2009-10*, Sep 2010, Table 2

Table 6.7: Main reason given for not wanting to buy a home among those households expressing this sentiment by income group: *England 2007-08*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| It is unlikely I will ever be able to afford it | 82% | 79% | 63% | 77% |
| I would not want to be in debt | 20% | 21% | 16% | 19% |
| I wouldn't want that sort of commitment | 14% | 15% | 19% | 15% |
| Repairs and maintenance would be too costly | 14% | 15% | 10% | 13% |
| I like it where I am | 15% | 13% | 12% | 14% |
| I do not have a secure enough job | 29% | 13% | 6% | 19% |
| I prefer the flexibility of renting | 8% | 9% | 13% | 9% |
| Other | 7% | 11% | 23% | 11% |

Notes: Income groups based on SEH definition: see Chapter 8.
Totals can sum to more than 100 per cent because each household can give more than one reason.
Source: RF analysis of CLG, *Survey of English Housing 2007-08*

### *Sustainability of home ownership*

***LME home owners more likely than higher earners to have difficulty meeting mortgage payments…***

Those LMEs who *were* able to buy property in the past decade are more likely to be facing difficulties sustaining this tenure following the developments of the past few years than higher earners. Table 6.8 shows that, in 2007-08, one-fifth (20 per cent) of LME mortgagors reported that they were finding it difficult or very difficult to keep up with repayments, compared with 9 per cent of higher earner mortgagors.

Table 6.8: Level of reported difficulty meeting mortgage payments among households by income group: *England 2007-08*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Having no difficulty in keeping up | 65% | 80% | 91% | 86% |
| Finding it rather difficult | 21% | 16% | 8% | 11% |
| Find it very difficult to keep up | 14% | 3% | 1% | 2% |
| All households buying with a mortgage | 100% | 100% | 100% | 100% |

Note: Income groups based on SEH definition: see Chapter 8.
Source: RF analysis of CLG, *Survey of English Housing 2007-08*

***Partly a reflection of higher loan-to-value levels…***

In part these difficulties are due to the general financial and employment pressures faced by LMEs discussed in Chapters 4 and 5. However, it is also due to the fact that LMEs are likely to have needed to stretch themselves more than higher earners to join the housing market in this period.

Table 6.9 details loan-to-value (LTV) distributions across mortgagors in each of the income groups in late-2009. It shows that, based on reported loan and estimated valuations, 24 per cent of LME home owners had LTVs in excess of 75 per cent, compared with 20 per cent of higher earners and just 6 per cent of benefit-reliant mortgagors.

Higher loan-to-vale mortgages have also meant that LMEs are more likely than members of the other two income groups to be in negative equity. The table shows that 8 per cent of LME mortgagors were estimated to have LTVs in excess of 100 per cent, compared with 5 per cent of higher earners. When asked to report on their own expectation of being in negative equity, the proportion rose to 16 per cent among LMEs, compared with 12 per cent among higher earners.

Table 6.9: Loan-to-value and expectations of negative equity among households with mortgages by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| *Distribution of loan-to-value (weighted base = 393)* | | | | |
| 0%-<25% | 38% | 16% | 26% | 25% |
| 25%-<50% | 24% | 32% | 36% | 34% |
| 50%-<75% | 32% | 28% | 18% | 21% |
| 75%-<100% | 6% | 15% | 15% | 14% |
| ≥100% | 0% | 8% | 5% | 5% |
| *Self-reported expectation of being in negative equity at time of survey (weighted base = 420)* | | | | |
| Yes | 7% | 16% | 12% | 13% |
| No | 92% | 83% | 87% | 86% |
| Don't know | 2% | 1% | 1% | 1% |

Notes: Income groups based on NMG definition: see Chapter 8.
Loan-to-value distribution based on calculations involving midpoint estimates of outstanding mortgage amounts and house values. Actual loan to values may therefore differ significantly from estimate.

Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

***More likely to be in negative equity and therefore have fewer options for moving and refinancing…***

Negative equity is only a problem if the property needs to be sold. However, households in or close to the position are less likely to move. LMEs are therefore likely to be suffering from geographical immobility at a time when employment options are particularly tight. Similarly, negative equity is likely to be limiting some LMEs' financing options, putting more pressure on them at a time when finances are already uncertain. This effect is likely to be compounded by a contracting mortgage market which is making it harder for LMEs with existing mortgages to shop around for better deals.

As discussed in Chapter 5, many households with mortgages have benefited from the reduction in the Bank Rate following the start of the financial crisis.

However, average rates paid by mortgage holders only fell following a lag of around a year, in part because lenders didn't pass on the full extent of the cuts and in part because some borrowers were tied into fixed rate deals.

Lenders' funding costs remain higher relative to the Bank Rate than they were prior to the financial crisis, meaning that reductions in mortgage rates have still not fully reflected the extent of the cut in the base rate. Chart 6.10 shows that, in Q3 2008, 89.6 per cent of mortgages were within 2 percentage points of the Bank Rate and just 0.4 per cent were more than 4 percentage points higher; the corresponding figures in Q2 2010 were 26.7 per cent and 36.7 per cent.



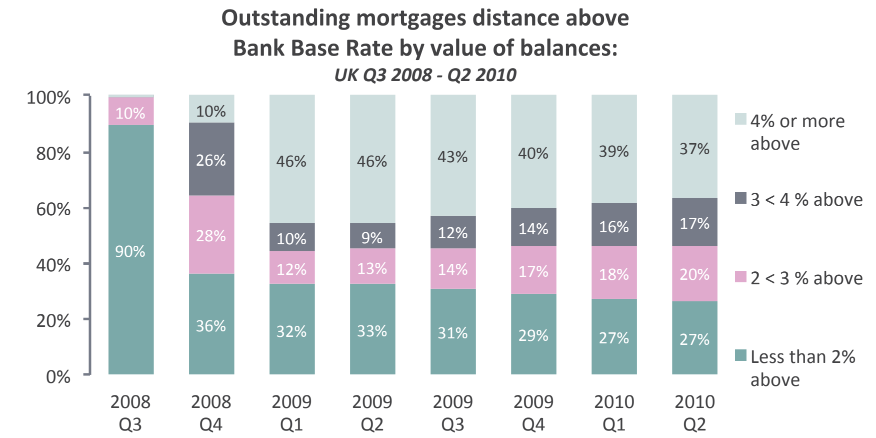



Chart 6.10: Mortgage interest rate relations to base rate: UK 2007-2010
Source: FSA, *Statistics on Mortgage Lending*, MLAR Table 1.22

***Many LME home owners benefited from lower mortgage rates, but fewer than among higher earners…***

Table 6.10 shows that, among LMEs, two-fifths (42 per cent) reported having lower monthly payments than in the previous year in late-2009. However, despite this positive outcome, LME mortgagors were less likely to have experienced a fall in costs than higher earners, 56 per cent of whom were facing lower payments.

Table 6.10: Distribution of reported changes in monthly mortgage payments in past year among households with mortgages by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Decreased | 60% | 42% | 56% | 53% |
| *Decreased > £250* | *10%* | *6%* | *14%* | *12%* |
| *Decreased ≤ £250* | *50%* | *36%* | *42%* | *41%* |
| No change | 24% | 51% | 38% | 40% |
| Increased | 15% | 7% | 6% | 7% |
| *Increased ≤ £250* | *8%* | *6%* | *5%* | *5%* |
| *Increased > £250* | *8%* | *1%* | *1%* | *2%* |

Notes: Weighted base = 341.
Income groups based on NMG definition: see Chapter 8.

Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

***Reflecting higher prevalence of fixed rate deals among LMEs…***

Half of LME mortgagors (51 per cent) reported no change in their monthly mortgage repayments. Table 6.11 shows that this is due to the fact that LME mortgagors are more likely than higher earner mortgagors to have fixed-rate deals, perhaps reflecting greater risk-averseness among those in insecure employment. In late 2009, 63 per cent of LME mortgagors had fixed rate mortgages, compared with 29 per cent of benefit-reliant mortgagors and 46 per cent of higher earners.

Table 6.11: Type of mortgage held by households by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Fixed | 29% | 63% | 46% | 49% |
| Variable | 30% | 20% | 26% | 25% |
| Base rate tracker | 23% | 11% | 21% | 19% |
| Capped | 11% | 3% | 2% | 3% |
| Discounted | 7% | 0% | 3% | 2% |
| Other | 0% | 2% | 2% | 2% |
| All mortgagors | 100% | 100% | 100% | 100% |

Notes: Weighted base = 397.
Income groups based on NMG definition: see Chapter 8.
Sources: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009
CML, *Table ML5*

***Those LMEs enjoying reduced costs typically use the extra cash to pay off debts or for weekly shopping bills…***

Table 6.12 shows that those who *had* experienced a decrease in payments in late-2009, were most likely to use the money to pay off debt (34 per cent) or spend on additional everyday items such as food (30 per cent). In contrast, higher earners (25 per cent) were much more likely than LMEs (4 per cent) to put their surplus incomes into savings.

Table 6.12: Uses of extra money among those households experiencing reduced mortgage payments in past year by income group: *GB Sep/Oct 2009*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Paying off debt | 41% | 34% | 28% | 31% |
| Spending on additional everyday items e.g. food, clothes | 37% | 30% | 16% | 20% |
| Nothing in particular, it just goes on a range of things | 18% | 30% | 30% | 29% |
| Paying into savings/investments | 15% | 4% | 25% | 20% |
| Spending on luxury items | 0% | 0% | 2% | 2% |
| Other | 7% | 8% | 5% | 5% |

Notes: Weighted base = 204. Figures do not sum to 100% because respondents can give more than one answer.
Income groups based on NMG definition: see Chapter 8.
Source: RF analysis of Bank of England, *2009 NMG survey*, Sep/Oct 2009

### *Social renting*

***17 per cent of LME households live in social rented sector…***

Reduced access to home ownership has meant that a considerable proportion of the LME group are reliant on rented accommodation. As Chart 6.11 shows, while a higher proportion of younger LMEs live in social rented property than older members of the group (20 per cent of households with heads aged 16-24, compared with 10 per cent of those aged 60-64), rates are significantly lower than among benefit-reliant households (50 per cent among households with heads aged 16-24 ).

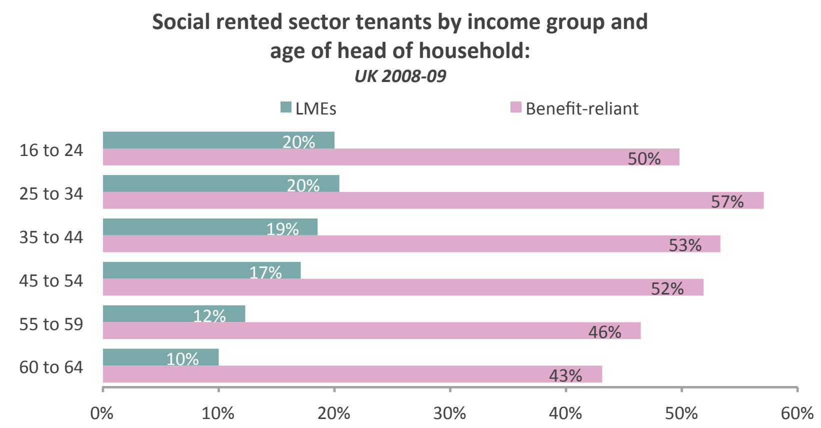



Chart 6.11: Social rented sector tenants by income group and age: UK 2008-09
Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, Family Resources Survey 2008-09



***Less likely to have access…***

While this is likely to in part reflect lower demand for social housing among LMEs, it is also a product of growing pressures on social housing supply, which has meant that places have become increasingly rationed. As discussed in Section 6.1, inadequate numbers of new dwellings have been added to the housing stock in the last decade – particularly in relation to social rented properties.

***Supply of social housing contracted in last decade; 1.8 million households on waiting lists…***

Chart 6.12 shows the social housing stock of property declined in most regions in England in the period 1997-2009, contributing to very significant increases in waiting list sizes. Overall, the stock of properties in England fell by 8 per cent, while waiting lists grew by 73 per cent. In 2009, 1.8 million households were on local authority housing waiting lists, accounting for 8 per cent of all households in England.

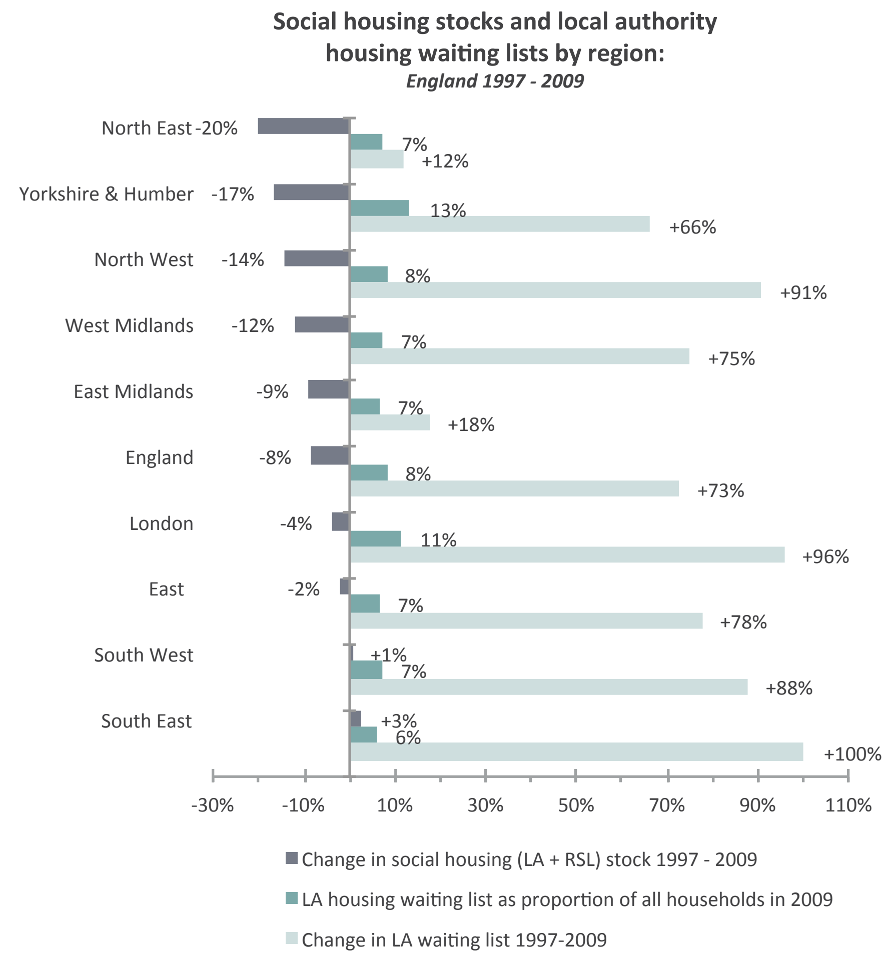



Chart 6.12: Social rental stock and local authority waiting lists: England 1997-2009
Sources: CLG, *Live Tables 115, 116 & 600*

***LMEs in social rented property likely to be among most vulnerable in group…***

Table 6.13 details the proportion of households within each income group and tenure that were in receipt of Housing Benefit in 2008-09. While around 14 per cent of Housing Benefit recipients in July 2010 were in employment,[56] LMEs by definition receive relatively little help with housing (Housing Benefit is one of the income-related benefits used to filter households into the benefit-reliant group). It is therefore not surprising that just 4 per cent of all LME households received Housing Benefit, compared with 62 per cent of benefit-reliant ones.[57]

56. DWP, *Housing Benefit and Council Tax Benefit figures*, 13 October 2010, Table 6
57. The proportion of LMEs who are eligible for Housing Benefit is likely to be higher. The DWP estimates that around half of those in work who are eligible are not claiming it. See DWP, *Supporting people into work: the next stage of Housing Benefit reform*, December 2009

However, among LME social rented sector tenants, the proportion rose to 16 per cent, reflecting the fact that only the most vulnerable LMEs are likely to qualify for social housing. Among those LMEs renting privately, 6 per cent received the benefit.

*Reflected in relatively high level of Housing Benefit receipt...*

Table 6.13: Proportion of households in receipt of Housing Benefit by tenure and income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Social rented sector tenants | 91% | 16% | 2% | 56% |
| *Rented from housing association* | *92%* | *18%* | *1%* | *54%* |
| *Rented from council* | *90%* | *13%* | *4%* | *58%* |
| Rented privately | 65% | 6% | 1% | 18% |
| *Rented privately - unfurnished* | *75%* | *7%* | *1%* | *23%* |
| *Rented privately - furnished* | *32%* | *4%* | *0%* | *8%* |
| All rented households | 83% | 11% | 1% | 37% |
| All households | 62% | 4% | 0% | 12% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*And more likely to have children...*

When LMEs *do* live in social housing, they are more likely than not to have children. Again this is likely to reflect the fact that LMEs without children are less likely to be considered a priority for social housing. Table 6.14 shows that 49 per cent of LME social housing tenants have a child, compared with 43 per cent of the benefit-reliant group.[58]

Table 6.14: Household composition of social rented sector tenants by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Couple with children | 15% | 29% | 17% | 20% |
| Single no children | 38% | 21% | 25% | 31% |
| Lone parent | 28% | 20% | 7% | 23% |
| Couple no children | 11% | 15% | 32% | 15% |
| Extended family | 7% | 15% | 19% | 11% |
| Unrelated sharers | 1% | 0% | 1% | 1% |
| All households | 100% | 100% | 100% | 100% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

*Often been in sector for considerable length of time...*

LMEs living in the social rented sector have benefited from subsidised rents and security of tenure, due to a policy of lifelong tenancies. Conditions in the sector have also improved considerably in the past decade, with one million homes having been brought up to the decent homes standard.[59] However, the flip side of this security has been immobility, which is estimated to be costing the UK's economy at least £542 million each year.[60] Table 6.15 shows that one-third (34 per cent) of LMEs in the social rented sector have lived at their address for 10 years or longer.

58. These proportions exclude the 'extended family' category.
59. www.homesandcommunities.co.uk/decenthomes
60. Human City Institute, *Counting costs: the economic and social impact of reduced mobility in social housing*, July 2010



Table 6.15: Length of residence at current social rented property by income group: *England 2007-08*

| | Benefit-reliant | LMEs | Highers earners | All households |
|---|---|---|---|---|
| Less than 2 years | 25% | 21% | 17% | 22% |
| 2 to less than 5 | 27% | 22% | 19% | 24% |
| 5 to less than 10 | 23% | 22% | 26% | 22% |
| 10+ | 26% | 34% | 37% | 32% |
| Total | 100% | 100% | 100% | 100% |

Note: Income groups based on SEH definition: see Chapter 8.
Source: RF analysis of CLG, *Survey of English Housing 2007-08*

### *Private renting*

*One-fifth of LMEs live in private rented sector...*

Not vulnerable enough to be given priority for social housing and too poor to buy their own home, an increasing number of LMEs face limited options. In addition to remaining in their parents' homes for longer, younger LMEs are frequently entering the private rented sector.

Chart 6.13 shows that, while 19 per cent of LME households are in private rented accommodation overall, the proportion rises to 64 per cent among households with heads aged 16-24. This is a higher proportion than in either the benefit-reliant (47 per cent) or higher earner (49 per cent) groups.

*Including two-thirds of youngest age group...*

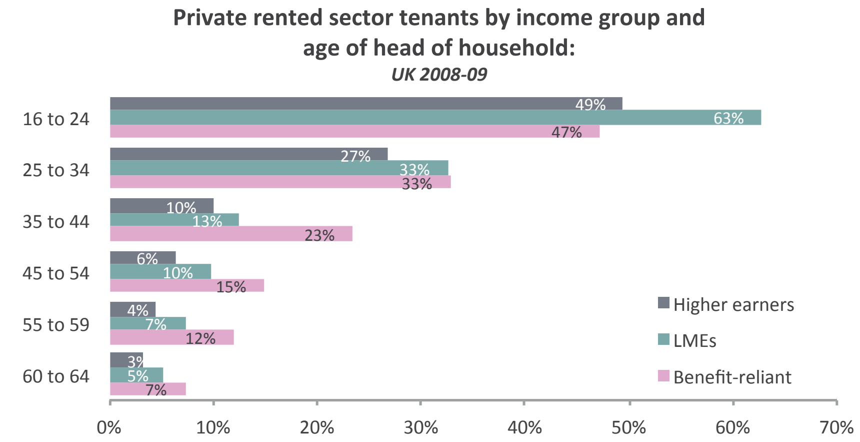



Chart 6.13: Private rented sector tenants by income group and age: UK 2008-09
Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey* 2008-09

*Diverse range of household compositions reflects different uses of the tenure...*

The sector accounts for a diverse range of LME households. Table 6.16 shows that around one-third (34 per cent) of LME private rented households contained children in 2008-09, around one-quarter (25 per cent) were single person households and around one-in-ten (12 per cent) housed unrelated sharers.

Table 6.16: Household composition of private rented sector tenants by income group: *UK 2008-09*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Couple with children | 15% | 26% | 11% | 17% |
| Single no children | 35% | 25% | 29% | 29% |
| Couple no children | 12% | 22% | 39% | 26% |
| Unrelated sharers | 7% | 12% | 11% | 10% |
| Lone parent | 28% | 8% | 2% | 11% |
| Extended family | 3% | 8% | 7% | 7% |
| All households | 100% | 100% | 100% | 100% |

Note: Income groups based on FRS definitions: see Chapter 8.
Source: RF analysis of DWP, *Family Resources Survey 2008-09*

***Some use it as a stepping-stone, others as a long-term solution…***

Many LME renters, like the private rented population at large, will be using the tenure as a stepping-stone to something else. However, a sizeable minority appear to use it as a long-term housing option. Table 6.17 shows that, while two-thirds (69 per cent) of LME households in the tenure had been resident for less than two years in 2007-08, 22 per cent had been in the property for five years or longer. By comparison, just 12 per cent of higher earner private renters had been in the same property for more than five years.

Table 6.17: Length of residence at current private rented property by income group: *England 2007-08*

| | Benefit-reliant | LMEs | Highers earners | All households |
|---|---|---|---|---|
| Less than 2 years | 54% | 59% | 68% | 63% |
| 2 to less than 5 | 26% | 19% | 20% | 21% |
| 5 to less than 10 | 14% | 12% | 7% | 9% |
| 10+ | 6% | 10% | 5% | 7% |
| Total | 100% | 100% | 100% | 100% |

Note: Income groups based on SEH definition: see Chapter 8.
Source: RF analysis of CLG, *Survey of English Housing 2007-08*

***Flexibility is welcomed by many…***

LMEs cite many reasons for moving into private rented accommodation. Table 6.18 details the reasons given for moving by those members of the private rented sector that did so in 2007-08 (including those who moved *within* the sector). It shows that one-fifth (20 per cent) of LME households cited job related reasons. This compares with a figure of 12 per cent (reported in Table 6.4) among all LME households, highlighting the more mobile nature of the private rented option.

Table 6.18: Reasons given for moving by current private rented sector households doing so in past 12 months by income group: *England 2007-08*

| | Benefit-reliant | LMEs | Highers earners | All households |
|---|---|---|---|---|
| To a larger/better home | 19% | 22% | 20% | 20% |
| Job related reasons | 2% | 20% | 28% | 21% |
| To live independently | 12% | 14% | 9% | 11% |
| To move to a better area | 17% | 12% | 15% | 14% |
| Landlord required tenant to move out/end of tied letting[1] | 14% | 9% | 7% | 9% |
| Divorce/separation | 9% | 9% | 12% | 10% |
| To a smaller/cheaper home | 2% | 9% | 4% | 6% |
| Other family/personal reasons | 17% | 8% | 8% | 9% |
| Marriage/cohabitation | 5% | 7% | 12% | 8% |
| To get children into a better school | 6% | 4% | 1% | 3% |
| Could not afford previous housing costs | 7% | 2% | 2% | 2% |
| Wanted to buy | 0% | 0% | 1% | 0% |
| Other reason | 19% | 12% | 13% | 15% |

Note: Figures do not sum to 100% because more than one reason could be given. Income groups based on SEH definition: see Chapter 8.
[1] Landlord required tenant to move out answer refers to both social and private landlord
Source: RF analysis of CLG, *Survey of English Housing 2007-08*

***But others dislike the tenure…***

While there are many positive motivations for renting, for some the tenure falls short. Chart 6.14 shows that dissatisfaction among LME households in the private rented sector (11 per cent were very or fairly dissatisfied) was higher in 2007-08 than among LME home owners (3 per cent).

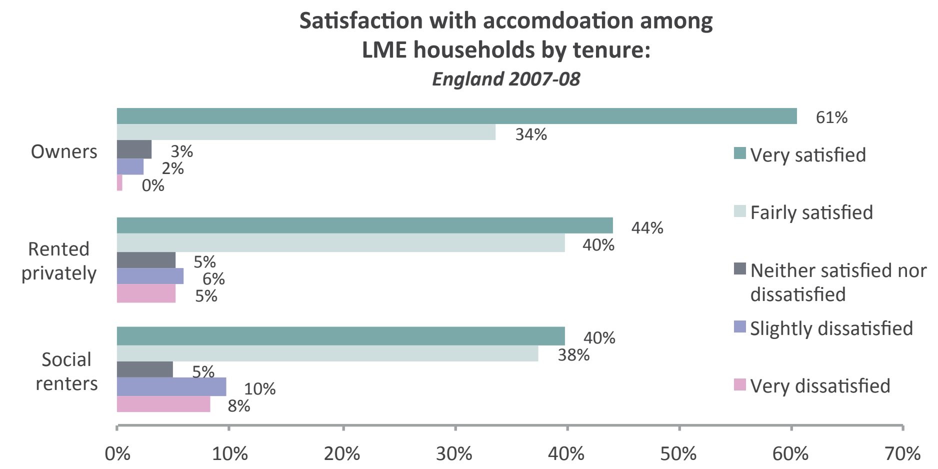



Chart 6.14: Satisfaction with accommodation among LMEs by tenure: England 2007-08
Note: Income groups based on SEH definitions: see Chapter 8.
Source: RF analysis of CLG, *Survey of English Housing 2007-8*

Dissatisfaction among LME private renters was lower than among those in the social rented sector but, when asked whether they considered their tenure to be a 'good' option, LMEs were most likely to disagree if they lived in the private rented accommodation. Chart 6.15 shows that 28 per cent of LME households in the tenure disagreed with this statement, compared with 8 per cent of social renters and just 1 per cent of home owners.

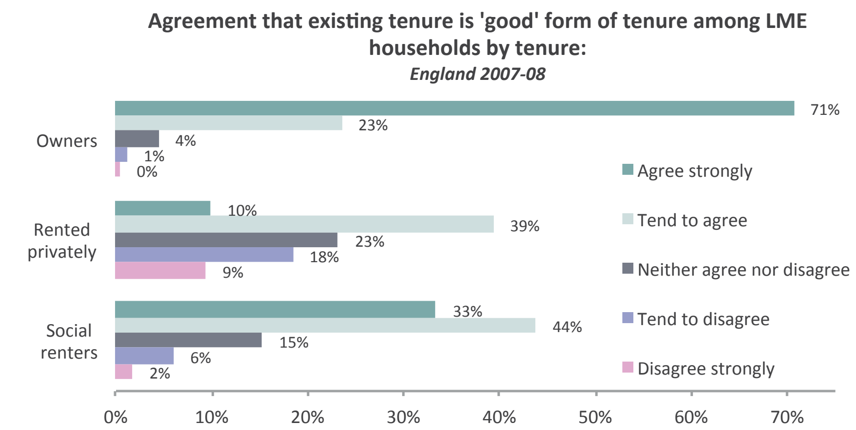



Chart 6.15: Attitudes towards current tenure among LME households: England 2007-08
Note: Income groups based on SEH definitions: see Chapter 8.
Source: RF analysis of CLG, *Survey of English Housing 2007-8*

*Younger, childless LMEs most likely to enjoy renting; families most likely to voice concerns…*

In order to better understand the experiences of LME households in the private rented sector, we conducted interviews with 40 LME tenants in summer 2010. Respondents were drawn from a range of locations in England and household compositions, with a mix of Housing Benefit recipients and households not in receipt of support.

The research painted a mixed picture. Generally speaking, the positive characteristics of private renting – flexibility, choice and independence – were more likely to be highlighted by those who were genuinely using it as a stepping stone to something else – largely younger, childless LMEs.

In contrast, tenants living more long-term in the sector frequently complained about choice, churn, costs and conditions compared to other tenures.

### Choice

*Difficult to find appropriate accommodation in some areas…*

In relation to choice, this was constrained where LMEs were living in areas of poor supply of suitable accommodation – that is, accommodation at the right cost, in the right location, with the right conditions and of the right type.

Families experienced particular difficulties, reflecting the predominance of flats in the sector: in 2004, 12 per cent of private rented sector dwellings had four or more bedrooms compared with 20 per cent of owner-occupied and 4 per cent of social sector properties.[61] Larger families spoke about the difficulties presented by a fourth 'box' room.

> *It was very difficult. The landlord sold the house, and it was done quite quickly and because we'd got lots of children of different ages and sexes we needed four bedrooms minimum. This one actually has five bedrooms which meant that our 12 year old son… had his own room, which was really important to him. If we only had four bedrooms, he would've been sharing with his two younger sisters.*

Choice was particularly compounded for those who were deemed 'risky' in some way. For example recipients of Housing Benefit experienced problems, as did those with poor credit ratings. Some landlords were also reluctant to let to families with children due to concerns about the potential damage they would cause:

> *Yeah, he was probably the only one that accepted [tenants with] Housing Benefit at the time, and he knows anyone who is on Housing Benefit he can put pressure on. When you've got four kids, nobody wants to know.*

A number of the LMEs we met were getting around these problems by lying about their circumstances.

### Churn

*Insecure tenure, and moving creates upheaval and costs…*

The issue of churn is clearly a double-edged sword. While the flexibility of tenure is welcomed by many tenants – particularly younger households and those who wish to move for job-related reasons – the insecurity associated with short notice periods and limited rights is a concern for some. Families in particular told us about the upheaval of moving and the disruption it causes to their children.

> *We would have to move the kids from school; I dread to think about it. I don't think we would be able to find somewhere. I mean we have got a dog and the kids love the dog. I don't think we could find somewhere that would accept pets.*

61. Grainger, The English private rented sector in the twenty first century: encouraging greater quality and quantity, 2008



While only a few of the tenants we spoke to had actually been asked to leave their properties by a previous landlord or been at the receiving end of a landlord repossession, the perceived threat of this or a rent increase created anxiety among many more, particularly when there was little other suitable accommodation in the area. Some of these tenants felt they would have benefited from a longer-term contract:

> *I know it could happen but I push it to the back of my mind because I have enough on my plate to worry about. It's a six-month tenancy agreement, so I forget about it for six-months. I would prefer a longer contract because then I wouldn't have to pay admin fees every time it comes up for renewal – they use it to get money out of me.*

Even for those who *do* want to move, entry costs (deposit and agency fees), act as a barrier, particularly where previous deposits have not been returned in full. Table 6.19 shows that around one-quarter (23 per cent) of those LME households that left the private rented sector in 2007-08 did not have their full deposit returned to them. It is worth noting, however, that the proportion in this position was higher in both the higher earners (30 per cent) and benefit-reliant (36 per cent) group.

Table 6.19: Returnable deposit outcome among households leaving private rented sector in past 12 months by income group: *England 2007-08*

| | Benefit-reliant | LMEs | Higher earners | All households |
|---|---|---|---|---|
| Returned in full | 64% | 77% | 70% | 73% |
| Returned in part | 3% | 9% | 21% | 16% |
| Not returned | 33% | 14% | 9% | 12% |
| All leaving private rented sector | 100% | 100% | 100% | 100% |

Note: Income groups based on SEH definition: see Chapter 8.
Source: RF analysis of *CLG, Survey of English Housing 2007-08*

### Costs

*Rents risen much more rapidly than in social rented sector…*

In relation to affordability, costs are generally lower than for home ownership, with rents for 2/3 bedroom accommodation in 2007 representing around two-thirds of the value of mortgage payments for equivalent properties.[62] However, private renters have faced more rapidly rising costs than social renters in the last decade and a 2008 survey of low income working households found that one-quarter of those in the private rented sector spent more than half their net household income on rent, compared with 15 per cent in the social rented sector.[63]

Chart 6.16 shows that mean private sector rents increased by 37 per cent in real terms between 1995-96 and 2007-08, compared with increases of 18 per cent in registered social landlord rents and 9 per cent in local authority rents over the same period.

62. Hometrack, *Cant Buy Cant Rent: the affordability of housing in Great Britain*, 2007
63. Shelter, *Breaking Point: how unaffordable housing is pushing us to the limit*, 2008

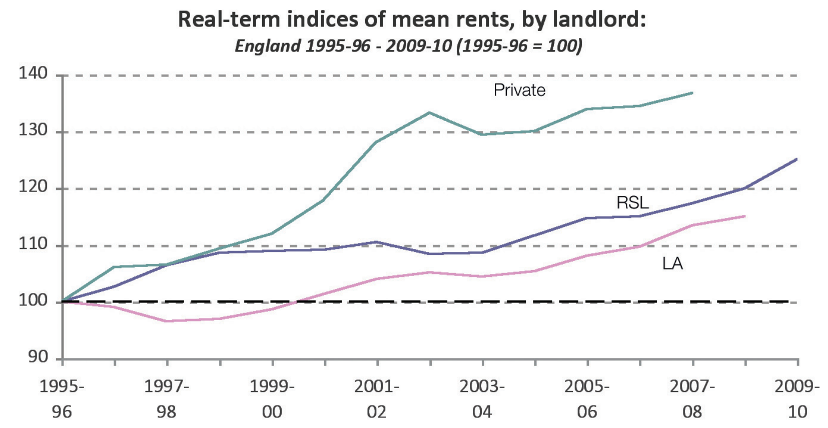



Chart 6.16: Real term indices of mean rents by landlord: England 1995-96 - 2009-10
Source: CLG, *Live Tables 701, 703 & 731*

*Conditions*

***And conditions are worse than in other tenures…***

Conditions in the sector are poorer than in social housing. As measured by the *English Housing Survey*, 'decent homes' must meet four criteria: a statutory minimum standard for housing; a reasonable state of repair; reasonably modern facilities and services; and providing a reasonable degree of thermal comfort. Chart 6.17 shows that, in 2008, 44 per cent of privately rented accommodation in England was considered non-decent, compared with 23 per cent of the RSL stock and 32 per cent of the local authority stock.

***Nearly half of private rented properties are 'non-decent'…***

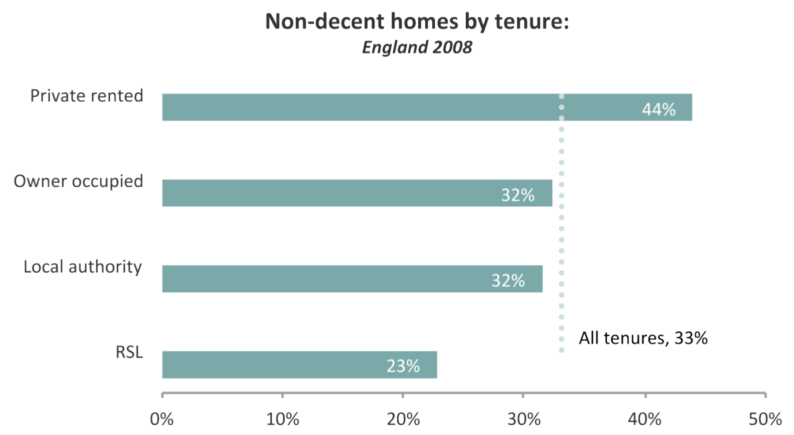



Chart 6.17: Non-decent homes by tenure: England 2008
Source: CLG, *English Housing Survey: Headline Report 2008-09*, Table 13

This is likely to be in part due to the difficulties in regulating a cottage industry – two-thirds of landlords are individuals or couples – but it also reflects a lack of political direction. The 2010 Communities and Local Government Select Committee review into housing standards noted that, while a significant amount of political will and finance had gone into improving conditions in the social sector, the private sector programmes and target had been 'quietly downgraded'.[64]

In addition to affecting quality of life, conditions have implications for affordability, with the relatively high number of energy inefficient homes in the private rented sector pushing up bills for tenants.

64.*Decent housing standards post-2010*, HC 60-I, March 2010, p3



***More likely to be energy inefficient than properties in social rented sector…***

For example, Chart 6.18 details home insulation provision in England in 2008 by tenure type. In relation to both cavity wall and loft insulation, provision was highest within the social rented sector and lowest within the private rented sector: 55 per cent of properties in the social rented sector with a cavity wall had it insulated and 36 per cent of those with a loft had insulation of 200mm or more. The corresponding proportions in private rented properties were 32 per cent and 17 per cent.

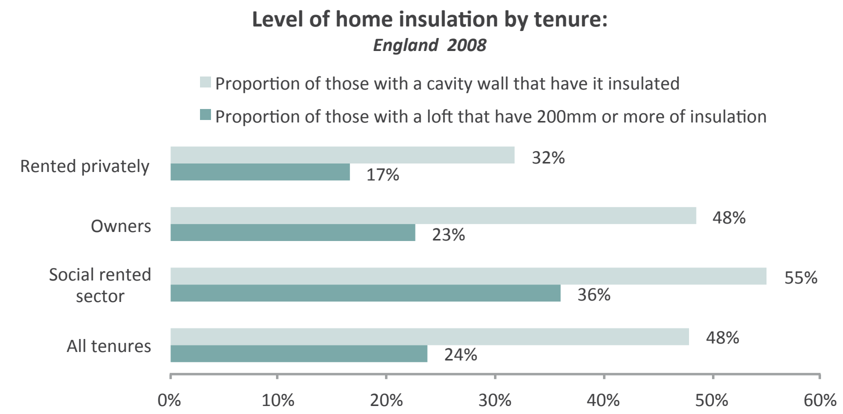



Chart 6.18: Level of home insulation by type of tenure: England 2008
Source: CLG, *English Housing Survey: Headline Report 2008-09*, Annex Tables 8 & 9

***With implications for household budgets…***

Table 6.20 shows changes in average standard assessment procedure (SAP) ratings – which measure the energy efficiency of properties – in England in the period 1996 to 2008 by tenure type. The closer the rating is to 100, the more efficient the home is.

In 1996, the average SAP rating in the social rented sector was 47, compared with 41 among owner-occupied property and 38 in the private rented sector. Ratings within the private rented sector subsequently got closer to those in the social rented sector but, in 2008, they remained several points lower (50, compared with 59).

Table 6.20: Average Standard Assessment Procedure (SAP_) rating by tenure: *England 1996-2008*

| *scale: 1 (least efficient)- 100 (most efficient)* | 1996 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|---|
| Social rented sector | 47 | 54 | 55 | 57 | 57 | 58 | 59 |
| *Local authority* | *46* | *52* | *54* | *55* | *56* | *56* | *58* |
| *Housing association* | *51* | *57* | *57* | *59* | *59* | *60* | *60* |
| Owners | 41 | 45 | 46 | 46 | 47 | 48 | 50 |
| Rented privately | 38 | 44 | 46 | 46 | 47 | 48 | 50 |
| All tenures | 42 | 47 | 47 | 48 | 49 | 50 | 51 |

Note: [1] The energy cost rating as determined by the Government's Standard Assessment Procedure, which is used to monitor the energy efficiency of homes. It is an index based on calculated annual space and water heating costs for a standard heating regime and is expressed on a scale of 1 (highly inefficient) to 100 (highly efficient, with 100 representing zero energy cost).

Source: CLG, *English Housing Survey: Headline Report 2008-09*, Table 11

A number of the issues discussed above were present in the story of one of the LME tenants we spoke to, highlighting the cumulative impact of housing situations on wider LME lives. Box 6.1 details Rachel's experiences.

### Box 6.1: Rachel's experiences of the private rented sector

Rachel, 40, works part-time as a retail assistant. She moved into her private rented accommodation with her daughter when she divorced her husband. Before she moved in she had to pay £1,850 up-front, comprising agency fees (£200), one month's rent in advance (£550), one month's standard deposit (£550) and another month's deposit (£550) because she had a dog. She covered the cost by borrowing from friends and family. Housing Benefit covers £220 of the rent each month, leaving her to find £350 a month from her wages and tax credits. She described this as a struggle:

> *I just about manage to pay everything each week. We don't have any holidays or luxuries, we just get by. Everything goes into the bank unless I have to dip into it. This week my lawnmower's gone but I have to leave that until the end of the month and see what's left.*

In addition to the rent, Rachel pays £120 in fuel costs because of an inefficient storage heater and water meter:

> *My water meter is £98 per month but they have reduced it to £54 per month which is still high; there are only two of us living here and we are out in the day.*

Rachel said would like to work full-time but that the hours are not available since the recession. She told us that there is a lack of cheaper properties in the area and that she doesn't want to move somewhere else for her daughter's sake. She is looking into moving somewhere a little more fuel efficient but doesn't think this will be possible until she has saved up enough money for another set of agency fees.

## 7. Policy challenges in 2011 and beyond

*The picture emerging from this year's Audit is a worrying one for LMEs. A potential 'triple-crunch' of earnings, tax-benefit and cost of living pressures – some short-term, some longer-running – mean that life in the coming year could get worse for many LMEs.*

*LMEs risk being further disadvantaged by the targeting of shrinking welfare support on the most vulnerable. The squeeze that goes to the heart of what life is like as a LME – too poor to flourish in the market economy, but too rich to rely heavily on the support mechanisms of the welfare state – is therefore set to become still tighter.*

***Face a 'triple crunch' of pressures in 2011…***

*2011 is therefore a key year for the government. These pressures on living standards provide an important opportunity to connect the theme of economic growth in a meaningful way to the jobs and prospects of LMEs, while ensuring that public service reform meets the needs of working households.*

The preceding chapters have detailed the experiences of LMEs in the UK in recent years. The picture painted is of a group that is precariously balanced and highly exposed: economically independent but struggling to move beyond just getting by. The next 12 months is set to test the resolve of LMEs still further, as a potential 'triple crunch' approaches:

+ unemployment and cuts in working hours and pay in the public sector and weak labour market recovery in the private sector will contribute to an earnings crunch;
+ withdrawal of various forms of financial support for working families will drive a tax-benefit crunch; and
+ permanent global pressures on food and fuel, the imminent VAT hike, increases in charges for public services and for public transport, the continued shortage of suitable housing supply and ongoing restrictions in access to credit will all help to create a cost of living crunch.

***Earnings will be under pressure from employment effects in public and private sectors…***

### 7.1 The earnings crunch

2011 is set to be a year of transition for the economy and outcomes are highly uncertain. While there are signs that unemployment has peaked, the pace of recovery is expected to be slow: OBR projections suggest that unemployment will still be above pre-recession levels at the start of 2016.[65] Contraction in some regions and sectors should be at least partially compensated by growth in others, but those living in the wrong areas or possessing the wrong skills-sets will face significant difficulties.

As discussed in Chapter 4, LMEs have been more exposed than higher earners to the weaknesses of the labour market in recent years. In part this has been due to the industries they work in, but within each sector LMEs have tended to be considered more expendable because of their concentration in lower-skilled jobs.

65. OBR, *Labour Market Forecasts*, 19 August 2010



This uneven distribution of labour market exposure is likely to continue in 2011, meaning that LMEs are likely to be hit harder than higher earners in areas where weaknesses persist, and less likely to share in the spoils where recovery is strongest.

As the government sets out its growth agenda in the coming months, it will have an important opportunity to connect the theme of economic growth in a meaningful way to the jobs and prospects of LMEs.

***More likely to be exposed to ongoing employment weaknesses…***

*Public sector job cuts*

The public sector accounted for around one-quarter (two million) of LME jobs in 2008-09.[66] Plans to cut around half a million jobs in the sector will therefore have a major impact on the group.

The Spending Review called for departments to mitigate job losses by seeking to reduce hours. Such flexibility can help to save jobs, while at the same time suiting the working needs of some employees. However, where a shift towards part-time working increases involuntary *under*employment, household budgets can come under significant strain. The private sector has successfully cut hours during the recession, but in most cases there is an expectation that hours will increase again as demand picks up. In contrast, the permanency of the public sector spending cuts implies that reductions in hours may not be reversed, meaning that underemployment could become the new normal for some.

***And less well placed to take advantage of new opportunities…***

*Private sector opportunities*

While prospects for jobs in the private sector are more positive than in the public, they are also less certain. The withdrawal of public sector demand will have an impact on the private sector, with the CIPD estimating that fiscal tightening will result in 900,000 jobs going in the private sector over the Spending Review period.[67]

Outcomes will vary from location to location. Those regions with disproportional shares of public sector jobs and relatively weak labour markets could experience a downward spiral in 2011. The NIC holiday for new businesses outside of London, the South East and East of England will help to offset these risks to some extent. There is however, no sign so far of a long-term labour market or industrial strategy for areas facing the biggest challenges.

***With training options becoming more limited…***

To the extent that growth in private sector employment does occur in 2011 and beyond, LMEs are less well placed than higher earners to take advantage of opportunities: both because of the disadvantages inherent in being lower-skilled and because of increasing barriers to re-skilling.

The decision to scrap Train to Gain has the potential to open up resources for a more beneficial scheme with less deadweight. However, the programme helped over one million adults gain a qualification and this level of provision needs to continue even if the method of delivery is to change. Yet, while the

66. This figure represents the numbers working in the three industrial sectors of *education*, *health* and *public administration*. It does not definitively capture the number of low earner public sector workers (it refers to jobs rather than individuals); some of the jobs recorded (e.g. private sector hospital activities) are in the private sector; and some public sector jobs (e.g. library staff) are recorded elsewhere. Nevertheless, it is a useful proxy.
67. CIPD Press Release, "CIPD estimates 1.6 million extra private sector jobs needed by 2015-16 simply to offset full impact of Coalition Government's spending cuts and VAT rise", 1 November 2010

government has promised increased funding for adult apprenticeships, overall investment in adult skills is due to fall by £150 million in 2012-13, while the total number of adult learners is forecast to drop by half a million.[68]

Opportunities for older workers will be further damaged by funding cuts in further education. Government proposals include removing entitlement to free training for a first full level 2 qualification for those over 25 and imposing fees on students aged 24 and over studying for a level 3 qualification (A-level equivalent). Although the proposal to extend higher education style loans to further education is a positive development

LMEs will also continue to suffer a disadvantage in the labour market because of the longstanding tendency for businesses to train already highly-skilled staff rather than lower-skilled employees.

*Wage pressures*

***Average wages will fall in real terms until 2013…***

Wage growth is likely to reflect the shape of recovery in the labour market. The OBR has forecast that average earnings will grow by 1.9 per cent in 2011 – below its forecasts for RPI and CPI inflation. Chart 7.1 shows that this situation is expected to persist until 2013. Other projections look ever less postive with the CIPD forecasting that pay settlements will be weaker than expected by the OBR over the next two years.[69]

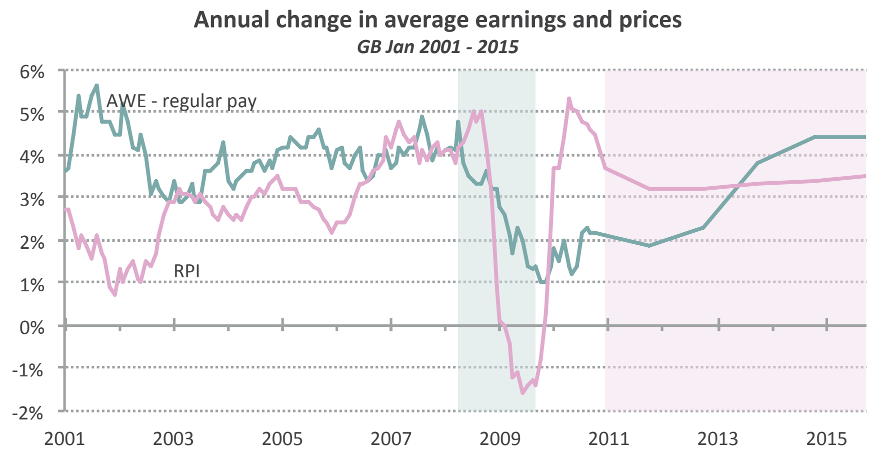



Chart 7.1: Wages and inflation: 2001 - 2015

Notes: AWE represents whole economy earnings excluding bonuses in Great Britain. Projections represent central OBR forecast.

Sources: Outturn: ONS Time Series KA18 & CZBH;

Projection: OBR, *Budget forecast*, June 2010, Table C2

***With LME workers likely to fare worse than average…***

Based on these projections, average LME household earnings would be £720 lower in 2012 than 2009 in real terms.[70]

As discussed in Chapter 3, wage inequality has grown over time. This suggests that LME salaries are likely to grow more slowly than the average in the forecast period, meaning that their real-terms earnings will fall even more sharply.

68. Does not included Adult Safeguard Learning or Offender Learning and Skills Services . BIS, *Further Education - New Horizon Investing in Skills for Sustainable Growth, 2010*

69. CIPD, *Labour Market Outlook*, Autum 2010

70.Based on average LME household earnings of £19,600 as set out in Table 5.1.



Conditions are set to be particularly tight for those working in the public sector. A two-year nominal pay freeze will be introduced from 2011-12, except for those earning £21,000 or less. The setting of a threshold offers welcome partial protection for the lowest paid members of the public sector workforce – although they are still very likely to face real-terms cuts because of current inflation projections – and the selection of £21,000 means that many in the top half of the LME group will be affected.[71]

Public sector wages are also set to be hit by changes to their pension arrangements. The Spending Review set out plans to raise an extra £1.8 billion from employee contributions by April 2012. The implementation will be staggered so that those in higher earning positions contribute more than LMEs, but on average contributions will rise by 3 percent of salary. For a typical LME in the public sector with an annual salary of £21,000 this means a £630 increase in their contributions – and commensurate drop in salary.[72]

## 7.2 The tax-benefit crunch

***Income will come under further pressure from tax credit reductions…***

Earnings, as discussed above, form only one aspect of household incomes. Changes in taxes and benefits in 2011 and beyond will have substantial consequences for LMEs, as will the ongoing restriction of access to credit.

*Support for work-related costs*

The incomes of many LMEs will receive a welcome boost from the £1,000 increase in the income tax personal allowance in April 2011.
Among working LMEs, around 1.3 million do not currently pay tax and will therefore be unaffected by the policy. However, for the majority of the 7.1 million working LMEs who currently pay income tax at the basic rate, the move will increase post-tax incomes by around £170.

The April 2011 increase in the National Insurance primary threshold will similarly benefit many lower paid LMEs, although the gain will be outweighed for higher paid members of the group by the one per cent increase in contributions.

Taken together, these changes in tax thresholds would benefit the average LME household by around £340 in 2012 compared to 2009, thereby offsetting some of the drop in real wages discussed above.[73]

Many LMEs will also benefit from an above-indexation increase in the child element of Child Tax Credit of £180. However, due to other changes, this increase will be felt mostly by those at the bottom of the income distribution. For many families the measure will be largely offset by significant cuts in Working Tax Credit (WTC). In total, the WTC budget will be cut by around £747 million in 2011-12, including £270 million from the childcare element. Some families – those claiming the maximum amount of support for one child in childcare – will be worse off by as much as £1,500 a year by 2012. This will make 2011 a challenging year for many LME families, particularly those facing high childcare costs in cities like London.

71. An ONS analysis of short-term pressures on Average Weekly Earnings in the public sector has suggested that there could be a rise in average wages due to structural factors such as the inclusion of banks in the public sector, existing multi-year pay deals and the likelihood that large public sector employers will be expected to make the largest reductions in employment and these usually have a staff profile that is biased towards those on lower pay grades. ONS, Zero pay growth in public sector average weekly earnings; is it likely? 2010

72. RF calculation based on 3 percent of £21,000 gross salary.

73. For simplicity the average LME household is assumed to contain only one earner with sufficient income to be affected by the threshold changes.

Overall, these reductions in spend outweigh planned increases, as Chart 7.2 shows. By 2014-15, for every additional pound the government plans to spend on tax credits, three will be cut.[74]

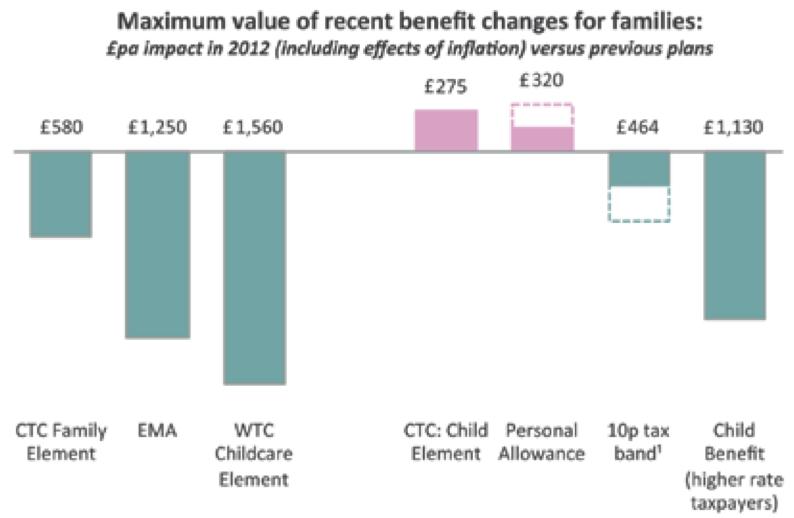



Chart 7.2: Magnitude of average cuts and gains associated with selection of recent welfare policies

Notes: All figures show the maximum potential inflation-adjusted impact of changes as they will apply to 2012, compared to the position that existed post-March 2010 Budget. Exception is the 10p tax band change which is the maximum loss calculated when it was removed in 2008-09.
Figures are presented at the relevant level: i.e. per child in relation to EMA, WTC childcare element, CTC child element and Child Benefit; per family for CTC family element; and per adult for income tax personal allowance and 10p tax band (with amounts for a couple shown by dotted lines). Loss of WTC childcare element assumes household claims the maximum award. Family element and childcare element include impact of increase in tax credit taper to 41%.

*Marginal deduction rates*

***Potentially reducing work incentives...***

As well as affecting the incentive to enter work, the tax-benefit system shapes significantly the ease with which LMEs can increase their household income by earning more. The key measure in this respect is the Marginal Deduction Rate (MDR), the amount of income that is taken away through the tax-benefit system for every additional pound earned in pre-tax income. In 2011, several reforms, including the more aggressive means-testing of tax credits, will increase MDRs for modest earners.

Figures in the Budget suggest that the number of people experiencing an MDR of over 70 per cent will rise from around 0.7 million in 2010-11 to around 2.2 million in 2011-12.[75]

The coalition's reforms to tax credits are primarily designed to target awards on those most in need, by reducing eligibility higher up the income scale. In 2008-09, around 10 per cent of higher earner families were in receipt of tax credits, so there is scope for tightening eligibility. However, increased MDRs for LMEs should be a real concern for a government that is committed to making work pay.

74. IFS, Spending Review 2010 analysis, 'Cuts to welfare spending take 2'
75. HMT, Budget 2010, 22 June 2010, HC 61, Table A3



The government will also need to spend time in 2011 getting the design of the Universal Credit right. The Universal Credit is designed, in large part, to reduce the high MDRs that are experienced by those at the bottom end of the income distribution. Households in receipt of Housing Benefit, Council Benefit and Tax Credits can currently face MDRs as high as 96 per cent. In contrast, the Universal Credit will ensure a flat MDR of 76 per cent for all recipients.

For households in receipt of tax credits but not other benefits like Housing Benefit – as many LMEs will be – this is not as good a deal: before the 1p increase in employee NICs and the June 2010 Budget's reforms to tax credits, they faced an MDR of 70 per cent, meaning that they could be made worse off.

Given that the overall objective is to make work pay, these plans will require careful reflection. For LMEs the risk is that, on top of the economic trends discussed above, these measures create an 'aspiration trap' that restricts the ability of those on low-to-middle incomes to move up the income distribution.

## 7.3 The cost of living crunch

***Dis-proportionately exposed to future cost of living increases...***

As discussed above, price rises are expected to outpace wages in 2011 and beyond, putting further pressure on household budgets. The nature of many of the drivers behind the rising cost of living means that it is budgets in the lower half of the income distribution that are under most pressure.

Because LMEs already live close to the edge of their means, increases in costs are likely to require them to scale back consumption and their already limited level of saving. However, because they spend a relatively large proportion of their income on goods that are difficult to cut back on – housing, fuel, food and transport – their options are likely to be limited.

*Inflation and pressure on prices*

***VAT and fuel price increases will weigh heavily...***

The increase in the standard rate of VAT from 17.5 per cent to 20 per cent that will come into effect in January 2011, will impact on all households. However, because the tax is regressive,[76] LMEs will face a bigger proportional impact than higher earners. LME households are set to be around £270 a year worse off as a result of the measure in 2011-12.[77]

The shift to permanently higher global fuel prices also falls more heavily on LMEs than on higher earners. While fuel prices have fallen slightly from their 2009 peak in the last year, there are signs that they are set to rise once more in 2011. Two domestic energy suppliers have already announced price increases for the coming year, and more are expected to follow suit. LMEs are disproportionately affected both because they spend a higher proportion of their income than higher earners on fuel and because they are increasingly reliant on private rented accommodation, which has lower levels of energy efficiency than other tenures.

76. When measured against incomes. IFS analysis shows that VAT is slightly progressive when measured against a distribution of expenditure.
77. Analysis of ONS, *Effects of taxes and benefits on household income* shows that LMEs account for around 26 per cent of household VAT receipts. The government expects the VAT measure to raise an additional £12.1 billion in 2010-11. Of this, around two-thirds is likely to be paid directly by households (rather than government departments, charities and others). Combining these two figures produces an average annual LME bill of around £270.

The introduction of the Green Deal in 2015, which will allow all householders – including private renters – the option of meeting the upfront costs of energy efficiency improvements by deferring payment, will be welcome. However, in the interim, fuel price hikes will continue to squeeze LMEs.

***As will public service charges...***

Various fiscal consolidation measures are also likely to feed through into higher prices for many working families. For example, while the increased cap on regulated rail fares is actually likely to hit higher earners more than LMEs – rail subsidies are typically regressive – for those LMEs who are affected, fare increases will add a significant additional financial pressure, and will act as a disincentive to work. Planned reductions in bus subsidies are more likely to hit LMEs directly.

More generally, the extension of user charges for public services – such as increases in prescription charges or the introduction of road-pricing – is likely to fall particularly heavily on the LME group, because they tend to fall just the wrong side of exemption and therefore face the largest proportional costs.

***Further limiting opportunities for saving...***

Together, these pressures will increase the difficulty LMEs have in creating a safety net of savings. The decision not to roll out the Savings Gateway and to abolish the Child Trust Fund will compound this problem. However, on a positive note, the introduction of auto-enrolment for pensions in 2012 is welcome. There is also much to be hopeful about in the creation of the new Consumer Financial Education body, which holds greater potential to champion the rights of consumers and ensure LMEs are fairly treated in the financial market. Similarly, the roll out of the National Money Advice Service will provide valuable support to LMES to help manage their finances, providing that the decision to make it universal doesn't result in LMEs' needs being overlooked.

*Access to affordable credit*

***Less able than in previous years to manage budgets by accessing credit...***

For many LMEs, credit has become an everyday part of life. It is particularly useful for those who need to smooth the peaks and troughs of income and spending commitments. However, continued tightness in financial markets means that access to credit will remain restricted in 2011.

Some members of the group may therefore opt for non-mainstream products, with all of the difficulties that they bring. Even among those still able to engage in prime markets, costs are likely to increase – both because interest rates could begin to climb in 2011 and because LMEs will be viewed as higher risk than higher earners.

*Housing implications*

***Housing costs likely to rise in all tenures...***

Potential rises in interest – and therefore mortgage – rates, coupled with contracting supply of affordable housing, means that housing costs are likely to increase for many in the next 12 months.

While many, though still a minority of, LMEs have benefited from lower interest rates in the last two years, an increase in rates designed to combat persistent above-target inflation could tip struggling home owners into repossession.

***Interest rate increases could tip some home owners into crisis...***

For the 63 per cent of LME mortgagors that have *not* benefited from falling mortgage costs because they are on fixed rate deals, the announcement in the Spending Review of a continuation of the recessionary changes to the Support for Mortgage Interest scheme will provide important support. However, the decision to reduce the rate of interest it can support down from 6.08 per cent to the Bank of England's average mortgage rate will mean that LMEs paying the highest interest rates will remain exposed.



***Supply shortage will drive up rents...***

As discussed above, a constrained credit market looks set to continue over the next few years. Younger LMEs will therefore find it increasingly difficult to get onto the property ladder, increasing the wealth divide and demand for rental accommodation. With CLG capital budgets set to be cut by 74 per cent, affordable housing demand will continue to outstrip supply for the foreseeable future. The need to kick-start large-scale private finance to support the housing needs of the LME group will therefore be critical in the coming year.

While increased demand for private rented accommodation is likely to put upward pressure on costs in that tenure, social rents are also set to increase, with new tenants facing rents of 80 per cent of market rates.

### 7.4 Access to public services

***Just as the triple crunch hits, LMEs will find their public services squeezed...***

In addition to facing the 'triple crunch' set out above – which will squeeze living standards in relation to their engagement with the market economy – LMEs are also likely to see their access to public services significantly constrained from 2011.

Next year is the first in which the spending reductions that have been trailed for the past year will finally bite. For example:

+ Per pupil funding in schools will fall by 2.25 per cent on average across the Spending Review period;
+ NHS funding will increase by 0.4 per cent in real terms, more slowly than the 1 per cent believed by the Kings Fund to be required to keep step with demographic pressures; and
+ Local government current spending will fall by 27 percent in real terms throughout the period, with significant discretion for Local Authorities as to which services are cut.

At the most basic level, cuts to public services hit LMEs harder than higher earners. The distributional analysis set out in the Spending Review suggests that households in quintile 2 (the middle of the LME group) consume public services[78] with a value of around £10,700 a year, compared with just £5,500 a year in the top quintile.

Particular reductions in the quality of services are likely to have a disproportionate impact on the quality of life of LMEs. In some instances, LMEs risk facing a withdrawal of services which they value highly – via any decision to refocus Sure Start on children from the poorest households for example. In others, they may experience changes in the nature of provision, such as more limited GP opening times or the withdrawal of after-school clubs, which will hit those working long hours. Reduced funding could, in areas such as social care, force responsibilities back on families themselves.

In undertaking public service reform in the coming year, the government must ensure that a well-intentioned desire to protect the most vulnerable does not lead to exclusion of those who are in work but who enjoy a fragile economic independence. Key services need to be more accessible, flexible and convenient in order to avoid worsening the tightening squeeze on living standards that LMEs face.

78. Not all public service consumption can be modelled. These figures relate to the two-thirds of resource expenditure that the government is able to provide estimates for. independence.

# 8. Technical annex

## 8.1 Definitions

The Resolution Foundation is concerned with improving outcomes for 'LMEs'. From a conceptual perspective, we define this group as including those who are squeezed by the workings of the mixed economy: too poor to be able to benefit from the full range of opportunities provided by private markets, but too rich to qualify for substantial state support.

From an analytical perspective, we consider the group to include those on below-average incomes who remain largely independent of state support. While median income is relatively straightforward to establish as an upper threshold, defining when people become independent of state support is more difficult, particularly as all income groups are entitled to some welfare payments.

The precise definition used has therefore evolved over time and has been dependent in part on natural limitations imposed by the data sources we have analysed. It remains unavoidably imperfect, but it is designed to ensure that as many as possible of those households that could be considered to sit within our conceptual definition are captured statistically.

Most of our statistical analysis is based on five large-scale surveys:

+ DWP's *Family Resources Survey*, which provides UK data at the house hold and individual level – latest data is 2008-09;
+ ONS's *Living Costs and Food Survey*, which provides UK data at the household and individual level – latest data is 2008;
+ NMG's *Financial situation of GB households survey*, which is produced annually for the Bank of England and provides data at GB level for households – latest data is Sep/Oct 2009;
+ CLG's *Survey of English Housing*, which provides England data at the household and individual level – latest data is 2007-08; and
+ The *National Child Development Study*, which is a continuing longitudinal study that seeks to follow the lives of all those living in Great Britain who were born in one particular week in 1958. There have been eight waves of surveys in total, the latest taking place in 2008.

The analysis in the *Audit* focuses on LME *households*, in an effort to remove the distortions associated with capturing a large number of students and non-working members of high income families when adopting an individual approach. The cost of this is that, in relation to households in which income and expenditure is not equally shared, we are likely to miss some individuals who fit the LME profile. However, in making the assumption that income is usually shared, we are consistent with the approach used by the DWP in its *Households Below Average* Income study.

The precise definition of the group varies from source to source, as set out below.

### *FRS definitions*

Many of the figures presented in the Audit are derived from an analysis of the DWP's *Family Resources Survey* (FRS), using a three-stage process, whereby we filter on the basis of age, gross income and benefit receipt.

We first remove retired households from the overall population. The reduced earnings faced by most people at retirement means that many of those considered LMEs during their working lives will fall into the benefit-reliant group in retirement, while some higher earners will drop into the LME group. However, because such households are also likely to face reduced spending commitments, the pressures they face should be less intense than those experienced by working-age households in corresponding income bands.

Among the remaining population of working-age households, we equivalise gross incomes to weight for differing household sizes and compositions, using a modified OECD scale.[79] This matters because we are interested in those households unable to access private sector opportunities. That is, for any given level of income, a household of five adults is likely to achieve a lower standard of living than a single-person household. The equivalisation process takes account of such differences by inflating the incomes of smaller households and deflating the incomes of larger ones.

Incomes before housing costs (BHC) are used. While an after housing costs (AHC) approach might better capture the living standards of those households that pay more for housing than is warranted by the quality of their accommodation (some households in London for example), it would also understate the living standards of those living in property of a higher quality than is suggested by their costs. In addition, the BHC approach is consistent with the government's child poverty target and allows better read across of the LME group to other surveys in which housing costs are not captured.

We next rank the working-age households on the basis of their equivalised incomes and separate them into ten equally-sized deciles (where decile 1 has the lowest income). Given that we are concerned with those on low-to-middle incomes, we use median income – the boundary between deciles 5 and 6 – as the upper threshold of the group. At the lower end we create a threshold at the boundary between deciles 1 and 2. We do this in part because it represents the approximate level of earnings associated with working full-time at the minimum wage, and in part because decile 1 often produces unusual results due to the large number of households within it that have temporarily low incomes or incomes that come neither from employment nor the state.

Therefore, at this stage, the LME group comprises all of those working-age households with equivalised gross incomes in deciles 2-5 of the income distribution. Boundaries for a selection of household compositions are detailed in Table 8.1. For simplicity, we refer to those households with above median incomes as *higher earners*, while those households with the lowest incomes are classified as being *benefit-reliant*.

79. The first adult in the household is given a weight of 0.67, the second is given a weight of 0.33 and all children are given a weight of 0.2. Hence income in a household with two adults and two children is divided by 1.4 to determine the equivalised value.

Table 8.1: Actual gross household incomes equivalent to equivalised LME income thresholds for selected household compositions: *UK 2008-09*

| | Weekly income (£) | | Annual income (£) | |
|---|---|---|---|---|
| | Lower | Higher | Lower | Higher |
| Single no children | 150 | 390 | 8,050 | 20,300 |
| Single with one child | 200 | 510 | 10,450 | 26,350 |
| Single with two children | 250 | 620 | 12,850 | 32,450 |
| Single with three children | 290 | 740 | 15,250 | 38,500 |
| Couple with no children | 230 | 580 | 12,000 | 30,300 |
| Couple with one child | 280 | 700 | 14,400 | 36,400 |
| Couple with two children | 320 | 820 | 16,800 | 42,450 |
| Couple with three children | 370 | 930 | 19,200 | 48,500 |
| Three adults, no children | 310 | 780 | 16,000 | 40,300 |
| Four adults, no children | 390 | 970 | 20,050 | 50,650 |
| Equivalised income | 230 | 580 | 12,000 | 30,300 |

Note: [1] Equivalised incomes calcualted using modified-OECD scale.

Source: RF analysis of DWP, *Family Resources Survey 2008-09*

Our third stage reduces the size of both the higher earner and, more particularly, the LME groups by filtering all those households that receive more than one-fifth of their household income from income-related benefits into the benefit-reliant group. The specification of *income-related* benefits means those in receipt of universal benefits such as Child Benefit are not excluded from the group. Tax credit receipts do not count towards a household's total level of income-related benefit because of their definition not as benefits but as negative tax for those on low-to-middle incomes.

Sample data is weighted using the grossing factor provided in the survey to present nationally representative data.

### *Households, adults and benefit units*

As discussed above, the Audit uses the household as the basis of measurement of LMEs. However, when using the FRS definitions, we also present data at adult and benefit unit level, and it is important to understand the distinction between the three terms.

*Households* are defined as 'a single person or group of people living at the same address who either share one meal a day or share the living accommodation'. So, for example, a group of students with a shared living room would be counted as a single household even if they did not eat together, but a group of bedsits at the same address would not.

*Adults* are primarily allocated to income groups based on the status of their household. That is, if a household is categorised as LME based on the three-stage process set out above, all adults within that house are considered to be LMEs. This rests on the assumption that adults living together in a household will share their incomes and expenditures, meaning that unequal income distribution within a household should not matter for the purposes of analysis.

In relation to *non-conventional* households comprising unrelated sharers however, this assumption is unlikely to hold. We therefore allocate adults living in such households to one of the three income groups on the basis of their place within the individual working-age income distribution. As with the three-stage household process, LME adults are those in income deciles 2-5 who receive less than one-fifth of their income from income-related benefits.



An additional filter is introduced in relation to *adults*, namely that all who described themselves as full-time students are removed from the analysis entirely. This is to avoid the unusual results often associated with the temporary income and living arrangements of students.

*Benefit unit* is a term that relates to the tighter family definition of 'a single adult or couple living as married and any dependent children'.A dependent child is aged under 16 or an unmarried 16 to 19-year-old in full time non-advanced education. So, for example, a man and wife living with their young children and an elderly parent would be one household but two benefit units. As with adults, those benefit units living in conventional households are assumed to share income and expenditure between them and are therefore allocated to the same income group as their overall household. Similarly, however, those benefit units living in non-conventional households are categorised on the basis of a three-stage process that centres on a benefit unit income distribution.

In most of the *Audit* we refer to benefit units as families or family units.[80]

### *LCF definition*

Household expenditure figures used in the *Audit* are sourced from the ONS *Living Costs and Food Survey*. Again a three-stage process is used to define the three income groups.

First, pensioner households and households in which the household reference person's (HRP) economic status is described as 'retired' are removed from the analysis. 'Pensioner households' are those in which retirement pensions account for more than three-quarters of total income, while a retired HRP is one who is both above retirement age and economically inactive.

Secondly, the population of households is split on the basis of equivalised gross income, with LMEs covered by deciles 2-5. In this instance, equivalised incomes are recorded alongside actual incomes in the survey itself, based on the McClements equivalence scale (this scale provides a more detailed breakdown of weights for dependent children than the OECD scale and is the one used by the ONS in its *Family Spending* publication).

Thirdly, those households reporting social security as their main source of income are placed into the benefit-reliant group, in order to reflect the level of *independence from state support*.

The alternative definition of the income bands means that the size of the three groups is slightly different from that captured by the FRS definitions, with 6.2 million LME households recorded, containing 13.1 million adults and 5.3 million children.

As with the FRS definitions, the sample is weighted using the grossing factor provided to present nationally representative data.

### *NMG definition*

Several outputs are based on the annual *Financial situation of GB households* survey carried out for the Bank of England by NMG Financial Services Consulting. Due to the nature of the data source, the income bands are defined on the basis of a two- rather than three-stage process.

80. The DWP also uses the two terms interchangeably in its *Households Below Average Income* publication.

First, records in which the respondent is above retirement age are removed from the analysis. Secondly, the population of households is split on the basis of equivalised gross income using the McClements scale. Because it is not possible to filter on the basis of level of state support, we do not include the whole of decile 2 in the LME group, but instead create a lower boundary at percentile 15. The equivalised income thresholds used in relation to the 2009 survey are therefore £8,200 and £21,900. Once again, the weighting factor provided is used as appropriate.

### *SEH definition*

Many of the housing statistics presented in the *Audit* are derived from the CLG *Survey of English Housing 2007-08*, which covers nearly 20,000 households. Once again, our analysis is based on a three-stage definitional process.

First, households in which the HRP's economic status is either 'retired' or 'full time student' are removed from consideration.

Secondly, the population of households is split on the basis of equivalised gross income, using the same modified OECD scale as in relation to our *Family Resources Survey* analysis. Income is recorded in £50 bands, thereby undermining the accuracy of our decile splits. Moreover, income data is missing for around 2.7 million working-age households (on a weighted basis) covered by the survey.

Thirdly, those households in receipt of any level of *income support* are filtered into the benefit-reliant group. We do this because we do not have details of the level of support received.

Sample figures are grossed to national (England) level by using the weighting factor provided.

### *NCDS definition*

The NCDS is a national cohort study that started in 1958 and surveyed all the children born in one week in that year in England, Scotland and Wales. The cohort has been followed-up periodically with new questions added to the questionnaire depending on the life-stage of the cohort. The NCDS data in this report covers waves 4 to 8 of the survey – 1981, 1991, 2000, 2004 and 2008 – over which period the cohort aged from 23 in 1981 to 50 in 2008.

In relation to analysis of this dataset, we have created four income groups – based on distributions of the individual gross weekly earnings from employment:

+ Lowest earners – deciles 1 and 2
+ Low-to-middle earners – deciles 3 to 5
+ Middle-to-high earners – deciles 6 to 8
+ Highest earners – deciles 9 and 10

As discussed elsewhere in this chapter, we usually divide the population into three income groups – considering all those with above average incomes to be higher earners. However, to add a degree of nuance to estimates of mobility it is useful to split that group for some analyses of the NCDS data.

The samples used in this report have been symmetrically truncated at the 1st and 99th percentiles to reduce the effect of outliers.[81]

### *ONS definition*

We use one other definition in the *Audit*, in relation to the ONS statistical release *The effect of taxes and benefits on household income*. The data is presented by the ONS by equivalised *disposable* (rather than gross which we use in relation to other sources) working-age household income decile. No information on the level of state support is provided and it is not possible to look within the decile data.

As such, our definition of LMEs is simply based on the data provided for income deciles 2-5. We simply multiply the average figures in each decile by the numbers in the sample and then average across the decile groups that we specify.

## 8.2 Qualitative research details

The LME responses we refer to in the *Audit* are drawn from two pieces of qualitative research:

+ OPM ran a focus group with LMEs, on our behalf, on the evening of 15 June 2009. The discussion focused on LMEs' experiences of and attitudes towards the recession. Group members were drawn from the Lewisham area and met the criteria contained in a detailed recruitment specification based on equivalised household income thresholds (see Appendix 3) and independence from means-tested benefits. All participants were aged between 18 and 70 and were either retired or lived in a working household: students and members of unemployed households were excluded. Twenty-one people attended in total and participants were paid £30 as a thank you for taking part and their travel and any childcare expenses were reimbursed.
+ We conducted 10 face-to-face and 30 telephone interviews with 40 LME tenants living in the private rented sector in the summer of 2010, to understand their patterns of use of the sector, access to it, affordability, conditions, relationship with their landlord and security of tenure. Respondents were drawn from a range of locations in England and household compositions, with a mix of Housing Benefit recipients and LME households not in receipt of support.

81. Schluter, C. Y and Trede, M (1999), "Local versus global assessment of mobility", Discussion papers in statistics and econometrics, University of Cologne, No. 4/99; Ayala, L and Sastre, M. (2002), "What determines income mobility differences across the European Union?", ISER working papers, No. 2002-27

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