Resolution Foundation

The Living Standards Audit 2022

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Executive Summary

The UK is in the middle of a remarkable real income shock, as inflation tops 9 per cent, its highest since the early 1980s, and the Government has responded with over £30 billion of direct support for households. But we must also assess how households were positioned going into this crisis (and the Covid-19 pandemic before it), and look to the medium-term future – where this income hit only adds to the need for a sustained period of strong, progressive income growth. As our Economy 2030 Inquiry is exploring, the 2020s are an important decade in which the UK must grapple with numerous challenges and seek to improve living standards, particularly for low-to-middle income households. This report – the latest in our long-running annual series – therefore sets out the key lessons we should learn from historic trends in UK incomes as well as from comparisons with other countries. In work to follow later this year, we will assess the immediate future for household incomes, and discuss the Chancellor's options in his autumn Budget.

The UK experienced sustained low growth in household incomes in the 15 years leading up to the pandemic

History teaches us that real growth in household incomes is normal. The typical household income after housing costs tripled between 1961 and 2019-20: growing by an average of 1.9 per cent a year, or 20 per cent each decade. Taking an even longer-term view, real GDP per capita has grown by an average of 1.3 per cent a year over the past two hundred years.

But this growth has not been steady, and the UK's recent track record has been particularly weak. Even before Covid-19, the 15 years between 2004 and 2019 were the weakest for growth in GDP per capita since 1919 to 1934. This has been mirrored in household income growth: the median non-pensioner income grew by 12 per cent (0.7 per cent a year) between 2004-05 and 2019-20, compared to the previous average since 1961 of 40 per cent every 15 years (2.3 per cent a year). Income growth towards the top of the income distribution also slowed dramatically to 0.7 per year, and incomes of the poorest people stagnated between 2004-05 and 2019-20, with a change of 0.1 per cent per year (by comparison, in the period from 1979 to 1994-95, the poorest were left behind but incomes generally grew).

Even within the past two decades, there has been a lot of variation in income growth, however. There was a mixed picture before the financial crisis, with weak growth for some groups such as poorer non-pensioners; a large income hit following the financial crisis; a period of income recovery (between 2012-13 to 2016-17); and a somewhat weaker period following the Brexit referendum, although incomes seem to have been growing strongly immediately before the advent of Covid-19 and high inflation.

Comparing households' typical spending power across European countries suggests that the UK performed worse than most from 2007 to 2018, with only households in Greece and Cyprus seeing less growth. Typical incomes rose by 34 per cent in France and 27 per cent in Germany, for example, over this period. But, when we adjust for purchasing power differences, the typical UK income actually fell by 2 per cent over this period. While the UK is undoubtedly a rich country by global standards, there are therefore now large living standards gaps with many of our peers. Compared to the UK, typical incomes are notably higher now in countries including Ireland (by 6 per cent), France (10 per cent) and Germany (19 per cent), to say nothing of even richer countries such as the US or Norway.

One of the consequences of this poor income growth was a relatively low level of financial resilience among British

households. Newly-available data covering the 24 months leading up to the pandemic confirms this, with just over one-in-four (26 per cent) of all adults (or just under four-in-ten of those in the bottom two income deciles) saying that they would not be able to manage for a month if their main source of income stopped. Financial resilience for families in Germany and France was stronger than that for those in the UK as the pandemic hit, with low-to-middle income households in Germany and France having higher incomes and savings.

The UK has had persistently high income inequality

The UK is also marked by high inequality, by historic and international standards. Having increased by 13 percentage points between 1978 and 1992, the Gini coefficient of inequality rose by a further 2 percentage points up to 2019-20 (although it fell during 2020-21). So, although there has been a period of weak growth for everyone, all of the top ten most unequal years on record have happened in the 21st century, and five of them were between 2013-14 and 2019-20.

Within that overall measure of inequality, the groups with the lowest typical incomes pre-Covid-19 (2017-18 to 2019-20) include social and private renters (37 and 24 per cent below the overall median), children (20 per cent below in the case of under 5s) and single parents (35 per cent below). The richest groups include mortgagors (27 per cent above the overall median – though this gap is likely to shrink over the next couple of years as interest rates rise), couples without children (33 per cent above), 55-to-60-year-olds (19 per cent above) and those in the South East of England (12 per cent above). On the whole, however, most between-group gaps (for groups defined by age, region, disability, family type and ethnicity) are slightly smaller than twenty years earlier, if still too large in many cases.

The UK's Gini coefficient is also high by international standards. In international data, the UK's Gini coefficient for disposable income was 0.37, lower than that in the US's (0.39) but higher than all other G7 countries, and higher than every country in Europe other than Bulgaria. Strikingly, across a wide range of

rich nations, the top 10 per cent's share of disposable income is considerably lower than it is in the UK, where it is 29 per cent (matching the US). For example, in Ireland the top 10 per cent's share is 24 per cent (5 percentage points lower), and in Australia it is 26 per cent (4 points lower). The flipside is that in most rich OECD nations except the US, the bottom 80 per cent of the population receives a higher share of total income than in the UK.

Overall, the UK's poor growth, income distribution and levels of financial resilience meant that too many households entered the double crises of the early 2020s in a weak state.

To do better we will need to learn from the past on the key drivers of household income growth and inequalities

Real household income growth will require real earnings growth, which in turn will require productivity growth (as the Economy 2030 Inquiry is exploring in detail). For most of the non-pensioner population, earnings (either employee or self-employed), benefits, taxes, and housing are the key determinants of household incomes. Even among the poorer half of the non-pensioner population, earnings make up 70 per cent of total gross income (with benefits making up most of the remainder).

The importance of pay – and particularly hourly pay and hourly productivity – is also evident from international and historic relationships. The UK lags internationally on hourly pay (adjusted for purchasing power) just as it does for household incomes, and the international correlation between levels of pay and household income is very strong. Historically, typical incomes, pay and productivity have generally moved in lockstep – with all three having more than doubled since 1975. Looking at GDP per capita, we can also see that changes in average hours and changes in the employment rate have been much less significant drivers of growth than hourly productivity has. Indeed, from 1971 to 2008, productivity growth accounted for over 100 per cent of growth in GDP per capita, with average hours falling.

The collapse in productivity and pay growth since the financial crisis was therefore clearly a terrible loss for living standards too. Average wages are no higher today than they were before the financial crisis, representing a wage loss of £9,200 per year, compared to a world in which pay growth had continued its pre-financial crisis trend.

One helpful labour market change for low-income households recently has been the rise in employment (which, at the aggregate level, is driven by women). Between 2007-08 and 2019-20, the employment rate rose by 6 percentage points in the bottom half of the income distribution, compared to 2 percentage points in the top half. Over a longer period, the proportion of working-age families with no household earnings fell by 6 percentage points between 1994-95 and 2019-20. This trend helped to keep household-level earnings inequality broadly flat over the same period, in the face of rising earnings inequality among working families. Although the minimum wage has been pushing up pay at the bottom, it has not closed wage gaps at the top, and a recent tendency for low-wage men to work fewer hours, and high-wage men to work more hours, meant that inequality in weekly earnings has continued to rise until fairly recently.

However, one important point is that this track record of record high employment makes it unlikely that households can repeat the performance again in the coming decade. And, although the incidence of low pay has reduced significantly thanks to bold targets for minimum wages, this alone is not a panacea for earnings and income inequalities: only 38 per cent of people with low weekly pay now have low hourly pay.

While earnings growth is crucial for boosting living standards, it is not sufficient. In the absence of any active policy changes, earnings growth in isolation would increase inequality, because earnings make up a smaller share of poorer households' incomes than that of richer households. The Basic State Pension is now (more than) linked to average earnings, via the 'triple lock', but there is no such automatic link for other benefits, which have additionally been subject to freezes and a switch from RPI to

(lower) CPI inflation as the basis for uprating. The lack of an automatic link to earnings implies persistent upward pressure on inequality and relative poverty, and no guarantee that the poorest will share in income growth (although benefits may catch up with earnings in the short term if the Government uprates benefits in line with inflation while earnings decline in real terms). Looking internationally, one notable feature of the UK's social security system is how low basic out-of-work support is relative to earnings when compared to our peers, with a weak social safety net to fall back on: basic unemployment support is now down to just 13 per cent of average pay, its lowest level on record. However, we also know that benefit changes can rapidly boost incomes and reduce poverty, playing an important role in cutting absolute poverty in the early 2000s and in 2020-21, for example.

Tax policy can also impact on income levels and inequalities. For example, the combined effective (average) rate of Income Tax and National Insurance for a highly-paid employee (on ten times the median wage) fell from over 60 per cent in the late 1970s to 37 per cent in 1988, contributing to that group's income growth and rising inequality. More recently, average direct tax rates on low-paid employees fell from 13 per cent in 2010 to 4 per cent in 2019. Although average direct tax rates are now rising, the UK stands out compared with our peers in how low direct tax rates are for most of the income distribution; although there are some rich nations with comparably-low top tax rates (such as the Netherlands and Germany), most have considerably higher rates. Other taxes such as Council Tax and VAT, for example, have risen over time, though the latter also has a low effective rate in the UK compared to most of its peers.

In contrast to taxes, rents are typically a larger share of renters' incomes in the UK than in most other rich nations. This, together with changes in mortgage interest costs and shifts in tenures, has had a significant impact on disposable incomes and inequalities over time. Across all households, between 2003-04 and 2008-09 the average ratio of housing costs to incomes rose from 16 to 19 per cent – which for an individual household is

equivalent to a hit to incomes after housing costs of 4 per cent – but this has reversed between 2008-09 and 2019-20.

Strong, progressive income growth should be a shared goal

Given the current cost of living crisis, the UK's record over the past decade or two, and its position relative to other countries, there should be a shared desire for higher income growth in the 2020s and beyond, and for growth to be fastest for lower-income households, ensuring a true 'levelling-up' of incomes.

To make these ambitions more concrete, it is worth noting that the UK has already committed to progressive growth, on paper, through the international Sustainable Development Goals. Target 1.2 is to "by 2030, reduce at least by half the proportion of men, women and children of all ages living in poverty in all its dimensions according to national definitions". One practical definition of this would be to reduce the absolute poverty rate (after housing costs) to less than half its 2015-16 level by 2029-30 (at the latest): a fall from around 20 per cent in 2015-16 to under 10 per cent, on current data. In addition, Target 10.1 is to "by 2030, progressively achieve and sustain income growth of the bottom 40 per cent of the population at a rate higher than the national average". One way of interpreting that (rather loosely worded) target is that the bottom 40 per cent's share should be higher in 2029-30 than 2015-16. In contrast, this share (for incomes after housing costs) has been fairly stable at around 17 per cent over the past three decades, only briefly rising to 18 per cent in the early 2000s.

In short, the UK needs more income growth, and to ensure that low-to-middle income households in particular benefit from that growth. The Economy 2030 Inquiry will explore in more detail what success could look like, and what policies are needed to deliver sustained, shared growth.

Section 1

Introduction

UK households are currently facing a large real income shock in 2022, with consumer price inflation of over 9 per cent.[1] The inflation-adjusted values of earnings and benefits are falling rapidly, mortgage interest costs are rising, taxes have gone up, and the Government has directed over £30 billion to supporting household incomes this year.[2]

Protecting households from this cost of living crisis remains the immediate policy priority – and future Resolution Foundation work will explore what is now happening to household incomes, what the prospects are for 2023-24 and beyond, and how the Government could respond in the Budget of autumn 2022. But it is also important to step back and consider the longer-term trends in household incomes. The key lesson is that one reason this current inflation shock – and the Covid-19 period immediately before it – required such large policy interventions is that those external shocks came on top of persistent income inequalities and existing weaknesses that left too many families only one shock away from having to choose between heating and eating.

The current hit to real incomes also makes the need for sustained, shared income growth in the 2020s all the more pressing: forecasts made by the Office for Budget Responsibility in March implied that typical real incomes for non-pensioners may not return to where they were in 2019-20 (let alone 2021-22) until 2026-27.[3] This is one of the reasons why the Economy 2030 Inquiry, being undertaken by the Resolution Foundation and the Centre for Economic Performance at the LSE, is exploring the big economic changes taking place in the UK, and will, over the next year or so, propose a set of policies that could help the country navigate towards higher living standards. The lessons for the future set out in this report, with a specific focus on household-level incomes, will help inform that.

The rest of this report proceeds as follows:

- Section 2 sets out the UK's twin major household income problems, of weak growth and persistent inequality, including relative to other rich nations;

1 T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.
2 T Bell et al., Back on target: Analysis of the Government's additional cost of living support, Resolution Foundation, May 2022.
3 T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.

- Section 3 explores what factors have been most important in driving those trends, and what lessons they offer for the future; and
- Section 4 concludes, with a discussion of what goals might be appropriate to help deliver progressive growth.

Section 2

There has been low household income growth and persistently high inequality

This section sets out the UK's twin household income problems: low growth over the past two decades – even before the pandemic and current cost of living crisis – and persistently high inequality. The 15-year period from 2004 to 2019 was the weakest since the era of the Great Depression for GDP per capita, and this was matched by exceptionally low growth across the income distribution, including stagnation for the poorest. Among European countries, only Greece and Cyprus experienced weaker growth in typical household incomes between 2007 and 2018, meaning we have fallen behind many of our neighbours.

Overall income inequality, as measured by the Gini coefficient, has hardly changed over the past two decades – reflecting the fact that growth has been weak for everyone. This contrasts strongly with the 1980s, when there was substantial growth, but it was not shared evenly across society. However, a lack of progress in reducing inequality means that the ten most unequal years on record have all happened since the turn of the century, and five of them were between 2013-14 and 2019-20.

The UK remains unequal not just by historic standards but by international standards, where it is among the most unequal rich nations both for market incomes and incomes after taxes and benefits. The share of disposable income that goes to the top 10 per cent in the UK (29 per cent) is notably higher than in other OECD nations except for the US – including European countries, other Anglophone countries, Japan and South Korea – while the bottom 80 per cent receive a lower share of income.

Within the UK, some income gaps between groups have shrunk, but large gaps remain: with the poorest groups including renters, single parents and children; and the richest including mortgagors, couples without children, and 50-64 year olds (something that reflects both 'age' and 'cohort' trends). Overall, the UK's income distribution, poor growth, and levels of financial resilience – one-in-four adults said

they could last less than a month on their savings in the 2018-20 period – meant that too many households entered the double crises of the early 2020s in a weak state.

The UK has experienced low household income growth for much of the past two decades

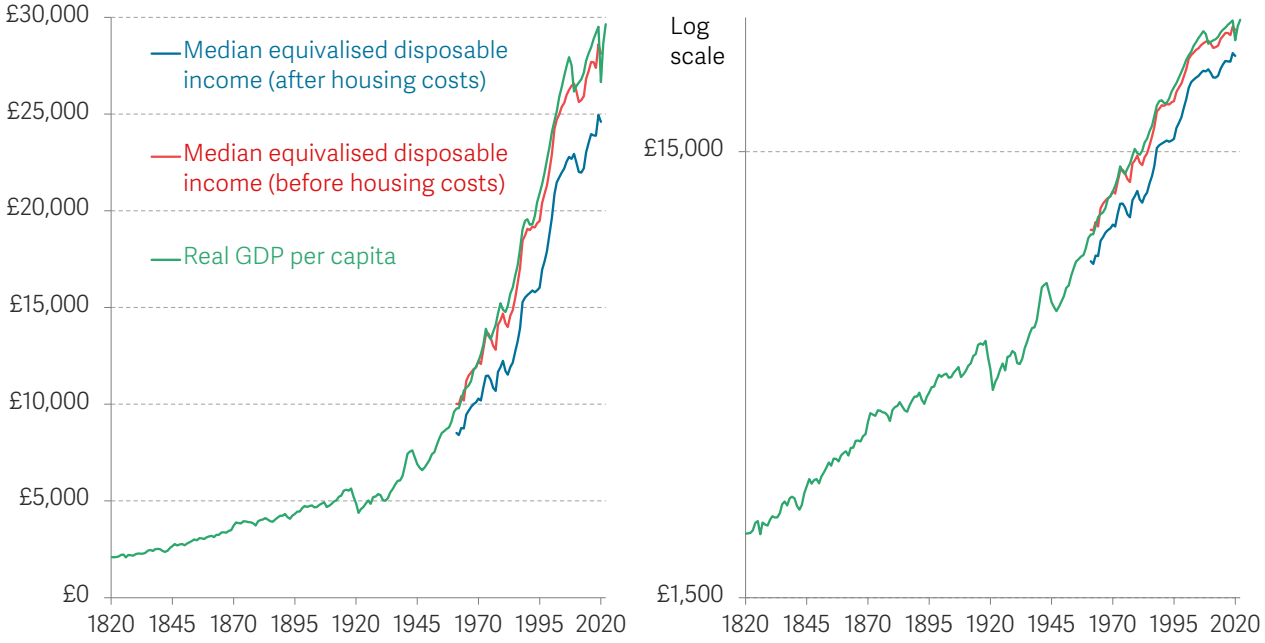
It is worth beginning with the very long-term picture. Figure 1 sets out incomes over the past two centuries, to make two points. First, despite the recent deficiencies that we will set out in this report, UK households have high inflation-adjusted incomes by historic standards. Second, income growth has been the historic norm. Few people would argue that GDP per person or disposable household incomes – the measures used in this chart – are complete measures of living standards and progress, particularly before we consider their distribution. However, the experience of the past two centuries or more, shown in Figure 1, suggests that it is not unreasonable to seek further growth in real incomes.

The typical real household income after housing costs, which we consider to be the best proxy currently available for households' living standards, tripled between 1961 and 2019-20: growing by an average of 1.9 per cent a year, or 20 per cent each decade (Box 1 outlines the definition of income that is used here and throughout most of this report, and discusses what impact this choice might have on our broad conclusions).[4] Taking an even longer-term view, real GDP per person has grown by an average of 1.3 per cent a year over the past two hundred years. As can be seen using a log scale, growth has been relatively steady over the long-term (producing a straight line for log incomes), but the second half of the twentieth century was a period of particularly strong, sustained growth.

4 This report does not focus on household incomes in 2020-21. This is partly because the focus of this report is on the factors have caused the low growth and high inequality environment in the years leading up to the pandemic, but also because there are concerns over the validity of the data for 2020-21. Results from the latest HBAI data are available: DWP, Households below average income: for financial years ending 1995 to 2021, March 2022, and are discussed here: J Cribb & T Wernham, Incomes for poorer families rose during the first year of the pandemic, Institute for Fiscal Studies, March 2022.

FIGURE 1: **Income growth has been the long-term norm, leaving UK households rich by historic standards**

Real household disposable incomes and GDP per person: GB/UK



NOTES: GB for household income data prior to 2002-03.
SOURCE: RF analysis of IFS, Living standards, poverty and inequality in the UK; Bank of England, A millennium of macroeconomic data; OBR, Economic and Fiscal Outlook.

BOX 1: **Alternative income definitions might give somewhat different results**

In this report we focus (as is usual in our reports on household incomes) on equivalised disposable incomes after the deduction of housing costs, a standard measure taken from the Department for Work and Pensions' Households Below Average Income (HBAI) data. We believe that this is the best proxy for people's financial living standards, given the data that is available at present. However, it is important to note the assumptions and choices that this income definition includes:[5]

1. The treatment of housing is an important choice in income data. The international data we explore in this report is based on disposable incomes before housing costs. However, this ignores the large living standards difference between, for example, an outright home-owner and a renter who are on the same salary. As a result, we prefer to look

5 For more detail, see the online appendix to: M Brewer, What Do We Know And What Should We Do About Inequality? SAGE Publishing, 2019.

at incomes measured after housing costs have been deducted (i.e. primarily rent and mortgage interest payments). A third alternative would be to measure incomes including the 'imputed rent' that home owners (and subsidised tenants) effectively receive from their properties, but such estimates are not commonly available. These three different concepts of income will give different pictures of which groups have the lowest and highest incomes, and of trends. Incomes after housing costs may underestimate living standards improvements, for example, growth in housing spending comes with higher quality housing, but the reverse would be true if standards deteriorated.

2. We look at disposable incomes after subtracting Income Tax, National Insurance and Council Tax, and adding income from state benefits and a very small number of near-cash benefits-in-kind. This means that the measure ignores the value of a broad range of publicly-provided private goods, such as free early-years childcare, state education or health care, or public goods, such as the value of defence and law and order. However, the ONS produces estimates of 'final income' after accounting for publicly-provided private goods as well as indirect taxes. This shows faster income growth in the 2000s than the disposable income measure, but, in general, the measures move in step over the long-term.[6]

3. Household incomes are 'equivalised' to account for household size. This means that a single person with a given disposable income is considered better off than a couple with two children on the same income. This principle is clearly a sensible one, but assessing exactly how different household sizes should be compared is not simple.[7] In theory, 'equivalisation factors' might vary over time, between countries and even between income levels, based on changing economies of scale with respect to household spending. Equivalisation factors could also be used to account for additional needs, such as for disability-related spending. But in practice, consistency over time and between countries has been prioritised. What work has been done suggests that the relative living standards of households with children may have been overestimated.[8]

4. Another key assumption in household income data is that incomes are shared equally within households, and that financial living standards are therefore equal for all members of a

6 ONS, Effects of taxes and benefits on UK household income: financial year ending 2020, May 2021. See the discussion in: A Corlett et al., The Living Standards Audit 2019, Resolution Foundation, July 2019.
7 The Social Metrics Commission, Equivalisation In Poverty Measures: Can We Do Better?, December 2019.
8 D Hirsch et al., The Minimum Income Standard and equivalisation: reassessing relative costs of singles and couples and of adults and children, Cambridge University Press, February 2020.

household. In most cases, this is likely to be a better assumption than the opposite: that there is no sharing of resources within households (which is clearly particularly incorrect in the case of children's living standards). But it is not ideal in the case of unrelated adults sharing a flat, for example. For many couples it will also be a misleading assumption, but arguably one that is hard to avoid.

5. There are some notable omissions from standard definitions of household income. As we have explored in previous work, all capital gains, pension lump sums, inheritances and gifts are excluded on the basis that they are 'irregular'.[9] These are significant choices that affect the relative incomes of different groups, trends across time and comparisons across countries. In the case of capital gains, this is true of taxable capital gains, but including the (untaxed) capital gains on main residences in estimates of income would have an even larger impact on such statistics.[10]

As we will see in Box 3, there are also some issues with the data that is collected (rather than conceptual questions) that also affect our understanding of income differences and trends.

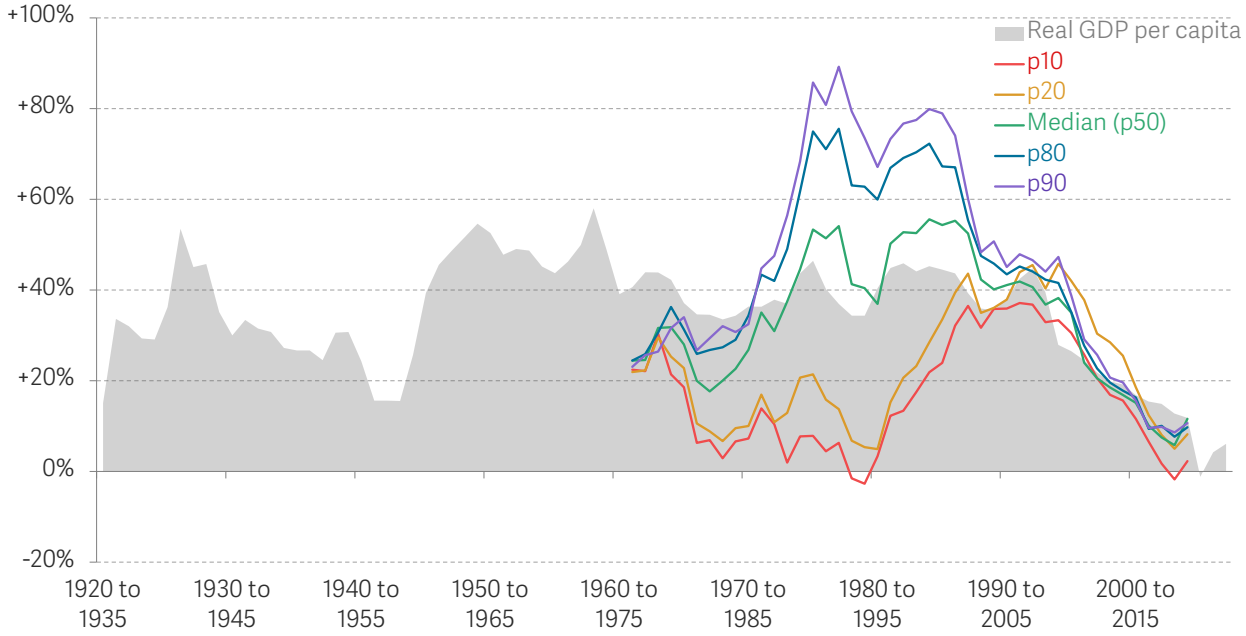
As is made clearer in Figure 2, however, there has been a marked slowdown in growth in incomes in the past two decades. GDP per person grew by 13 per cent between 2004-05 and 2019-20 (0.7 per cent a year), but this was the smallest increase over a 15-year period since 1919 to 1934 – which spans the Great Depression – and events since 2019 have only worsened the growth rate.[11]

For the period since 1961, we can also look at the distribution of disposable incomes (with a focus here on non-pensioners). Even before Covid-19 and the current inflation hit, the 15 years between 2004-05 and 2019-20 were among the weakest on record for median household income among non-pensioners: this grew by 0.7 per cent a year (12 per cent overall), compared to the average from 1961 to 2004-05 of 2.3 per cent (40 per cent per 15-year period). Income growth towards the top of the income distribution (the 90th percentile, shown as p90) also slowed dramatically, to 0.7 per cent a year; while the incomes of the poorest people (the 10th percentile, shown as p10) stagnated between 2004-05 and 2019-20, with a change of 0.1 per cent per year. The only comparable period to this recent stagnation for low-income households was from 1979 to 1994-95, but in that case the poorest were left behind while incomes generally grew.

9 A Corlett, A Advani & A Summers, Who gains? The importance of accounting for capital gains, Resolution Foundation, May 2020.
10 A Corlett & J Leslie, Home county: Options for taxing main residence capital gains, Resolution Foundation, December 2021.
11 Similar arguments were made in: A Corlett & L Try, The Living Standards Outlook 2022, Resolution Foundation, March 2022.

FIGURE 2: **Even before Covid-19 and high inflation, growth had slowed to the lowest in a century**

15-year real growth rates in non-pensioner household disposable incomes, after housing costs, and GDP per person: GB/UK



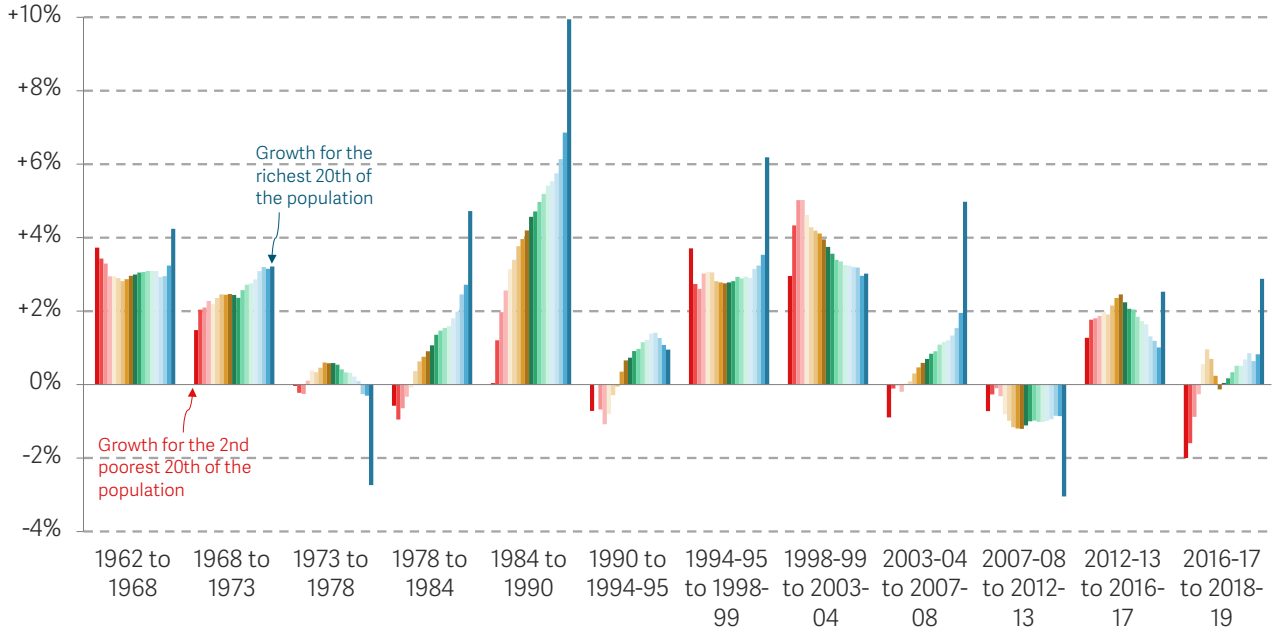
NOTES: Disposable income data is GB from 1994-95 to 2001-02.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; Bank of England, A millennium of macroeconomic data; OBR, Economic and Fiscal Outlook.

It is worth noting, however, that there have been significant variations within these 15-year periods, as we show in Figure 3. Within the period from 2004-05 to 2019-20, there has been a sub-period of falling incomes following the financial crisis (2007-08 to 2012-13). But there was also weak growth in incomes for low-income non-pensioners before that, and income growth between 2016-17 and 2018-19 was generally weak by historical standards, as elevated inflation after the Brexit referendum contributed to falling real earnings and came on top of discretionary cuts to social security entitlements.[12] On the other hand, incomes were growing for many groups before the financial crisis; there was a period of strong growth in household incomes between 2012-13 and 2016-17, reflecting a recovery from the crisis and falling energy prices; and income growth in 2019-20 (not shown) appears to have been strong.[13]

12 S Dhingra et al., The Big Brexit: An assessment of the scale of change to come from Brexit, Resolution Foundation, June 2022.
13 For the last point, see: K Handscomb, K Henehan & L Try, The Living Standards Audit 2021, Resolution Foundation, July 2021.

FIGURE 3: **The financial crisis led to a big real income hit, but there have been other periods of weak growth both before and since that crisis**

Average annual real growth in average equivalised household disposable income for non-pensioners, after housing costs, by income vigintile: GB/UK



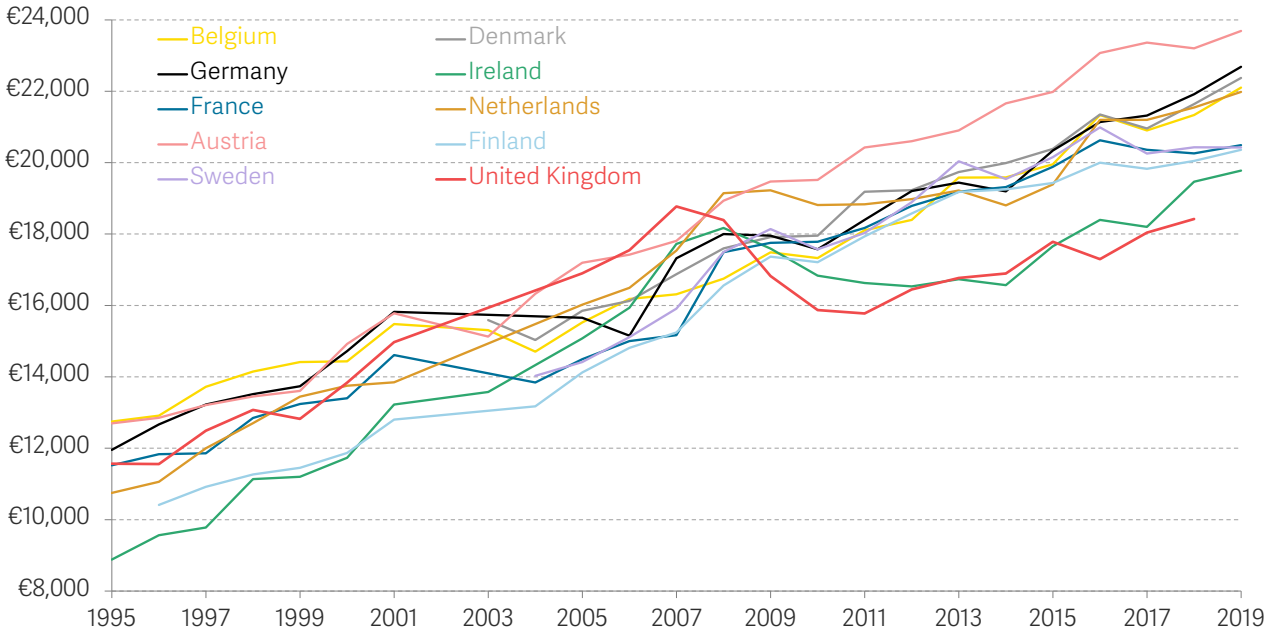
NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income.

Although the financial crisis was an international phenomenon, this poor record on household incomes in the past two decades does not appear to be shared across countries. Comparing median disposable incomes (before housing costs, and including pensioners), and adjusting for the local purchasing power of each currency, the British experience stands out within European data. On this measure, the typical UK income fell by 2 per cent between 2007 and 2018, with only Greece and Cyprus performing worse among European countries. In contrast, incomes in France grew by 34 per cent and those in Germany by 27 per cent. Increases in relative prices in the UK compared to the EU average were crucial to these differences, echoing the decline in the value of Sterling (relative to the Euro) between 2007 and 2009.[14]

14 M Gustafsson et al., After shocks: Financial resilience before and during the Covid-19 crisis, Resolution Foundation, April 2021.

FIGURE 4: **UK incomes have fallen behind those in neighbouring countries**

Median equivalised disposable income, before housing costs, adjusted for purchasing power



NOTES: Some gaps are interpolated, including all countries in 2002, and UK in 2003 and 2004.
SOURCE: Eurostat dataset ilc_di04.

As a result of this stagnation, typical incomes in the UK in 2018 were lower than these comparable European countries, whose incomes had at times previously been below those in the UK on this measure. The typical income in Germany in 2018 was 19 per cent higher than in the UK, and France's was 10 per cent higher; typical income in Ireland has overtaken the UK to be 6 per cent higher, and Finland and the Netherlands have also overtaken the UK since the late 1990s. And although the UK remains a rich country by global standards, the gaps in typical incomes with other countries such as Norway and Switzerland, or the US, Canada and Australia are even larger than the gaps we have illustrated here.[15]

The UK has had persistently high income inequality since the late 1990s

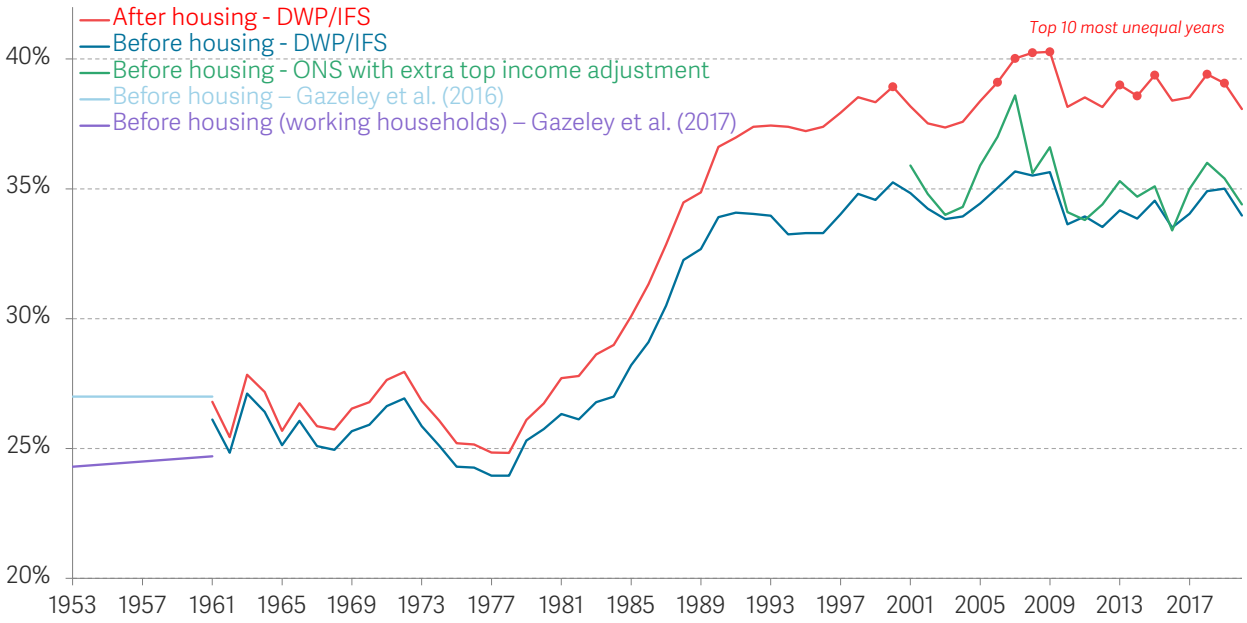
As demonstrated in Figure 2, growth has been weak right across the income distribution since the mid-2000s. This is reflected in a relatively unchanging level of overall income inequality for around the past two decades, at least as measured by the Gini coefficient. While this inequality measure (using income after housing costs) leapt from 0.25 in 1978 to 0.37 in 1992, it rose more slowly to 0.38 in 1999-00 and then only slightly further to 0.39 in 2019-20.[16]

15 OECD median disposable incomes in 2018 adjusted for purchasing power parity.
16 For more on this, see previous editions of the Resolution Foundation's Living Standards Audit, or: M Brewer, What Do We Know And What Should We Do About Inequality? SAGE Publishing, 2019.

But this unchanging level of inequality is also a high level of inequality, with this Gini coefficient comparing to an average value of just 0.26 through the 1960s and 1970s. (The way that inequality rose in the 1980s can also be seen very clearly in Figures 2 and 3, which show how unequally the gains from growth were shared out.) As a result, on an after housing costs basis, the ten most unequal years on record have all happened since the turn of the century, and five of them were between 2013-14 and 2019-20, as highlighted in Figure 5.[17]

FIGURE 5: **Overall income inequality has been hovering near record highs**

Gini coefficient of income inequality: GB/UK



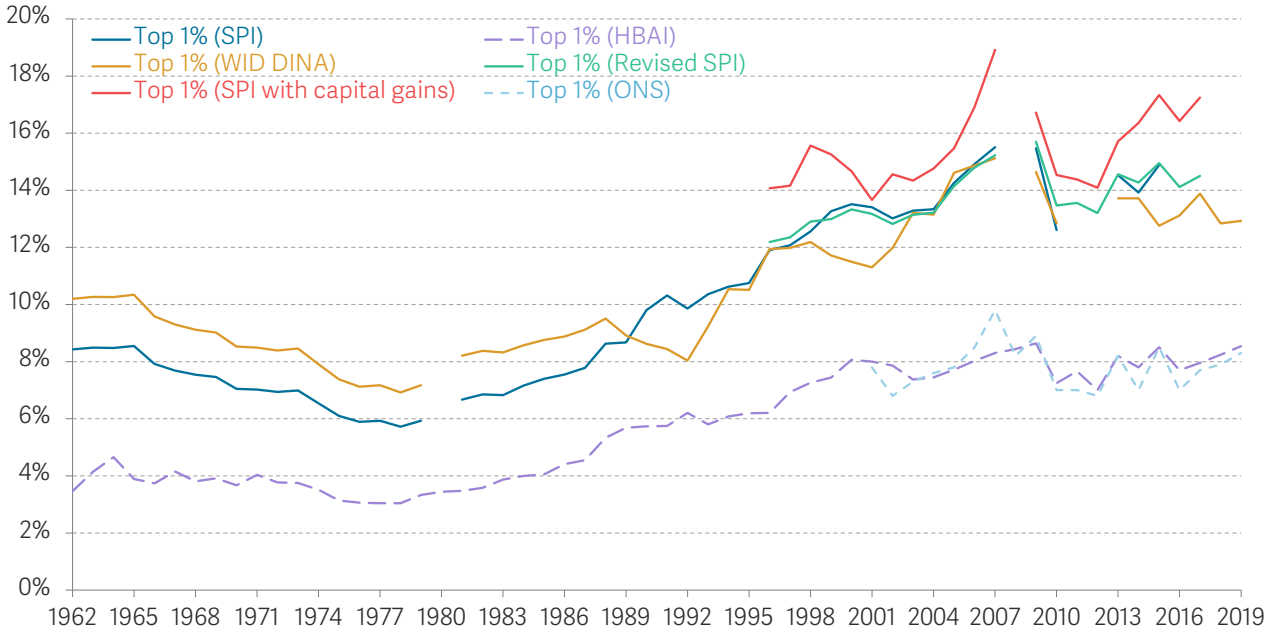
NOTES: GB from 1961 to 2001-02.
SOURCE: IFS, Living standards, poverty and inequality in the UK; ONS, Household income inequality, UK: financial year ending 2021; I Gazeley et al., The poor and the poorest, 50 years on: evidence from British Household Expenditure surveys of the 1950s and 1960s, 2016; I Gazeley et al., What Really Happened to British Inequality in the Early 20th Century? Evidence from National Household Expenditure Surveys 1890–1961, 2017.

One important element of this persistently high inequality – and of some of the changes that have happened over time – is the role of top incomes. Figure 6 shows a number of measures of the top 1 per cent's share of income: like the Gini coefficient, this rose in the 1980s, but it continued to rise through the 1990s and in the mid-2000s, peaking just before the financial crisis. The top 1 per cent's share has not quite returned to the 16 per cent (pre-tax) that it reached in 2007-08, but nor has it greatly receded. Including taxable capital gains – as discussed in Box 1 – the top's share of income is even higher, reaching 17 per cent in 2017-18: one of the highest figures on record.

17 Figure 5 shows that this general story remains true using incomes measured before housing costs, although the rise in inequality during the 1980s was slightly smaller.

FIGURE 6: **Top incomes continued to rise through the 2000s**

Share of income going to the top 1 per cent of adults: UK

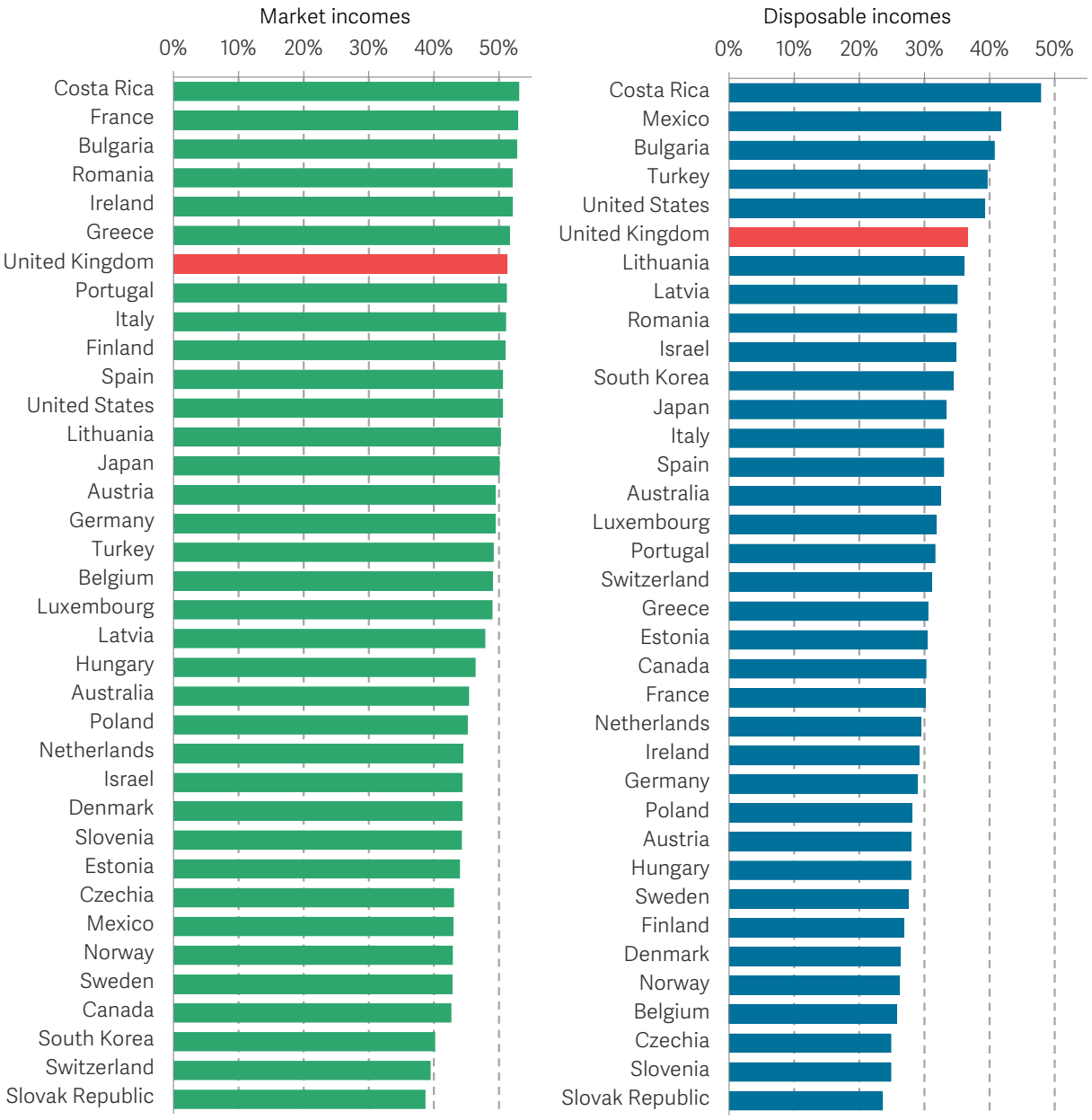


NOTES: 'WID-DINA', 'SPI', 'Revised SPI' and 'SPI with CG' series show pre-tax income share; 'HBAI' and 'ONS' series show share of net household income, without deducting for housing costs.
SOURCE: 'WID-DINA' is series 'sptinc' from https://wid.world/ (accessed 15/06/2021). 'SPI' is from M Brewer & C Samano-Robles, Top incomes in the UK: analysis of the 2015-16 Survey of Personal Incomes, ISER WP 2019-06, 2019. 'ONS' from ONS, Household income inequality, UK: financial year ending 2020. 'Revised SPI' and 'SPI with CG' from A Advani, A Summers & H Tarrant, Measuring top income shares in the UK, IFS Working Paper, January 2022. 'HBAI' from IFS/DWP, Households Below Average Income.

Income inequality in the UK is not only high by historic standards but also compared to other rich nations. Figure 7 shows that the UK is near the top of the OECD rankings for income inequality, both in terms of market income (despite relatively high employment rates) and disposable income. In this data, the UK's Gini coefficient for disposable income inequality was 0.37 in 2018 – lower than the US's (0.39) but considerably higher than that of Japan and Australia (0.33), Canada and France (0.30), or Ireland and Germany (0.29) – let alone the Nordic countries. In Europe, only Bulgaria has a higher Gini coefficient.

FIGURE 7: **UK income inequality is high by international standards**

Gini coefficient for equivalised household incomes, 2018



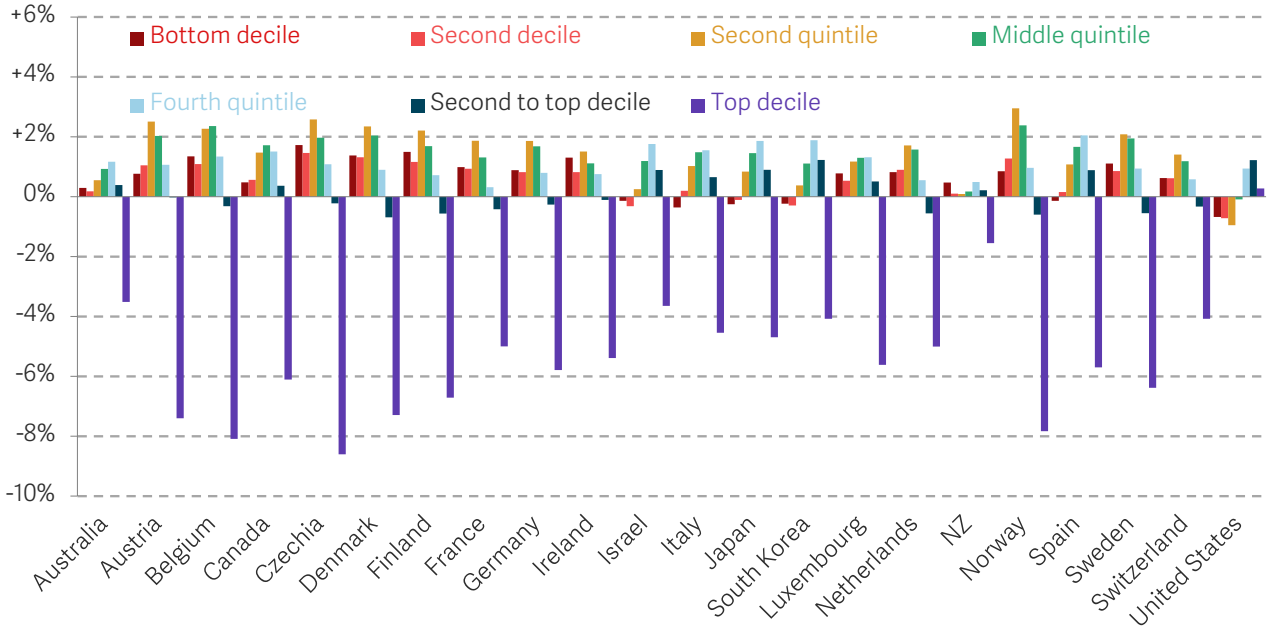
NOTES: Disposable incomes here are before housing costs.
SOURCE: OECD, Income Distribution Database.

The Gini coefficient gives a single number that summarises differences across the entire income distribution, but it is helpful to look in more depth at how the UK's distribution of income differs from its rich peers. Figure 8 looks at differences in what share of each country's total disposable household income goes to each tenth or fifth of the population. Strikingly, in every country shown except the US, the top 10 per cent's share of disposable income is considerably lower than in the UK, where it is 29 per cent. This is, again, not just a contrast with Nordic nations but also with other Anglophone countries, other European countries, and rich Asian nations. For example, in Ireland the top 10 per

cent's share is estimated to be 24 per cent (5 points lower than the UK) while in Australia it is 26 per cent (4 points lower). The corollary is that in every country shown except the US, the bottom 80 per cent of the population receives a higher share of total income than in the UK (while the share going to the second highest income decile is less unusual). There are some other nations where the poorest 20 per cent receive a lower share of total income than in the UK – Japan, South Korea, Israel and Italy – but elsewhere shares are again higher than in the UK (and in proportional terms these differences are large).

FIGURE 8: **In the UK, a lower share of total income goes to the bottom and middle**

Percentage point differences in equivalised disposable income shares with the UK, 2019 (or latest available year)



NOTES: Disposable incomes here are before housing costs.
SOURCE: RF analysis of OECD, Income Distribution Database.

One piece of good news is that income gaps between some groups in society are falling, even if they remain large

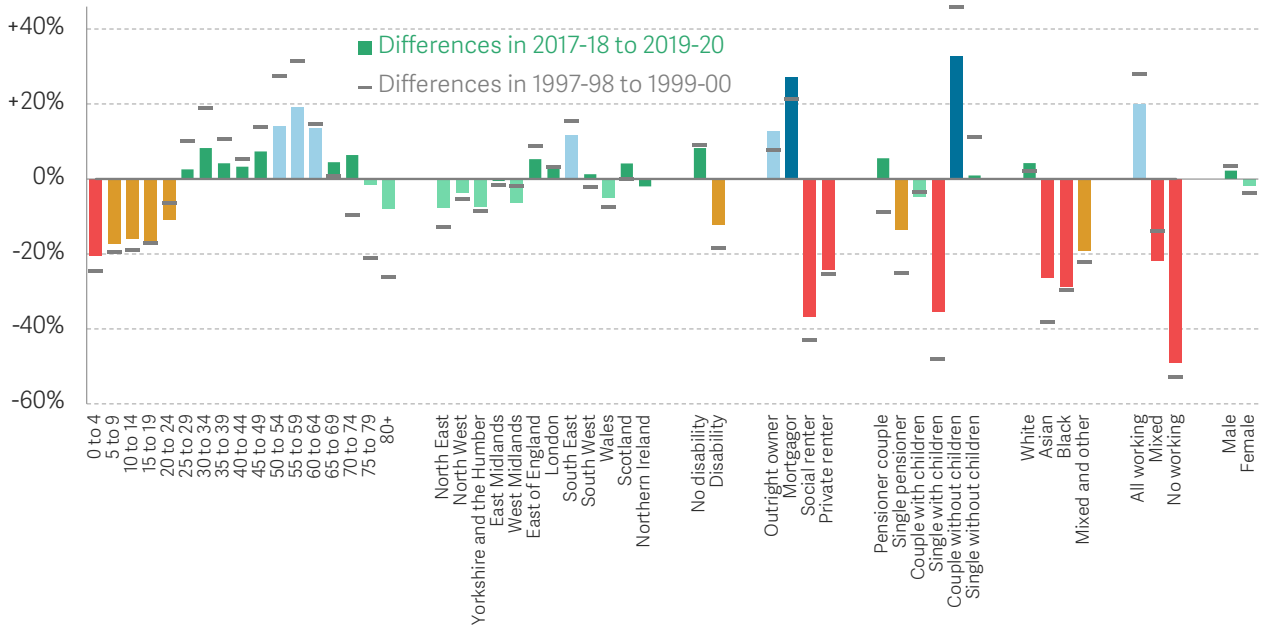
The UK, then, has high inequality between its rich, middle and poor; but another aspect of inequality is the gaps between different groups in society. Here, there has been some good news, in that the gaps between the typical incomes of different groups in society are more likely to have shrunk since the end of the 1990s than grown (see Figure 9, which shows both how close or far the typical income of different groups is to the overall median income, and how these gaps have changed over time). One particularly large (and well-documented) trend has been the convergence of pensioner incomes with the rest of the population, something that reflects the impact of policy but also an increasing

affluence among newly-retired pensioners (i.e. a 'cohort' effect).[18] But falls are seen in general across these groups, with the (unweighted) average absolute gap among the data points shown in Figure 9 shrinking from 12 per cent in the late 1990s to 9 per cent in the late 2010s.

But large gaps still remain between these groups. The groups with the lowest typical incomes pre-Covid-19 (2017-18 to 2019-20) included social and private renters (37 and 24 per cent below the overall median), children (20 per cent below in the case of under 5s) and single parents (35 per cent below). The richest groups included mortgagors (27 per cent above the overall median – though this gap may be shrinking at the time of writing, as higher interest rates feed through into greater mortgage payments), couples without children (33 per cent higher), 55-to-60 year olds (19 per cent higher) and those in the South East (12 per cent higher).

FIGURE 9: **The groups with the lowest typical household incomes include renters, single parents and children**

Median equivalised household disposable income, after housing costs, relative to the overall median, by group: GB/UK



NOTES: Age and gender are based on individual (rather than household) characteristics. Household work status groups are restricted to non-pensioner families.
SOURCE: RF analysis of DWP, Households Below Average Income.

Of course, Figure 9 only shows the differences between the medians of these groups and is not an exhaustive representation of inequalities. There is a great deal of inequality within each of these groups. And what matters for overall inequality is not just the gaps

18 See, for example, Figure 38 in K Henehan et al., An intergenerational audit for the UK: 2021, Resolution Foundation, October 2021, or: A New Generational Contract: The final report of the Intergenerational Commission, Resolution Foundation, May 2018.

between different groups but also the changing sizes of these groups – such as the growth of the private rented sector (discussed further in Section 3).

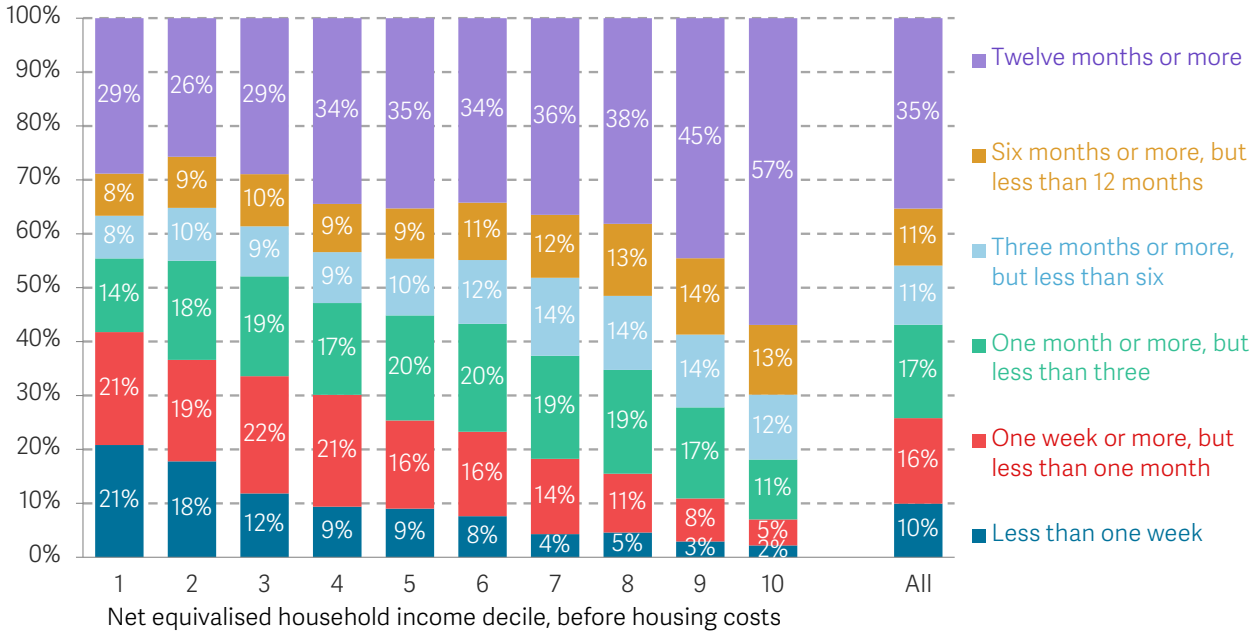
Low growth and high inequality meant that households entered the double crises of the early 2020s in a weak state

One of the consequences of the poor income growth in the run-up to the pandemic was a relatively poor level of financial resilience among British households.

Newly-available data covering the 24 months leading up to the pandemic confirms this, with Figure 10 showing how long people (over the 2018-20 period) thought their savings would last them if their main income source stopped. Just over one-in-four (26 per cent) of all adults would not be able to manage for a month; and just under four-in-ten of those in the bottom two income deciles.[19]

FIGURE 10: **One-in-four adults could last less than a month on their savings**

Share of adults reporting how long their money would last if their main source of income was lost, by income decile: GB, 2018-20



NOTES: Household reference person was asked 'for how long would you [and your partner] be able to make ends meet if you lost the main source of income coming into your household?'. Percentages have been rebased to exclude 'don't know' and 'refusal' answers.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

This is in line with previous Resolution Foundation work, using pre-pandemic cross-national data, which showed that financial resilience for families in Germany and France was stronger than for those in the UK, with low-to-middle income households in Germany

19 This chart is kindly taken from Resolution Foundation's third annual wealth audit, due to be published in late July 2022.

and France having higher incomes and savings. UK households, by contrast, were more reliant on relatively illiquid housing wealth as their source of financial resilience.[20]

These low-levels of preparedness for shocks, combined with the way that the pandemic affected different people's incomes and outgoings, help explain the pattern of changes to assets and debts that we have seen over the past two years. Although, in aggregate, the Covid-19 crisis led to increased savings and reduced debt, Resolution Foundation work showed that, a year into the pandemic, the highest-income fifth of families were four times as likely to have increased saving during the pandemic as the poorest fifth, and were two-and-a-half times as likely to have reduced debt levels.[21]

In Section 4 we will touch on how the UK should respond to its persistent inequality and poor growth and aim for better outcomes for low-to-middle income households, but in Section 3 we first look at the key drivers of income changes and inequalities.

20 M Gustafsson et al., After shocks: Financial resilience before and during the Covid-19 crisis, Resolution Foundation, April 2021.
21 J Leslie & K Shah, (Wealth) Gap Year: The impact of the coronavirus crisis on UK household wealth, Resolution Foundation, July 2021.

Section 3

To do better we will need to learn from the past on the key drivers of household income growth and inequalities

The previous section set out the UK's record on household income growth and inequalities, including in comparison to other countries; this section now explores some of the key drivers of these trends and differences, to inform thinking on how the country might do better in future.

We show that growth in pay and productivity are crucial. The largest component of income for non-pensioner households is earnings; across countries the correlation between levels of pay and household income is very strong; and typical incomes, pay and productivity have historically generally moved in lockstep. Indeed, from 1971 to 2008, productivity growth accounted for over 100 per cent of growth in GDP per capita.

While earnings growth is crucial for boosting living standards, it is not sufficient. In the absence of any active policy changes, (equal) earnings growth in isolation would increase inequality, because earnings make up a smaller share of poorer households' incomes than that of richer households. Although the Basic State Pension is now (more than) linked to average earnings, there is no such automatic link for other benefits, and this puts persistent upwards pressure on inequality.

Tax policy can also impact on income levels and inequalities. In the case of Income Tax and personal National Insurance, the most notable point is that average rates are low by historic and international standards – particularly for low and middle earners.

In contrast to taxes, rents are typically a larger share of renters' incomes in the UK than in most other rich nations. This, together with changes in mortgage interest costs and shifts in tenures, has had a significant impact on disposable incomes and inequalities over time. Across all households, between 2003-04 and 2008-09 the average ratio of housing costs to incomes rose from 16 to 19 per cent – which for an

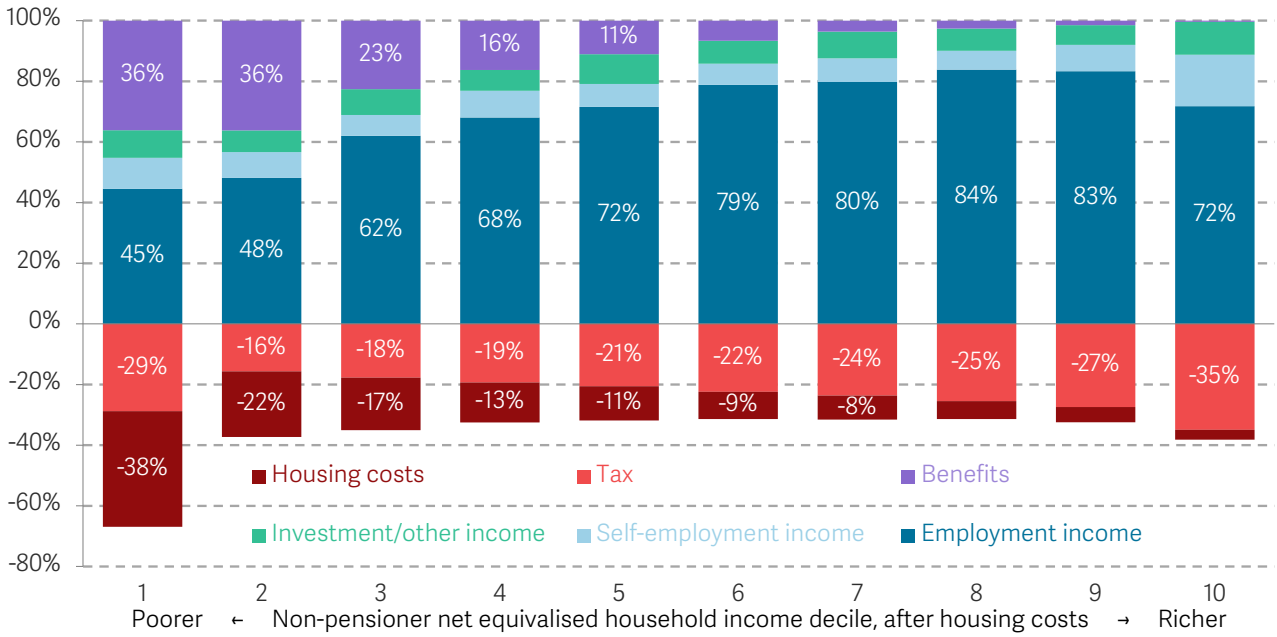
individual household is equivalent to a hit to incomes after housing costs of 4 per cent – but this has reversed between 2008-09 and 2019-20.

The main factors that determine most people's household incomes are earnings, benefits, taxes and housing costs

Why has household income growth been weak, and why has inequality remained high by historic and international standards? To explore these questions, we need to dig into the key components of disposable household incomes.[22] For most non-pensioners, this primarily means earnings (from employment and self-employment), benefit income, direct taxes and housing costs. (Among pensioners, occupational pension income and other investment income are also very significant.[23]) Even among the poorer half of the non-pensioner population, earnings make up 70 per cent of gross income, as set out in Figure 11.

FIGURE 11: **Household disposable incomes are dominated by earnings, followed by benefits and the impact of taxes and housing**

Sources of non-pensioner household incomes as a fraction of gross household income, by income decile: UK, 2019-20



NOTES: Tax refers to Income Tax, personal National Insurance and Council Tax (or Domestic Rates).
SOURCE: RF analysis of DWP, Households Below Average Income.

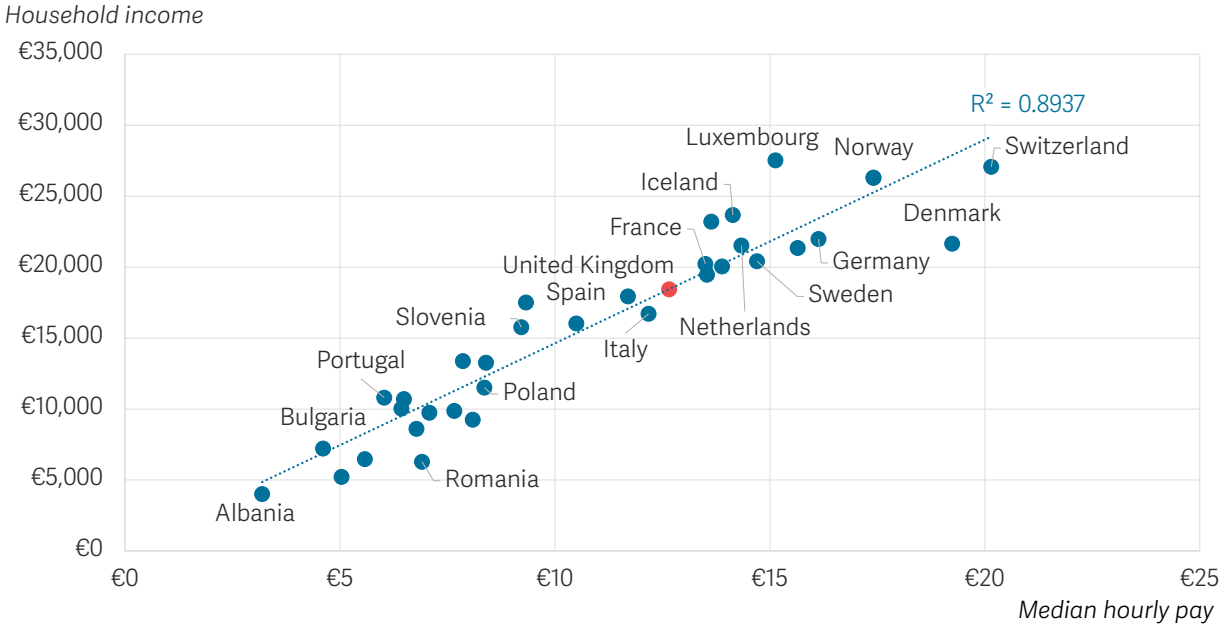
22 Some of this section updates: A Corlett et al., The Living Standards Audit 2019, Resolution Foundation, July 2019.
23 See Figure 11 in DWP, Households below average income: an analysis of the income distribution FYE 1995 to FYE 2021, March 2022.

There is no substitute for (hourly) earnings growth

The clear importance of earnings for household incomes can also be seen by looking at historic and international relationships between the two. Figure 12 shows that there is a strong relationship between a country's median hourly earnings and its median disposable income. Indeed, the UK's income gaps with other countries are matched by earnings gaps: all European countries with higher household incomes than the UK also have higher hourly earnings (both adjusted for local purchasing power). For example, the Netherlands has typical earnings 20 per cent higher than the UK's and a typical household income 27 per cent higher.

FIGURE 12: **All European countries with higher household incomes than the UK also have higher hourly earnings**

Median hourly earnings and median household incomes, adjusted for purchasing power, 2018: European countries

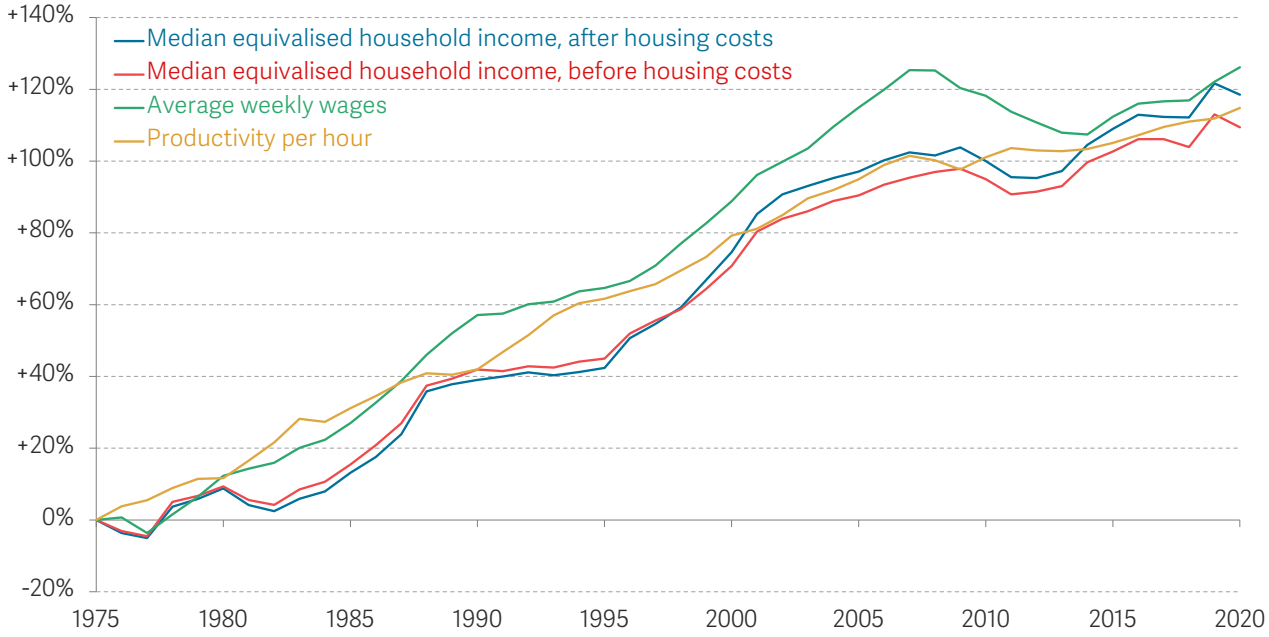


SOURCE: RF analysis of Eurostat, Distribution of income by quantiles (EU-SILC and ECHP surveys); Eurostat, Median hourly earnings.

What's more, typical household incomes have historically grown in lockstep with average real earnings, and – in turn – both have also mirrored productivity growth. As Figure 13 shows, average productivity per hour rose by 112 per cent between 1975 and 2019, average pay rose by 122 per cent, and the typical equivalised household income after housing costs (across all individuals, including pensioners) rose by an identical 122 per cent.

FIGURE 13: **Over the long-term, typical household income, earnings and productivity have moved together**

Cumulative growth in real incomes, wages and productivity since 1975: GB/UK



NOTES: GB for income data prior to 2002-03.
SOURCE: Analysis of Bank of England, Millennium of Macroeconomic Data; OBR, Economic and Fiscal Outlook, March 2022; ONS, Labour Productivity; IFS, Living standards, poverty and inequality in the UK.

As we have seen in Figure 2, it is quite possible for some groups to be excluded from economic growth, but it is clearly not the case that the typical household income has been decoupled from broader growth in the UK.[24] A recent paper concluded that:

> *"Productivity growth was far and away the most important factor in accounting for the growth of living standards which was substantial up to 2007; rising inequality prior to 2007 retarded the growth of living standards but not by much. Since 2007 productivity growth has collapsed as has also the growth of living standards."* [25]

Given that productivity and pay growth are key drivers of living standards improvements, the slowdown over the past twenty years is therefore hugely concerning.[26] Average wages are no higher today than they were before the financial crisis, representing a wage loss of £9,200 per year compared to a world in which pay growth had continued its pre-financial crisis trend.[27] Internationally, the UK was one of the OECD countries with the lowest growth in real earnings over the period from 2007 to 2019.[28]

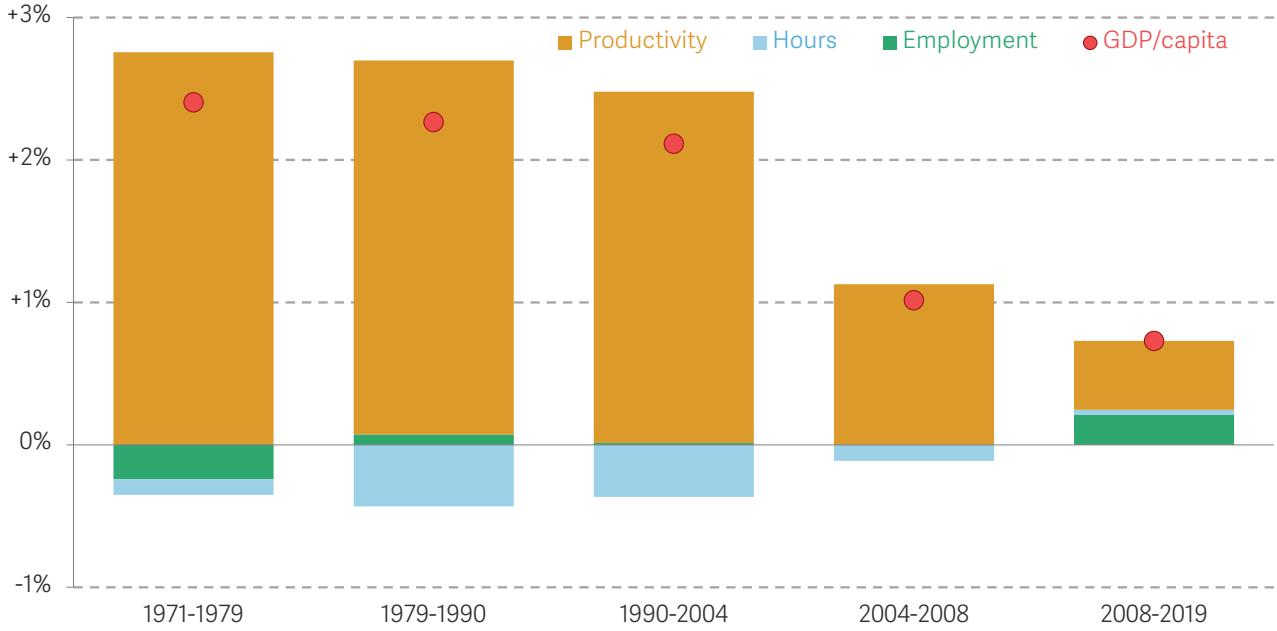
24 For further discussion of the links between productivity and pay in the UK (as well as the US), see M Whittaker, Dead-end relationship? Exploring the link between productivity and workers' living standards, Resolution Foundation, January 2020.
25 N Oulton, The Productivity-Welfare Linkage: A Decomposition, ESCoE Discussion Paper, March 2022.
26 Previous Economy 2030 reports have looked at the UK's record on productivity. See: J Oliveira-Cunha et al, Business time: How ready are UK firms for the decisive decade?, Resolution Foundation, November 2021.
27 Analysis of ONS, Average Weekly Earnings; ONS, Consumer Prices Index including owner occupiers' housing costs.
28 G Giupponi & S Machin, Labour market inequality, IFS Deaton Review of Inequalities, March 2022.

To further highlight the indispensability of growth in productivity per hour (and hourly pay) in explaining growth in incomes, Figure 14 shows the result of a decomposition of changes over time in GDP per capita into changes in labour productivity (in terms of output per hour worked) and total labour supply, which in turn can be split into the number of people in work and how many hours they work.

In general, average hours worked have declined over time (indeed, they have done so for at least the past 150 years) and have therefore not been a source of income growth.[29] Changes to the number of people working made essentially no contribution to growth in GDP per capita between 1971 and 2008; a rise in employment did account for a small part of growth in GDP per capita over the period from 2008 to 2019, but in absolute terms this growth contribution was small, and some of the increase in employment and changes in hours worked in this period may well have been a response to households' financial insecurity.[30] In every other period, growth in labour productivity per hour has accounted for more than 100 per cent of growth in GDP per capita.

FIGURE 14: **In most periods, growth in labour productivity per hour has accounted for at least 100 per cent of growth in GDP per capita**

Break down of annualised growth in GDP per capita: UK



NOTES: Contribution of productivity, hours and employment scaled so that sum matches GDP/capita.
SOURCE: Analysis of Bank of England, Millennium of Macroeconomic Data; OBR, Economic and Fiscal Outlook, March 2022; ONS, Labour Productivity; ONS, Labour Market Statistics.

29 G Bangham, The times they aren't a-changin': Why working hours have stopped falling in London and the UK, Resolution Foundation, January 2020.
30 T Bell & L Gardiner, Feel poor, work more: explaining the UK's record employment, Resolution Foundation, November 2019.

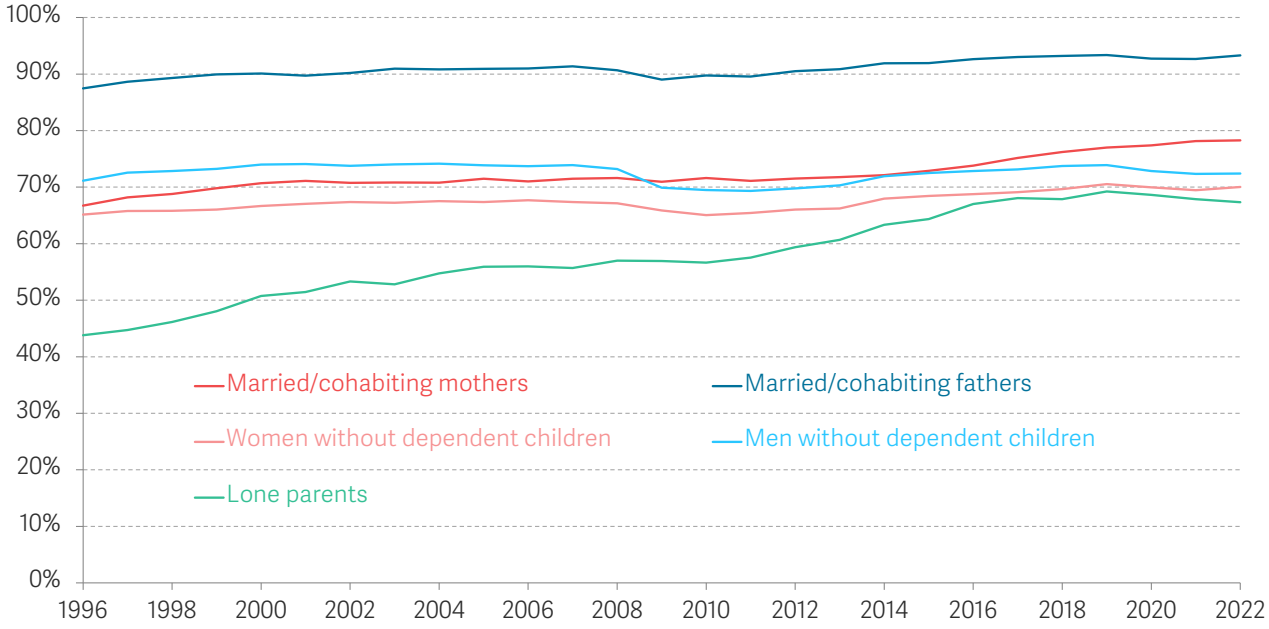
Recent increases in employment have shored up incomes towards the bottom of the distribution

While average hourly productivity and earnings are therefore at the heart of aggregate income growth, changes in employment, hours and earnings can also have marked impacts on incomes and inequalities.

This report does not seek to give a detailed exploration of labour market trends, which have been well covered in other work.[31] But one of the most important labour market trends has been the rise in the proportion of working-age women in work, and a fall in the proportion of men in work. These include a stark increase in the employment rate of single parents (the majority of whom are women), as is shown in Figure 15, as well as a long-term rise in the rate among mothers who live with a partner: these changes have helped close gender gaps in the labour market.[32]

FIGURE 15: **Increases in (female) employment rates have played a role in income growth and shaping inequalities**

Percentage of people in employment by parental status (among working-age households): UK



NOTES: Not seasonally adjusted.
SOURCE: ONS, Working and workless households in the UK: January to March 2022.

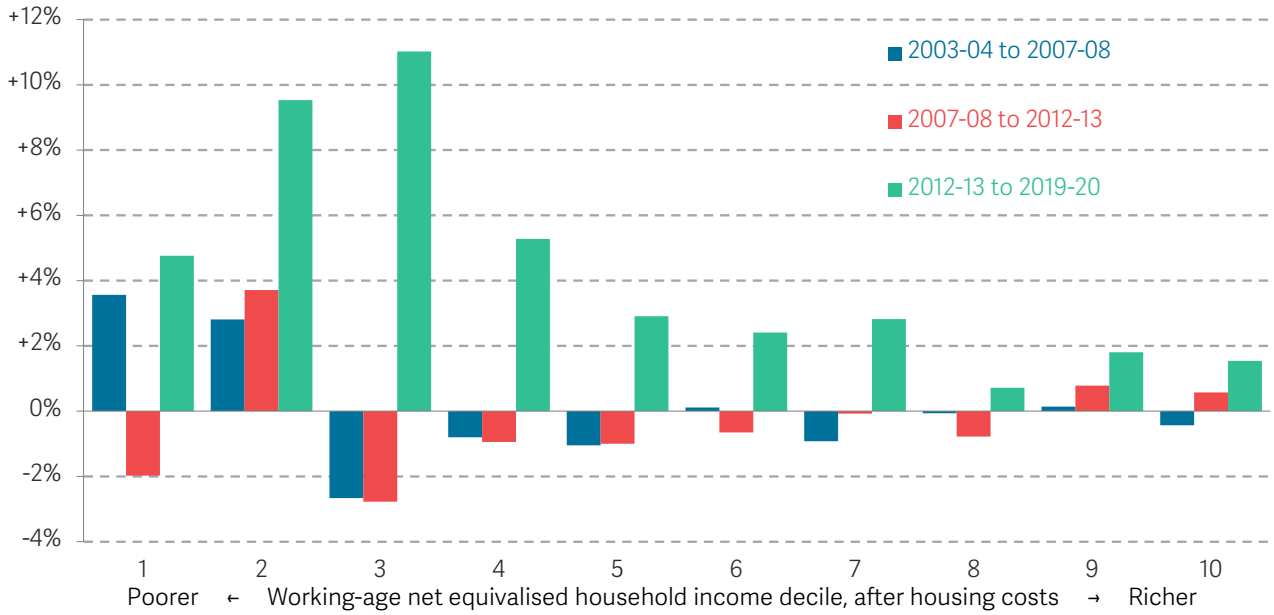
But at a household level, increases in employment have acted in a way that narrows income gaps. For example, between 2007-08 and 2019-20, the employment rate rose by 6 percentage points among the poorest half of the working-age population, compared to

31 See for example: G Giupponi & S Machin, Labour market inequality, IFS Deaton Review of Inequalities, March 2022; and: N Cominetti et al., Low Pay Britain 2022: Low pay and insecurity in the UK labour market, Resolution Foundation, May 2022.
32 A Andrew et al., Women and men at work, IFS Deaton Review of Inequalities, December 2021.

2 percentage points among the richest half (Figure 16 shows how this breaks down by each income decile).

FIGURE 16: **Employment rates have increased much more in the bottom half of the income distribution**

Percentage point change in 16-64 employment rate by decile of working-age equivalised household income, after housing costs: UK



SOURCE: RF analysis of DWP, Households Below Average Income; DWP, Family Resources Survey.

This is clearly related to the fall in the proportion of working-age families with no earnings (shown by the purple line in Figure 17), which has fallen by 6 percentage points over the past 25 years, to 15 per cent.

Hours worked by those in work have also changed differently for men and women, and in ways that have also reduced gender gaps: in general, the past few decades have seen men work fewer hours, and women work more hours. For men, this has manifested itself in increasing rates of part-time work among low-wage men; for women, this is evident in increasing rates of full-time work among low-wage women.[33]

33 See Figure 15 of G Giupponi & S Machin, Labour market inequality, IFS Deaton Review of Inequalities, March 2022. These trends are also discussed in: J Cribb, R Joyce & T Wernham, Twenty-five years of income inequality in Britain: the role of wages, household earnings and redistribution, Institute for Fiscal Studies, March 2022, and will be explored in greater detail in: P Bourquin, M Brewer & T Wernham, Trends in income and wealth inequalities, The IFS Deaton Review of Inequalities, forthcoming.

Although the minimum wage has been reducing pay gaps at the bottom for over twenty years, overall inequality in wages and earnings has fallen consistently only since the financial crisis

It is now well understood that the UK's marked rise in income inequality in the 1980s was driven by inequality-enhancing trends in the labour market.[34] Figure 17 focuses on the period since the mid-1990s to show how inequality in various measures of hourly wages or weekly earnings – as captured by the Gini coefficient – has been changing (a change in the underlying dataset used to measure household income introduces a structural break in 1994-95). For hourly wages, the introduction of the minimum wage in 1999, and the more recent real-terms increases in the National Living Wage, have reduced pay gaps at the bottom of the distribution.[35] But changes in the top half of the hourly pay distribution – particularly among men – have meant that overall hourly wage inequality has not fallen consistently until fairly recently (Figure 17 suggests from 2012).[36]

Inequality in weekly earnings also remained at high levels through the 2000s and early 2010s, and has also only begun to fall consistently since about 2014 (as with hourly wages, this hides a large fall since the 1990s in the 50:10 ratio but a rise in the 90:50 ratio). This reflects, as we discussed above, that male earnings inequality has been continuing to rise, pushed up by the tendency for low-wage men to work fewer hours, while female earnings inequality has been continuing to fall, as low-wage women work more hours.

Despite this, however, inequality in the overall distribution of earnings across working-age households – including those with no earnings – is at broadly the same level in 2019-20 as it was in 1994-95. This is the outcome of two offsetting trends: an increase in inequality in family-level earnings among those families with someone in work, and a reduction in the proportion of families where no-one is in work.[37] The first of these phenomena is discussed further in Box 2.

34 The labour market trends are shown in: G Giupponi & S Machin, Labour market inequality, IFS Deaton Review of Inequalities, March 2022. The impact on income inequality is shown in: M Brewer & L Wren-Lewis, Accounting for Changes in Income Inequality: Decomposition Analyses for the UK, 1978–2008. Oxford Bulletin of Economics and Statistics, 78, 2016.

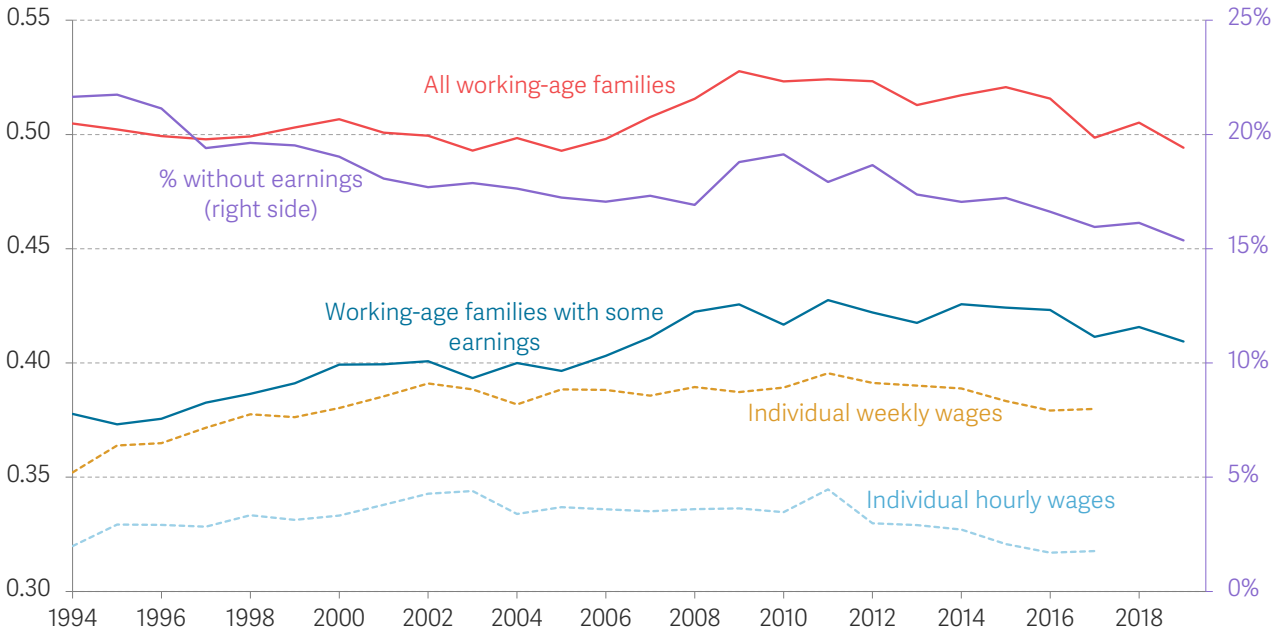
35 N Cominetti et al., Low Pay Britain 2022: Low pay and insecurity in the UK labour market, Resolution Foundation, May 2022.

36 The precise trends would be different if we had used 90:10 ratios; this is because the changes in the distribution are most pronounced towards the top and bottom. This is explored in: P Bourquin, M Brewer & T Wernham, Trends in income and wealth inequalities, The IFS Deaton Review of Inequalities, forthcoming.

37 See also: J Cribb, R Joyce & T Wernham, Twenty-five years of income inequality in Britain: the role of wages, household earnings and redistribution, Institute for Fiscal Studies, March 2022. This shows that, as an overall source of income, household earnings have grown faster among low-income working-age households (including the non-working households) than they have among high-income households, and this is driven by the fall in the proportion of households where no one works.

FIGURE 17: **Inequality in the distribution of earnings across working-age families has been shaped by employment, pay inequality and other factors**

Gini coefficient of various measures of hourly wages or weekly earnings, and fraction of working-age families with no earnings: GB/UK



NOTES: GB for household data prior to 2002-03. Wage figures refer to employee earnings: 'earnings' refers to total employee and self-employed income.
SOURCE: RF analysis of DWP, Households Below Average Income. Wage figures are republished from C D'Arcy, Low Pay Britain 2018, Resolution Foundation, May 2018 – Figure 3.

BOX 2: **From labour market inequalities to household income inequalities**

The way that labour market changes since the mid-1990s among men and women have combined to affect inequality in household income among non-pensioner households has been studied in a recent paper by researchers at the IFS.[38] The paper shows, as we discussed above, that the past two and a half decades have seen falls in the gender gap in labour supply (with a fall in employment among men and a rise in employment among women, and a fall in hours worked among working men and a rise in hours worked among working women). But these changes have not happened equally for low- and high-wage individuals, and the way that they have been related with hourly wages has meant that inequality in weekly earnings has reduced among women, but increased among men. Across all workers, weekly earnings have grown particularly strongly at the bottom of the distribution and at the top (the result of this is shown in Figure 17, where the Gini coefficient in weekly

38 J Cribb, R Joyce & T Wernham, Twenty-five years of income inequality in Britain: the role of wages, household earnings and redistribution, IFS, March 2022.

earnings is now higher than it was in the mid-1990s, but this hides a large fall in the 50:10 ratio and a rise in the 90:50).

However, the changes in women's earnings and working patterns since the mid-1990s have not reduced inequality between households by as much as they have reduced gender gaps in the labour market. The IFS report shows that, among working households, inequality in household earnings among those who have some earnings is now higher than it was in the mid-1990s, although the trend has been downward since the financial crisis (we show something similar in Figure 17). The IFS report attributes the rise in inequality in household earnings to the rise in inequality in male earnings, but trends in household formation and in patterns of household labour supply have also played a role. In particular, three factors have contributed to household earnings inequality growing by more than individual earnings inequality.[39] First, living as a single adult (rather than with a partner) has become more common across those who left education at age 18 or under, and less common among those in the highest-education group. Second, until the financial crisis, the rise of two-earner couples was pushing up household earnings inequalities, as this was more likely to happen among high-earning individuals; this trend has reversed slightly since then, though. Third, the extent to which high-paid people live with other high-paid people has increased over time, especially in the top half of the earnings distribution (for example, the average earnings-rank of the partner of someone at the 90th centile has risen by about 11 percentage points for men and 10 percentage points for women since 1968.

The UK labour market has had some success stories since the 1990s – firstly in increasing and sustaining employment rates (though a post-Covid-19 rise in inactivity is an exception); and in keeping the lid on – and eventually turning around – wage inequality trends with a rising wage floor. There are certainly more employment gaps that could be closed, but there are limits to how many more working-age adults could do some paid employment; and while the National Living Wage is set to keep rising to two thirds of the median wage by 2024, this cannot be expected to do all the work of narrowing gaps in weekly pay, let alone household income. For example, now only 38 per cent of people with low weekly pay have low hourly pay.[40]

39 This draws on: P Bourquin, M Brewer & T Wernham, Trends in income and wealth inequalities, The IFS Deaton Review of Inequalities, forthcoming.
40 N Cominetti et al., Low Pay Britain 2022: Low pay and insecurity in the UK labour market, Resolution Foundation, May 2022.

Earnings growth needs to be accompanied by benefit income growth to avoid leaving people behind

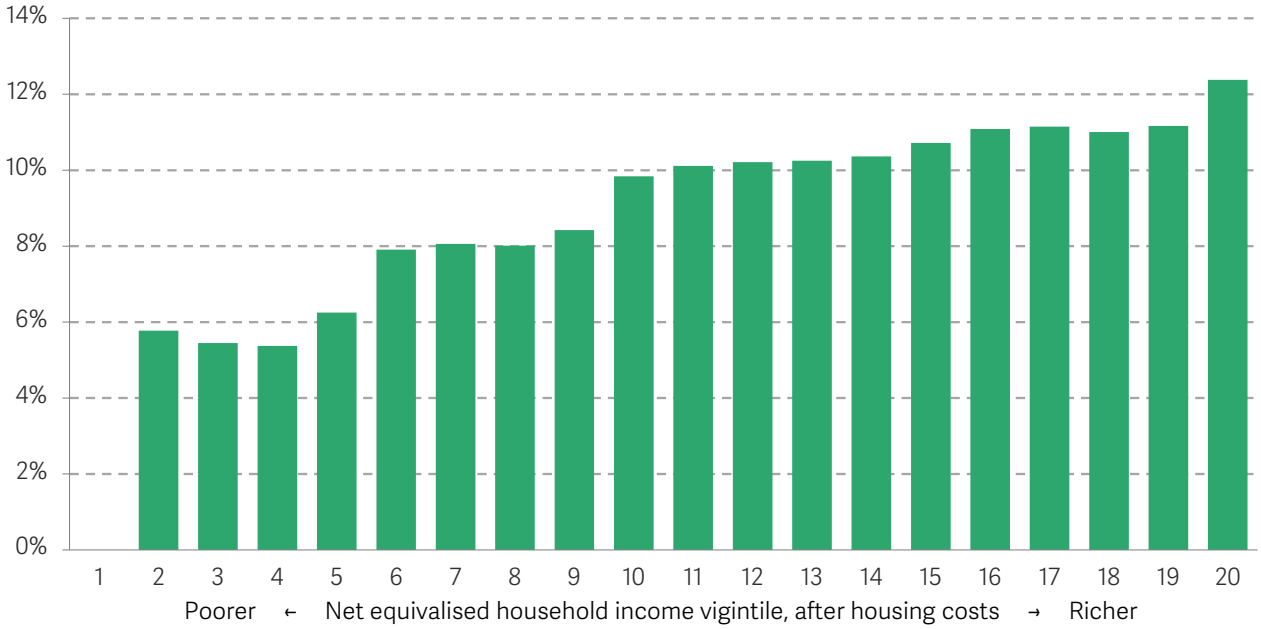
Earnings growth is crucial for boosting living standards, but it is not sufficient to ensure broad-based improvements in incomes, even when focused only on non-pensioner households. Figure 18 shows how an illustrative 15 per cent rise in all workers' earnings would affect household incomes (including pensioner households) across the distribution. While disposable incomes would rise by 12 per cent for the top fifth, the average income of the bottom fifth would rise by only 6 per cent, and that of the middle by 10 per cent. Relative poverty would accordingly rise.

This pattern mostly reflects that not all adults work, and workers are not shared equally across rich and poor households. As a result, earnings make up a smaller share of poorer households' incomes than that of richer households (recall Figure 11). The corollary is that benefit income made up 22 per cent of pre-tax income for the poorer half of the non-pensioner population in 2019-20. The second factor behind the pattern of income changes in Figure 18 is that not all workers face the same effective marginal deduction rate; although workers in rich households may well face the higher rate of Income Tax, the highest effective marginal deduction rates will be faced by low-income workers who earn enough to pay Income Tax but are also receiving Universal Credit or tax credits.[41]

41 How effective marginal deduction rates vary within and between workers at different parts of the income distribution was shown in Figure 21 of: A Corlett, The shifting shape of UK tax: Charting the changing size and shape of the UK tax system, Resolution Foundation, November 2019.

FIGURE 18: **Without real increases in benefits, earnings growth would push up inequality**

Modelled proportional change in average household disposable incomes, after housing costs, from a 15 per cent rise in all earnings, 2024-25: UK



NOTES: We increase employee earnings, self-employed earnings, and pension contributions by 15 per cent; and the direct effects of this on taxes paid and benefits received; but do not include any effect on pension uprating, policy choices or real housing costs, nor any rise in investment incomes.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model.

In the case of pensioners, successive governments have ensured that the Basic State Pension keeps pace with growth in earnings – indeed, the 'triple lock' means that it grows faster than earnings in the long run – and Pension Credit's standard minimum guarantee is also typically increased each year by at least the growth in average earnings. Although not perfect, these policies ensure that pensioners share in the proceeds of growth.[42] But there is no such automatic link for other benefits; indeed, many working-age benefits have additionally been subject to freezes in the 2010s, and the Government has switched from using RPI to (lower) CPI inflation as the basis for uprating.

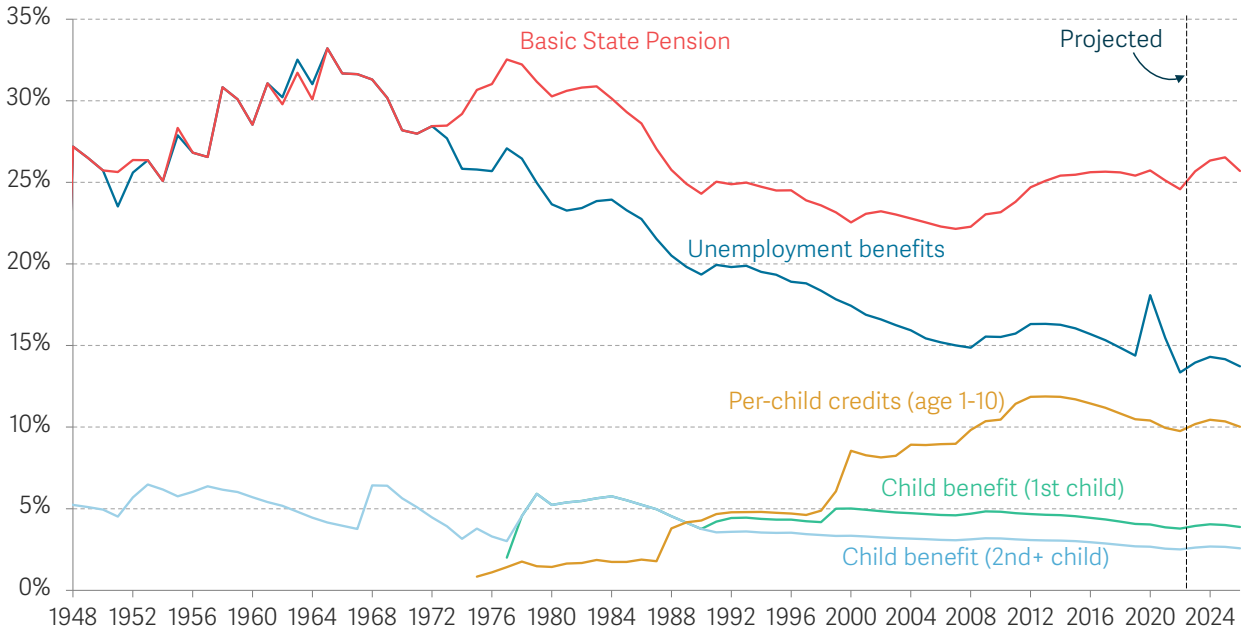
As shown in Figure 19, this disconnect between how benefits are uprated and earnings growth has led to marked changes in generosity over time. The basic unemployment benefit was equivalent to 28 per cent of average earnings in 1972-73 (when it had the same value as the Basic State Pension), but this had halved to 14 per cent of average earnings by 2019-20, and in 2022-23 is likely to average 13 per cent. In the short term (2023-24 and 2024-25), falling real earnings means that benefits should not lose any of their relative value (assuming the Government uprates them in line with inflation) but, in the absence of policy changes, the relative standing of working-age benefits will

42 Alternatives to the triple lock that still ensure that pensioners share in growing prosperity were set out in: T Bell & L Gardiner, Locked in? The triple lock on the State Pension in light of the coronavirus crisis, Resolution Foundation, June 2020.

continue to decline in the longer term, putting upward pressure on relative poverty and inequality and helping to exclude the poorest from any increased prosperity.

FIGURE 19: **The relative generosity of benefits has varied greatly over time, including decades of decline for unemployment support**

Value of selected benefits as a share of average weekly earnings: UK



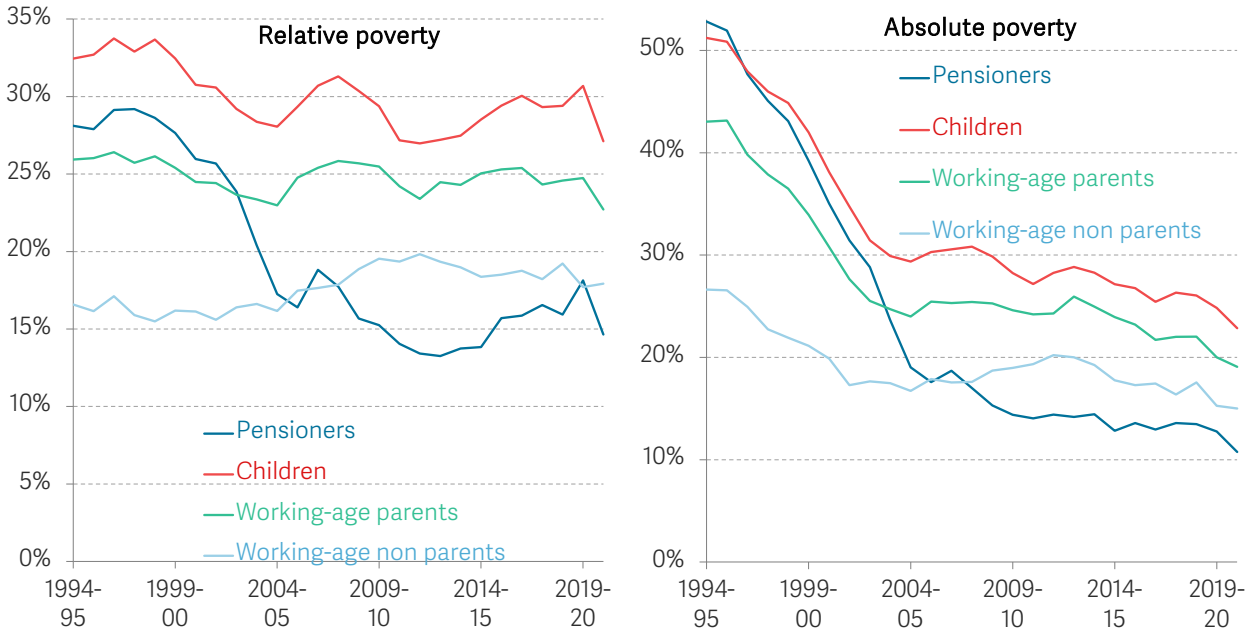
SOURCE: RF analysis of ONS, Average Weekly Earnings; DWP, Abstract of Benefit Statistics; ONS, CPI; OBR, Economic and Fiscal Outlook, March 2022; Bank of England, Monetary Policy Report, May 2022.

However, we also know that benefit changes can rapidly boost incomes and reduce poverty (both absolute and relative). For example, between 1998-99 and 2004-05, the proportion of pensioners living in relative poverty was slashed by 11 percentage points (40 per cent), and the proportion of children cut by 6 percentage points (17 per cent) – see Figure 20 (and the scale of these changes is likely underestimated, as we discuss in Box 3). These shifts were in part due to deliberate policy choices, with policies such as increases in the State Pension, increases in the (then) Minimum Income Guarantee, and the introduction of the Pension Credit for pensioners; and large increases in means-tested child support and Child Benefit.[43] More recently, absolute poverty rates were reduced in 2020-21 (likely temporarily) despite the negative impacts of Covid-19 – thanks to policies such as the £20 a week increase in basic welfare support (also visible in Figure 19).[44]

43 See: T Clark, Recent pensions policy and the Pension Credit, Institute for Fiscal Studies, February 2001, and: M Brewer et al., Child poverty in the UK since 1998-99: lessons from the past decade, Institute for Fiscal Studies, October 2010.
44 A Corlett & L Try, The Living Standards Outlook 2022, Resolution Foundation, March 2022.

FIGURE 20: **The UK has experience of reducing poverty rates through benefit policy, such as in the early 2000s and in 2020-21**

Proportion of people living in relative/absolute poverty, after housing costs: GB/UK



NOTES: GB prior to 2002-03.
SOURCE: IFS, Living standards, poverty and inequality in the UK.

BOX 3: **Benefit underreporting in survey data affects our understanding of income trends**

As discussed earlier, the domestic income data in this report is primarily based on the Households Below Average Income (HBAI) survey data, produced by the Department for Work and Pensions (DWP). International comparisons are also largely based on household surveys. However, one known problem with the UK data is that the surveys underestimate total benefit income relative to what we know is spent each year (and we should not assume that the data for other countries is any better). Our previous work shows that over £40 billion a year is unaccounted for in the HBAI data, and this has an impact on statistics about income and inequality levels and how they have changed over time.[45]

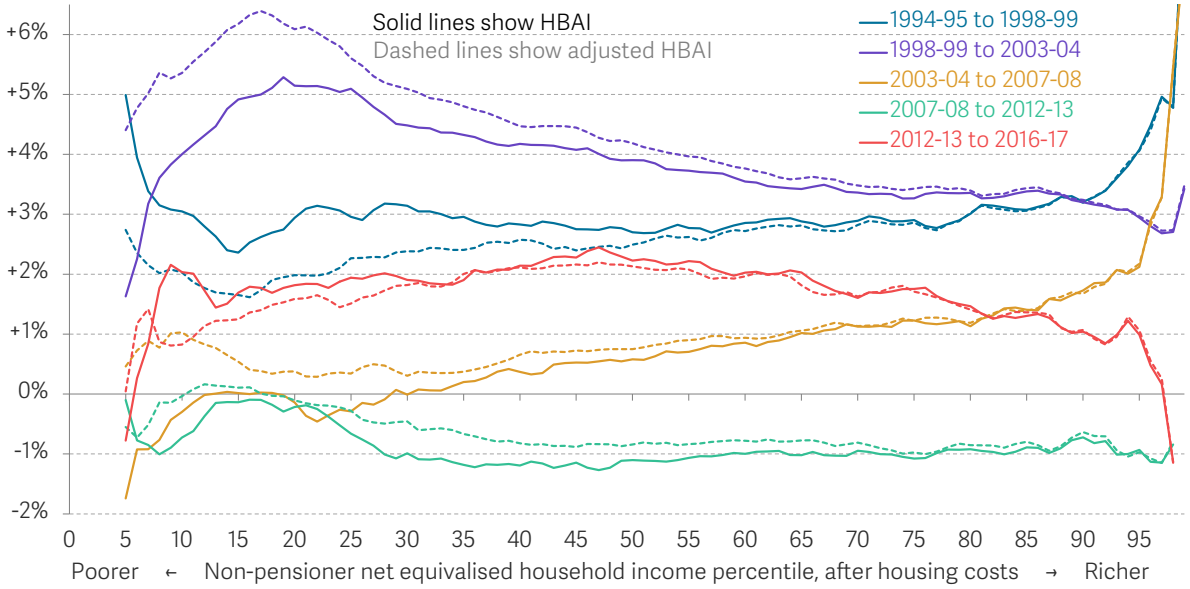
Data improvements are expected at the DWP and ONS, at least for the most recent or future years of data, with the potential to use administrative data to correct survey responses. But our earlier work suggests that poverty reductions in the 2000s were even larger than the data in Figure 20 suggests. Figure 21 shows that income

45 A Corlett et al., The Living Standards Audit 2018, Resolution Foundation, July 2018.

growth over the period from 1998-99 to 2003-04 was perhaps even stronger and more progressive than suggested in Figure 3; and that growth was slightly less poor over the periods from 2003-04 to 2007-08 and from 2007-08 to 2012-13 than suggested, but still very slow. Other than in Figure 21, we do not adjust for this data issue in this report, but it should be borne in mind.

FIGURE 21: **Adjusting for benefit under-reporting, the growth in incomes from 1998-99 to 2003-04 was even stronger and even more progressive**

Average annual growth in real household disposable incomes, after housing costs, by non-pensioner income percentile: GB



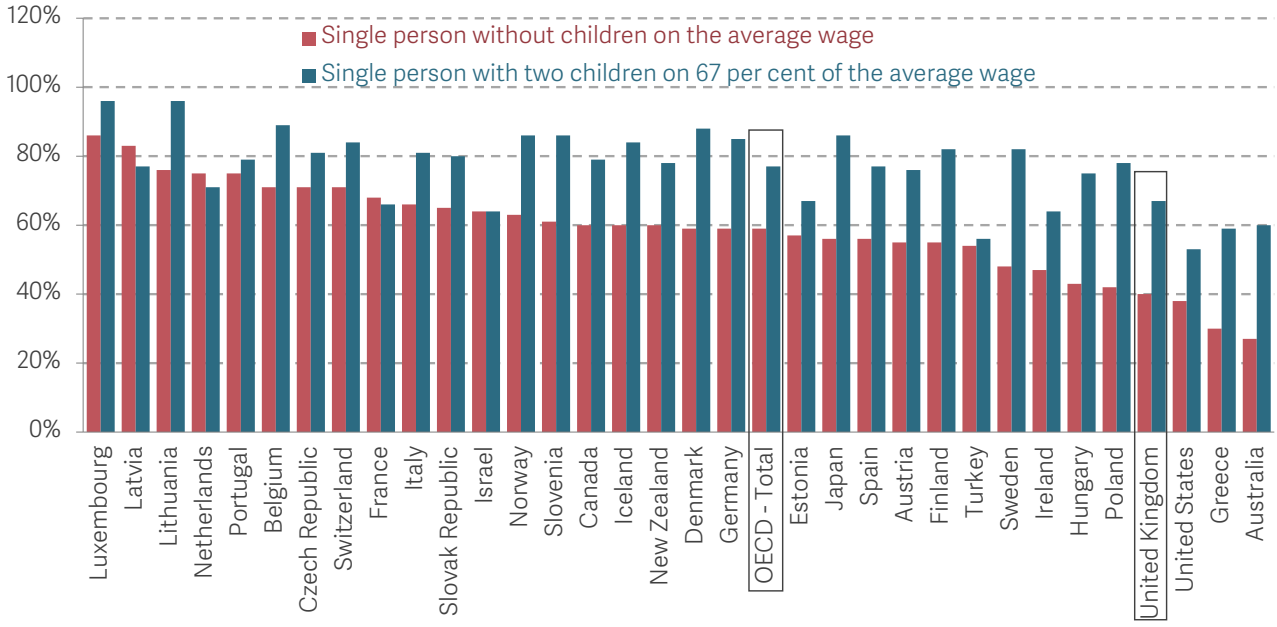
NOTES: The top percentile goes beyond the vertical axis maximum for 1994-95 to 1998-99 and 2003-04 to 2007-08. We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: DWP, Households Below Average Income; plus RF analysis. See A Corlett et al., The Living Standards Audit 2018, Resolution Foundation, July 2018.

International comparisons of benefit generosity are difficult, given the range of systems available and that overall levels of benefit spending depend on need as well as relative levels of support. But previous work has set out that one notable feature of UK benefit spending compared to our peers is how low basic out-of-work support is relative to earnings.[46] For a single person with no children on the average wage, the UK's 'replacement rate' if those wages are lost (including housing support) is only 40 per cent, compared to an OECD average of 59 per cent, 47 per cent in Ireland and 60 per cent in Canada, for example. For those with extra needs, such as children, support is not as notably low compared to other nations, although the UK is still significant below the OECD average (with a replacement rate of 67 per cent compared to 77 per cent).

46 M Brewer et al., Social Insecurity: Assessing trends in social security to prepare for the decade of change ahead, Resolution Foundation, January 2022.

FIGURE 22: **The UK provides notably little basic unemployment support compared to other rich nations**

Net replacement rate in the event of unemployment, OECD countries: 2020



NOTES: Replacement rates shown are for one month of unemployment and include social assistance and housing benefits.
SOURCE: OECD, net replacement rate in unemployment.

So, on both levels and growth, the UK's current benefit policies leave a lot to be desired. This is one reason why there was essentially no income growth for the poorest between 2004-05 and 2019-20, and why households were not set up to weather the storms of the early 2020s. And, looking forward, current default policies for non-pensioner benefits are going to weigh against progressive growth, with some elements of the system merely keeping step with CPI inflation, some permanently frozen, and some cuts still being rolled out (such as the two child limit) or growing in scope (such as the benefit cap). Policy makers may consider an automatic link to earnings (as with the triple lock, and as has recently been instituted in New Zealand),[47] or irregular discretionary (but permanent) boosts instead. As we concluded in a report earlier this year, our current approach to the working-age social security system is not going to deliver an answer to the UK's high levels of poverty and inequality or the lack of income growth for the poorest working-age households.[48]

Tax policy choices help determine levels of inequality

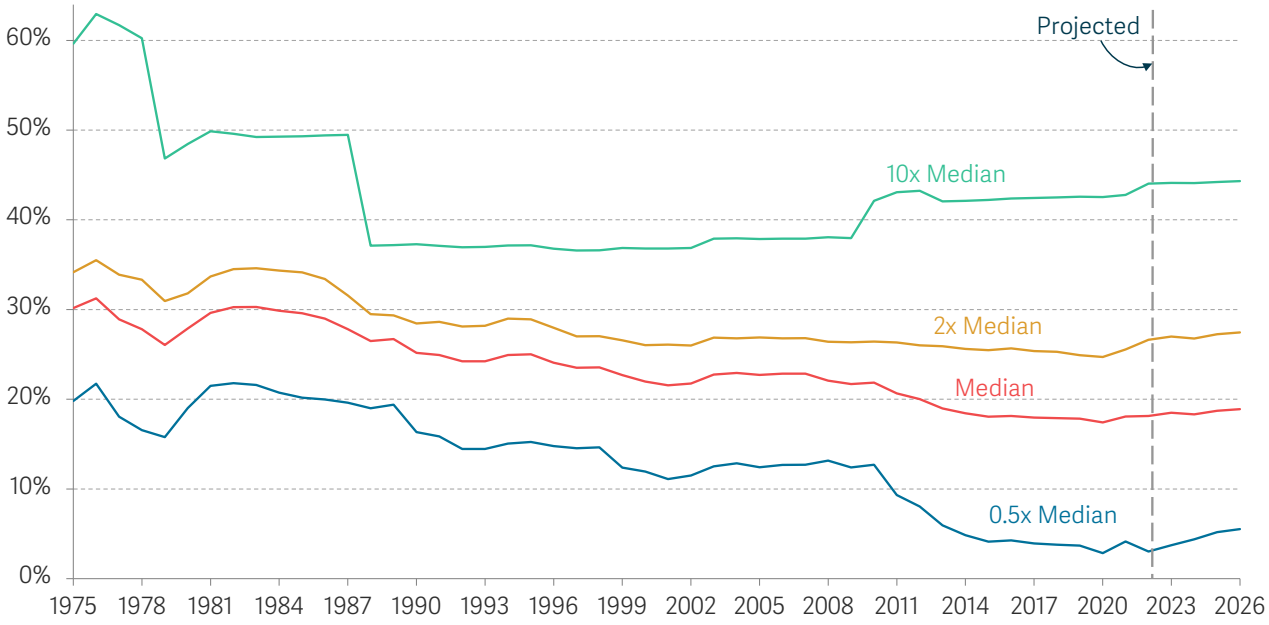
Like social security, tax policy can also directly and rapidly effect disposable income levels and inequalities. For example, as Figure 23 shows, the combined effective (average)

47 New Zealand Treasury, Budget 2019, May 2019.
48 M Brewer et al., Social Insecurity: Assessing trends in social security to prepare for the decade of change ahead, Resolution Foundation, January 2022.

rate of Income Tax and personal National Insurance for a very-highly-paid employee (defined as one on ten times the median wage) fell from over 60 per cent in the late 1970s to 37 per cent in 1988-89, contributing to that group's income growth and rising inequality. More recently, average direct tax rates on low-paid employees fell from 13 per cent in 2010-11 to 4 per cent in 2019-20 due to policy choices. Despite projected increases due to frozen tax thresholds, and the fact that taxes as a share of GDP are expected to rise to a 70-year high,[49] the effective tax rate for the median employee is expected to be lower in 2026-27 than that it was at any point between 1975 and 2013-14 (at 19 per cent). Changes in Income Tax and personal National Insurance combined have therefore generally been tailwinds rather than headwinds to growth in households' disposable income.

FIGURE 23: **Changes in direct tax policy have usually been a boost to household incomes**

Effective tax rates for employees on different levels of weekly pay: UK



NOTES: Includes Income Tax and Employee (but not Employer) National Insurance. For consistency, tax rates are for unmarried employees under 65 with non-volatile earnings. Recent divergences in Scotland are not included. Projections include threshold freezes and the planned reduction in the basic rate of Income Tax.
SOURCE: RF analysis using median earnings figures from ASHE/NESPD and tax history from HMRC and IFS.

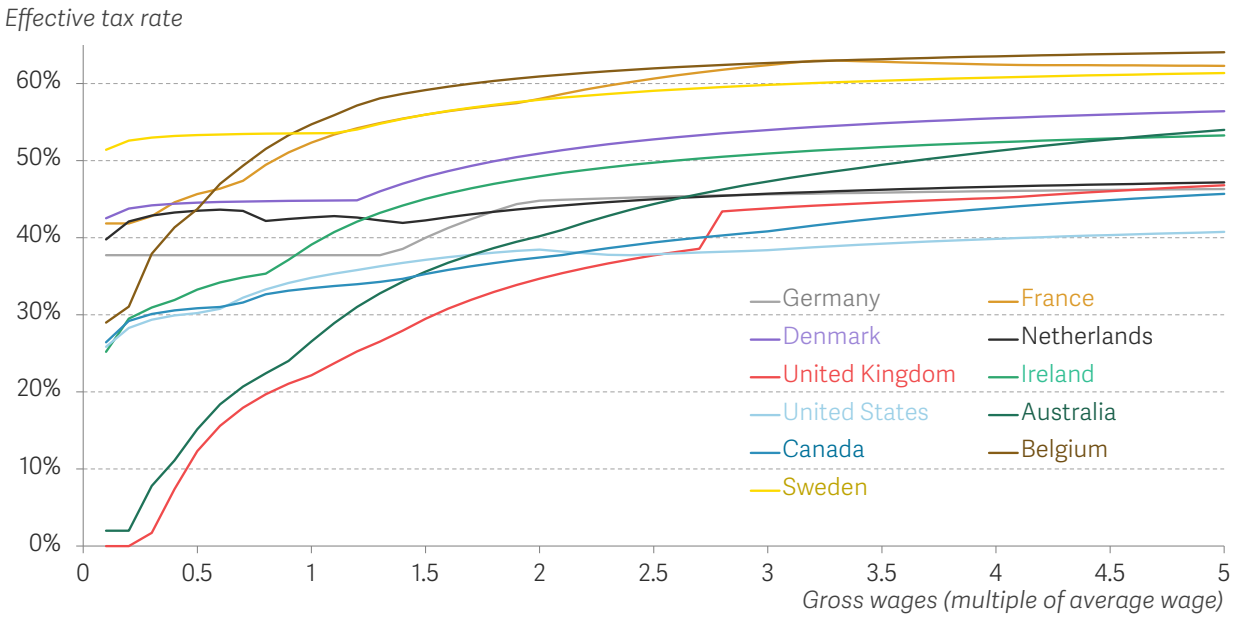
Internationally too, it is clear that any weakness in the UK's disposable incomes for low-and-middle income households is not due to the way we tax earnings (even when payroll taxes are included – i.e. employer National Insurance in the UK). As can be seen in Figure 24, the UK stands out in how low direct tax rates on earnings are for most of the income distribution.[50] For the mean salary, average tax rates (including employer and employee

49 T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.
50 This data is taken from D Neidle, How much tax do we actually pay on our wages?, Tax Policy Associates, May 2022.

social security) are more than twice as high in Belgium, Sweden, France and Denmark as in the UK, for example. At wage levels that are five times the national average, there are some rich nations with similarly low top tax rates (such as the Netherlands and Germany) or lower (the US and Canada), but more countries have higher effective rates (e.g. 54 per cent in Australia compared to 47 per cent in the UK).

FIGURE 24: **Across the distribution – but especially for low and middle earners – direct taxes are low by international standards**

Effective tax rates by wage level (relative to the average wage) in selected countries, 2020



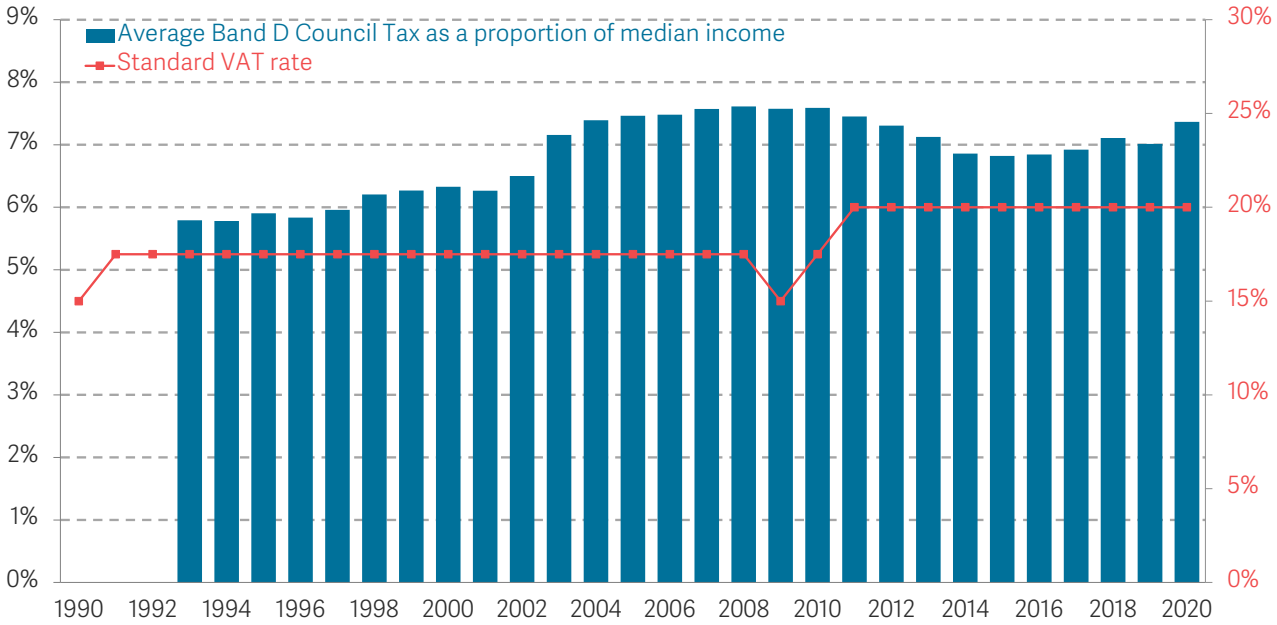
NOTES: See source for full notes and caveats. Based on the tax systems for single adults without dependants. Includes employer and employee social contributions, and national and state/local income taxes (using the national average).
SOURCE: D Neidle, How much tax do we actually pay on our wages?, Tax Policy Associates, May 2022.

Of course, direct taxes on earnings are not the only part of the tax system. As shown in Figure 25, the average Band D Council Tax has risen faster than typical disposable incomes – and this is a tax that is far less progressive than the taxes on income set out above.[51] The standard rate of VAT has also risen over time (from 15 per cent in 1990 to its current level of 20 per cent). However, it remains the case that the UK has a lower effective consumption tax rate than its peers – particularly in Europe, but also New Zealand – due to a relatively low standard rate of VAT and a particularly narrow tax base.[52]

51 A Corlett & L Gardiner, Home affairs: options for reforming property taxation, Resolution Foundation, March 2018.
52 A Corlett, The shifting shape of UK tax: charting the changing size and shape of the UK tax system, Resolution Foundation, November 2019; J Lundberg et al., Taxing High Incomes: A Comparison of 41 Countries, Tax Foundation, October 2019.

FIGURE 25: **In contrast, Council Tax and VAT have risen**

Average Band D Council Tax rate relative to the median disposable income after housing costs (left axis) and the standard rate of VAT (right axis): England & Wales / UK



NOTES: Council Tax figures are for England and Wales; income figures are GB; VAT rates are UK-wide.
SOURCE: RF analysis of IFS, Fiscal Facts; and IFS, Living standards, poverty and inequality in the UK.

A comprehensive review of the tax system of the UK and other countries is beyond the scope of this report. But one lesson for the future should be that it is difficult to 'tax-cut' your way to lower inequality. The basic rate of Income Tax has been cut before and is set to be cut again, but this is clearly a regressive tool.[53] The starting point for paying Income Tax was raised substantially in the 2010s. However, this too favoured the top half of the income distribution (albeit by less than rate cuts).[54] And even consumption tax cuts are usually distributionally-neutral at best (low-income households tend to spend more of their budget on zero-rated items, but high-income households tend to save more, and these broadly offset each other). However, it is possible to redistribute the tax burden: Government decisions mean that National Insurance bills are falling for low earners in 2022-23 but increasing for higher earners, and the reverse will take place for Income Tax liabilities in 2024-25 when the basic rate is cut while the personal allowance is frozen.[55] And it is very easy to raise taxes in ways that raise revenue and reduce inequality.

Housing costs (and wealth) are an important source of inequalities

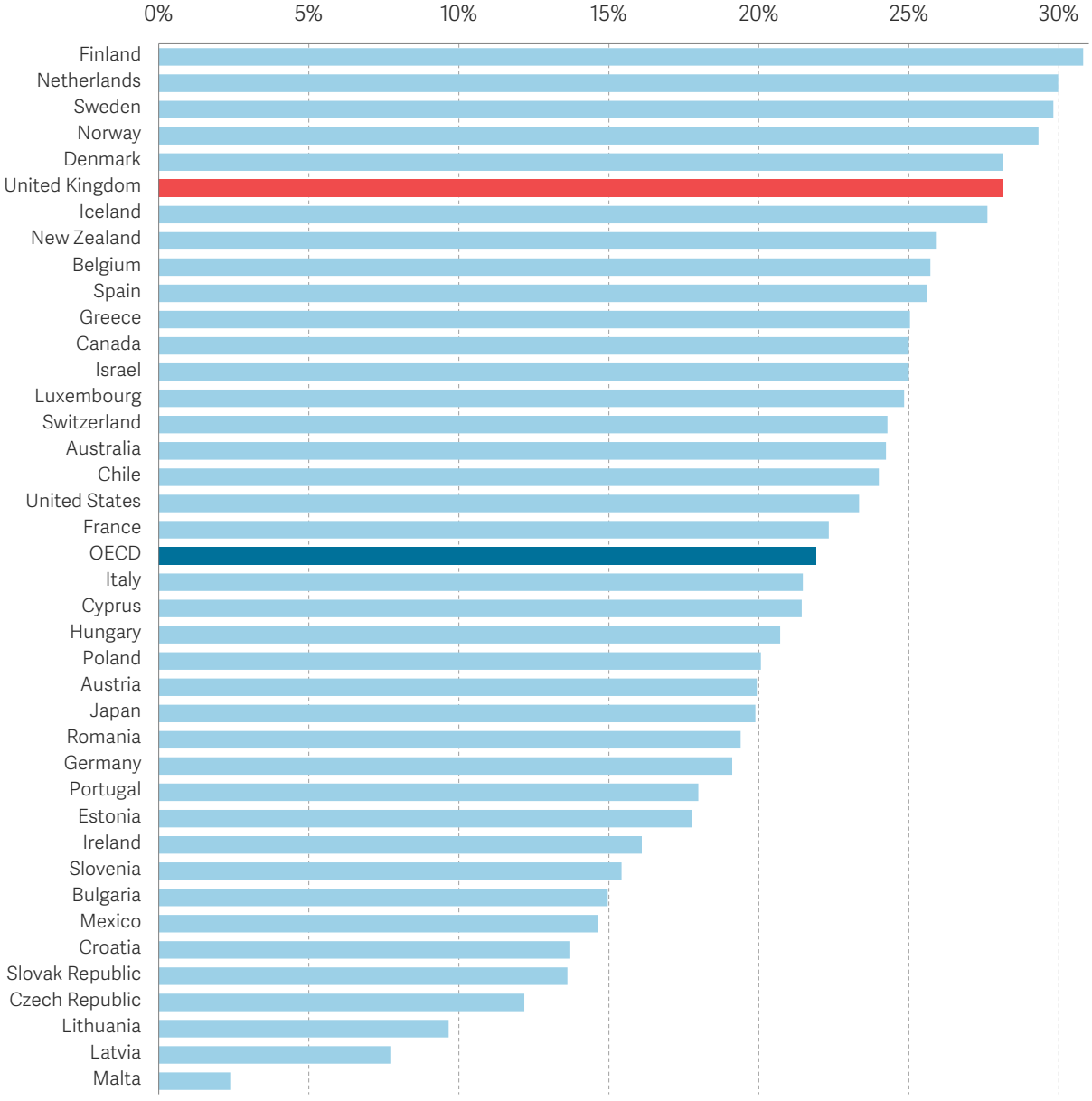
After earnings, income from the social security system and direct taxes, a final important component of disposable income is housing costs. Figure 26 shows that the typical

53 A Corlett, Happy new tax year? National Insurance and Income Tax changes in 2022, Resolution Foundation, April 2022.
54 A Corlett, M Whittaker & G Kelly, Missing the target: Tax cuts and low to middle income Britain, Resolution Foundation, December 2014.
55 A Corlett, Happy new tax year? National Insurance and Income Tax changes in 2022, Resolution Foundation, April 2022.

renter in the UK spends 28 per cent of their disposable income on rent, compared to an OECD average of 22 per cent and 16 per cent in Ireland. There are, however, rich, relatively equal countries with higher rents, with a typical ratio of 31 per cent in Finland.

FIGURE 26: **The typical renter in the UK spends a higher share of their income on renting than in most other rich countries**

Median rent burden (private market and subsidised rent) as a share of disposable income, 2019 (or latest year available)



SOURCE: OECD, Affordable Housing Database.

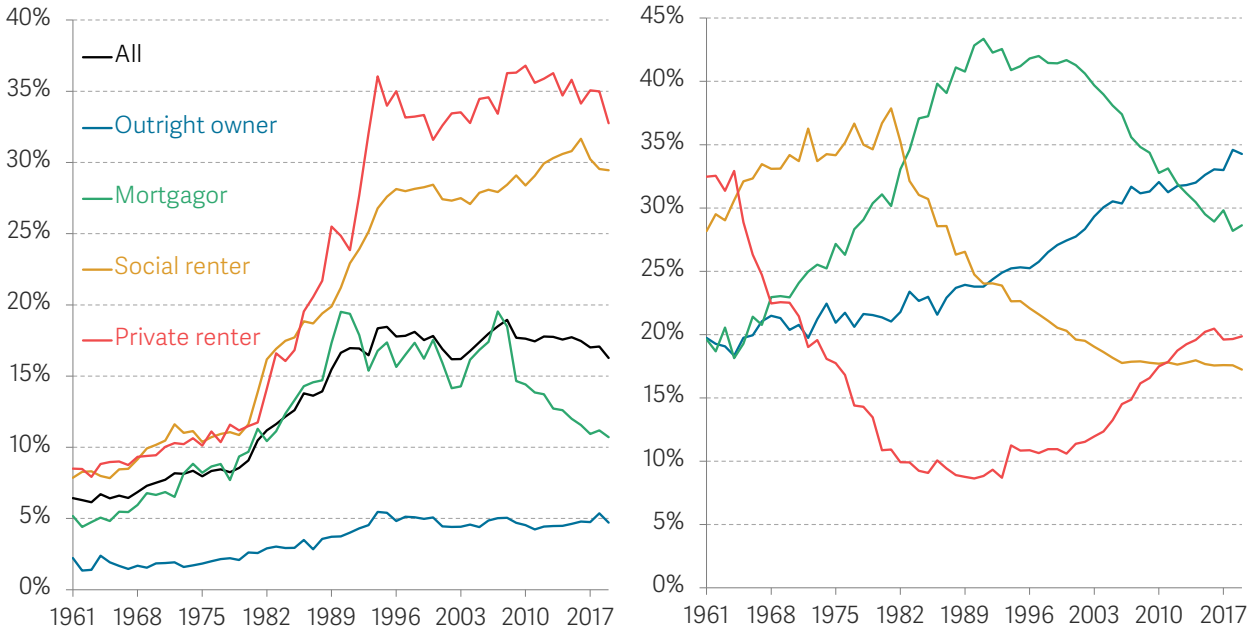
More comprehensive data on how housing costs have evolved over time is shown in Figure 27, where the left-hand panel plots the ratio of housing costs to income (known as 'housing cost to income ratios', or HCIRs) for households of different tenure types, and

the right-hand panel shows how tenure patterns have changed over time. For all tenure types, HCIRs are higher now than they were in the 1960s and 1970s. But that change is only a small one for mortgagors, whereas it is dramatic for both social and private renters, having exploded in the 1980s and 1990s (and more recently in the case of social rents), widening income inequality between renters and home owners. Moreover, the proportion of households renting privately has been rising since the 1990s.

These changes, as well as movements in mortgage interest costs (particularly as Bank Rate has changed), have had a large impact on housing costs relative to incomes over time. Between 2003-04 and 2008-09, for example, the average HCIR rose from 16 to 19 per cent: which for an individual household is equivalent to a hit to incomes after housing costs of 4 per cent. On the other hand, the period from 2008-09 and 2019-20 saw a fall in HCIRs of an equivalent size, providing an income boost.

FIGURE 27: **Both the size of the private rented sector and the average rental burden have rocketed since the 1980s, though recently there have been falls**

Average housing cost to income ratios (left) and proportion of family units in each tenure (right): GB/UK



NOTES: GB from 1994-95 to 2001-02. Change of data source in 1994-95.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income.

Although the proportion of families with mortgages has declined to 29 per cent – back to where it was in the late 1970s – the prospect of rising interest rates (together with house price increases) mean that changes in these interest costs are now more likely to drag on household incomes than to boost them.[56] Whether average housing cost burdens can be

56 T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.

kept down may therefore rest on the path of private and social rents, together with the country's tenure mix.

This section has explored some of the key drivers of the UK's poor record on recent income growth, and its persistently high level of inequality. The next section considers how the country should aspire to do better in future.

Section 4

Conclusion: Strong, progressive income growth should be a shared goal

As set out in Section 2, the UK was not delivering strong income growth or inequality reductions prior to Covid-19. As such, there are now significant differences in both income levels and degrees of inequality between the UK and most of the countries we might consider to be our peers. We should aim to do better, with a shared goal for the rest of the decade of delivering strong, progressive income growth. That is in some ways a timeless goal, but it is also emphasised by the current cost of living crisis: it is clear that weak growth and high inequality have left too many households very exposed to higher energy prices, and that a strong income recovery will be urgently required.

We should not expect to exactly or easily copy any other country's prosperity or income distribution, but the abundance of examples of richer and more equal countries should suggest that it is quite possible to do better, particularly given that some differences stem from direct policy choices, as shown in Section 3. The UK's history of often lower inequalities and faster growth should suggest the same, while its recent experience with the minimum wage also offers some antidote to fatalism: the UK used to have a high prevalence of low hourly pay, but a deliberate policy choice is improving its international position.[57]

To make these growth and inequality ambitions more concrete, it is worth noting that the UK has already committed to progressive growth, in theory, through the international Sustainable Development Goals.[58] Within Goal 1 – "end poverty in all its forms everywhere" – Target 1.2 is to "by 2030, reduce at least by half the proportion of men, women and children of all ages living in poverty in all its dimensions according to national definitions". One definition of this would be to reduce the absolute poverty rate (after housing costs) to less than half its 2015-16 level by 2029-30 (at the latest): a fall

57 N Cominetti et al., Low Pay Britain 2022: Low pay and insecurity in the UK labour market, Resolution Foundation, May 2022.
58 ONS, 17 goals to transform our world.

from around 20 per cent in 2015-16 to under 10 per cent.[59] This is shown in its historical context in Figure 28.[60] Various combinations of earnings growth and pro-poor tax and benefit policy could deliver this, but the latest economic forecasts and policy trajectories suggest that significant improvements in the outlook will be needed.[61]

In addition, Goal 10 is to "reduce inequality within and among countries" and, within that, Target 10.1 is to "by 2030, progressively achieve and sustain income growth of the bottom 40 per cent of the population at a rate higher than the national average". One way of interpreting that (rather loosely worded) target is that the share of income going to the bottom 40 per cent should be higher in 2029-30 than 2015-16.[62] As Figure 28 shows, this share (for incomes after housing costs) has been fairly stable at around 17 per cent over the past three decades, briefly rising to 18 per cent in the early 2000s. Given that the UK's income distribution is notably skewed towards the top compared to other rich nations (as we showed in Figure 8), merely increasing at all the bottom 40 per cent's share of disposable income should not be considered a high bar.

59 The data provided at https://sdgdata.gov.uk/1-2-1/ is one relating to a relative poverty measure. This might be seen as committing the Government to lowering relative poverty (before housing costs) to 8 per cent. This would be the lowest on record (lower than in the 1960s or 1970s), and so would represent an extremely ambitious endeavour. Separately, one of the stated objectives of the Department for Work and Pensions is "reducing poverty", for which it uses absolute poverty before housing costs as a metric, and which it notes contributes to the delivery of the Sustainable Development Goals: DWP, Department for Work and Pensions Outcome Delivery Plan: 2021 to 2022, July 2021. The Scottish Government, meanwhile, is committed to lowering child poverty using a range of measures using income measured after housing costs.

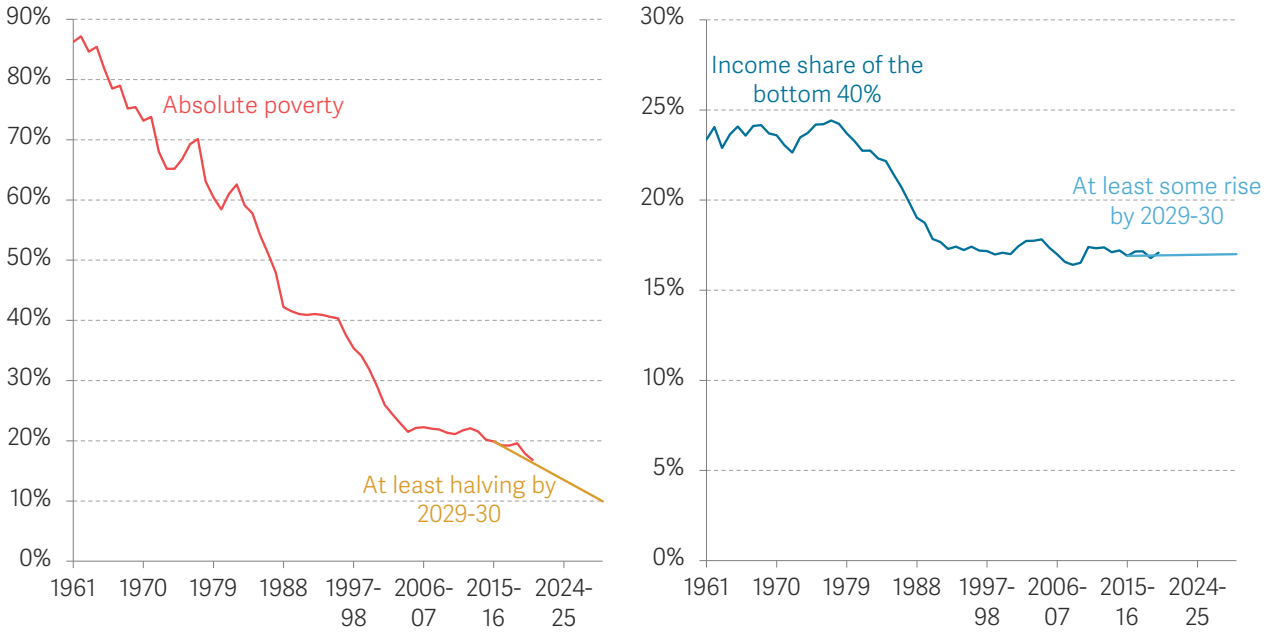
60 Note that our nowcasting (not shown) suggests absolute poverty rose in 2021-22 and (at least prior to additional spending announcements) was projected to rise in 2022-23. See: T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.

61 T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.

62 There are not precise technical timings associated with these targets, but the goals are "by 2030" and "a baseline year of around 2015 [when the targets were adopted]" has been used in UN, Sustainable Development Goals Progress Chart 2020, 2020.

FIGURE 28: **The UK is committed to halving poverty by 2030 (on some measure) and (in essence) increasing the bottom 40 per cent's income share**

Proportion of people living in absolute poverty, after housing costs (left panel), and the bottom 40 per cent's share of total disposable income, after housing costs (right panel), with illustrative minimum targets: GB/UK



NOTES: These targets are in line with the Sustainable Development Goals, but the UK Government is not committed to using these specific accountability measures. Illustrative scenarios for 2029-30 are relative to 2015-16. Absolute poverty fell in 2020-21 but is expected to have risen in 2021-22 (not shown). GB from 1994-95 to 2001-02 for income shares, and from 1961 to 2001-02 for poverty.
SOURCE: RF analysis of DWP, Households Below Average Income; and IFS, Living standards, poverty and inequality in the UK.

In short, the UK needs more income growth, and to ensure that low-to-middle income households in particular benefit from that growth. This report does not attempt to make proposals for the essential task of boosting productivity growth, nor for changing the distribution of income (although the analysis in Section 3 gives some pointers on benefit policy, taxes and housing). We will return to that in future reports of the Economy 2030 Inquiry.

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

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

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