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Living standards: what's happened and where next?

CASE Welfare and Policy Analysis Seminar

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Overview of living standards



- Can make a case for optimism or pessimism-lite, though any scenario bound to be an improvement on 2008-15
- Will touch on:
 - Overall household incomes
 - Employment
 - Wages
 - Tax and welfare
- Look at some of the policy responses on offer

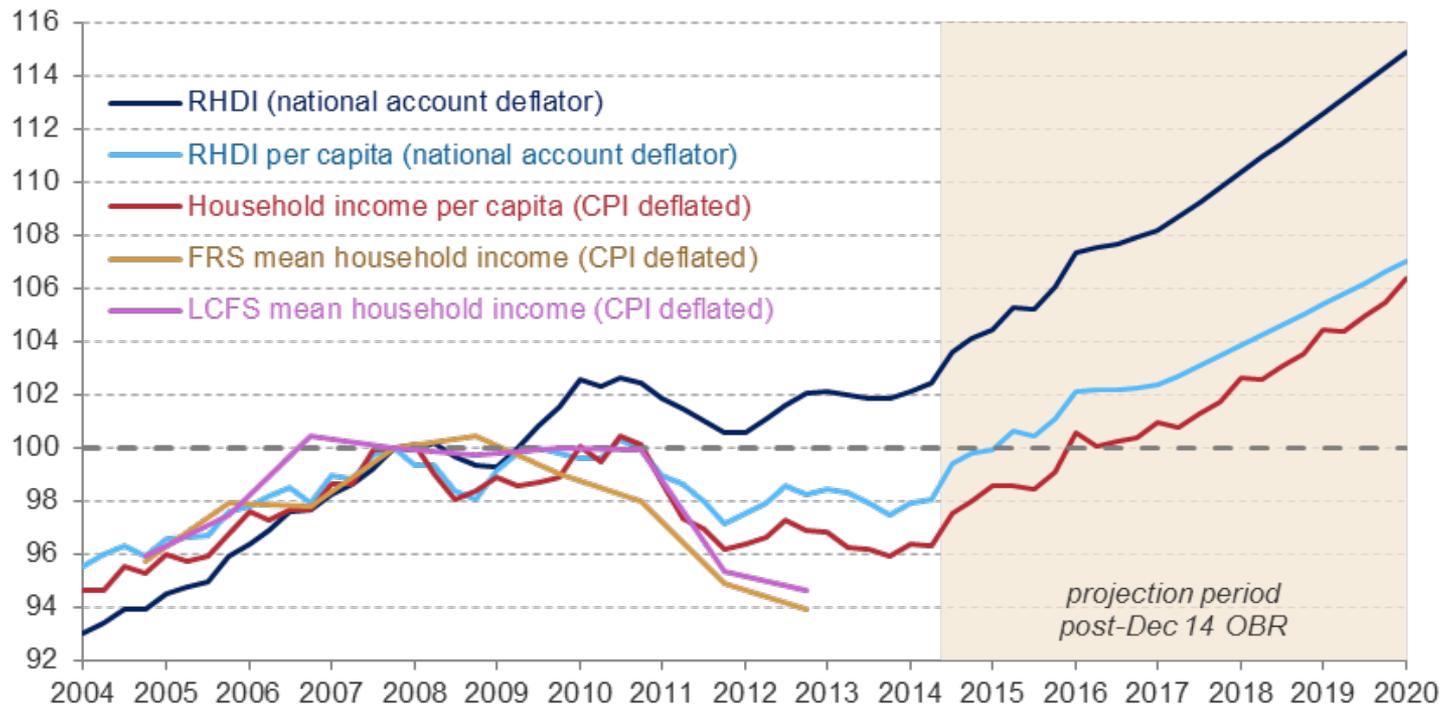


Household incomes

Household incomes are still lagging their pre-crisis levels – but you can pick a stat and tell very different stories



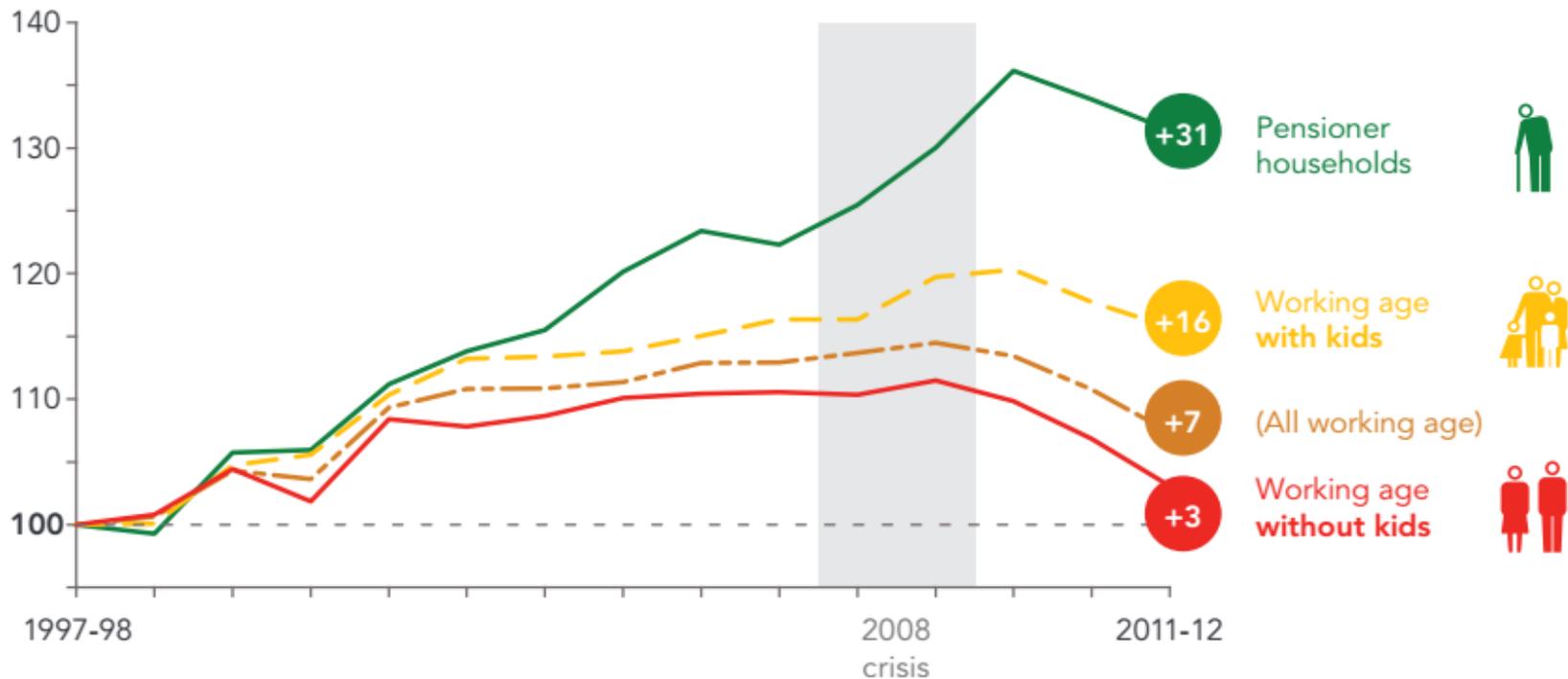
Indices of household income: Q4 2007=100 (4-quarter rolling sum for RHDl measures)



Played out very differently across household types



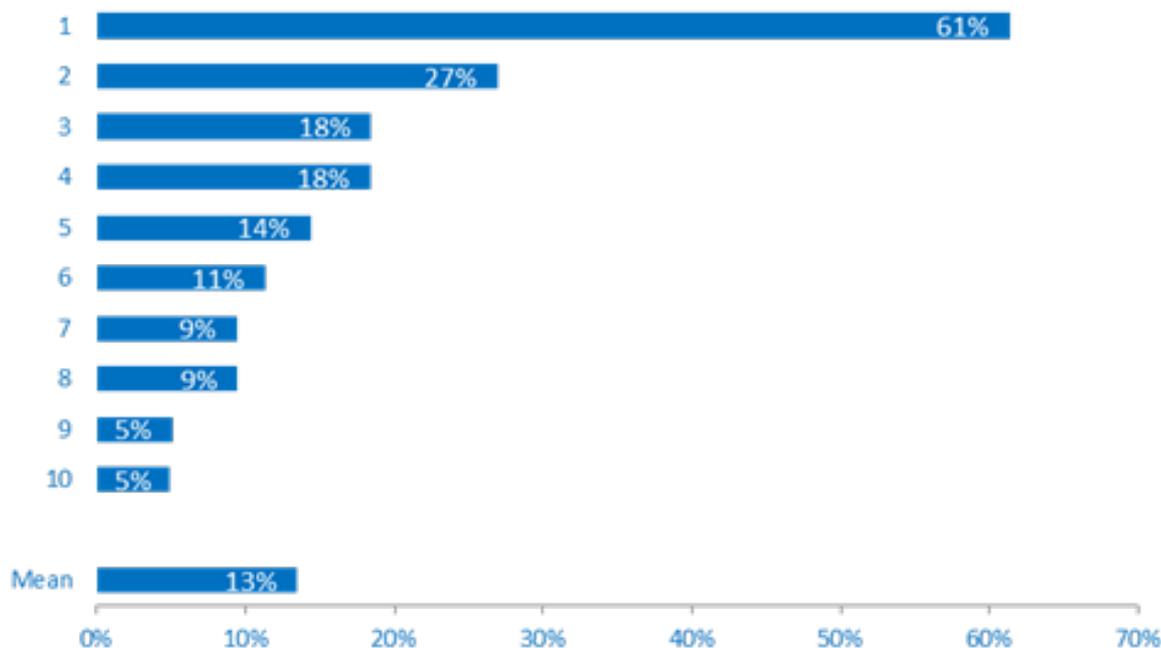
Growth in net income for pensioner and working-age households



Household debt burden is set to rise far beyond pre-crisis high – distribution of it is a worry



Proportion of 'highly geared' mortgagor households in 2014 by income decile

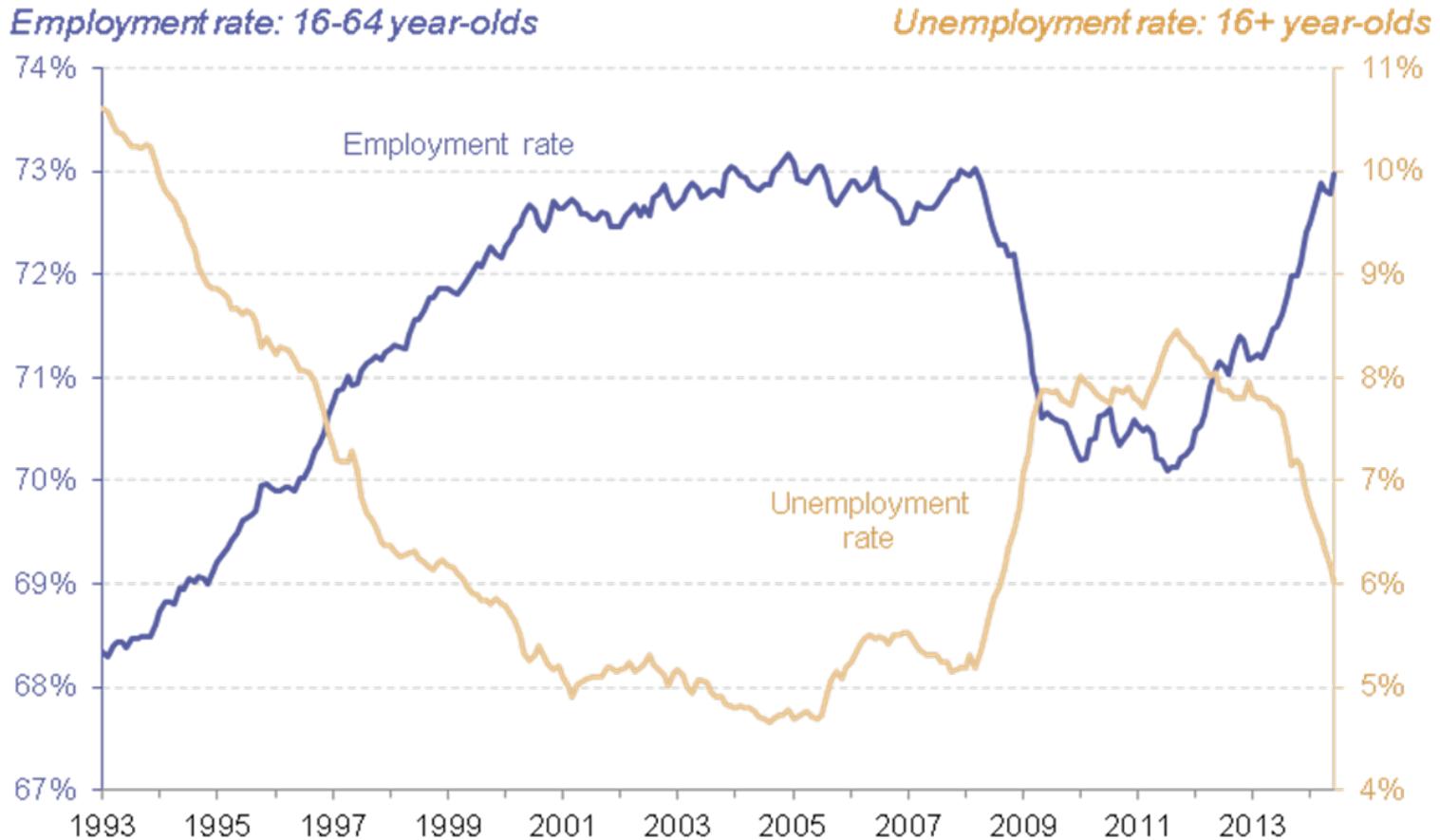


- **13%** of mortgagor households were highly geared in 2014
- If interest rates rose by **2.5%** by 2018, we estimate that proportion would rise to **27%**
- That level of interest rate increase looks less likely, but OBR suggest the level of debt is set to increase significantly.
- Household debt peaked at 170% of disposable income pre-crisis; fell to 145%; now projected to rise to **185%** by 2020



Employment

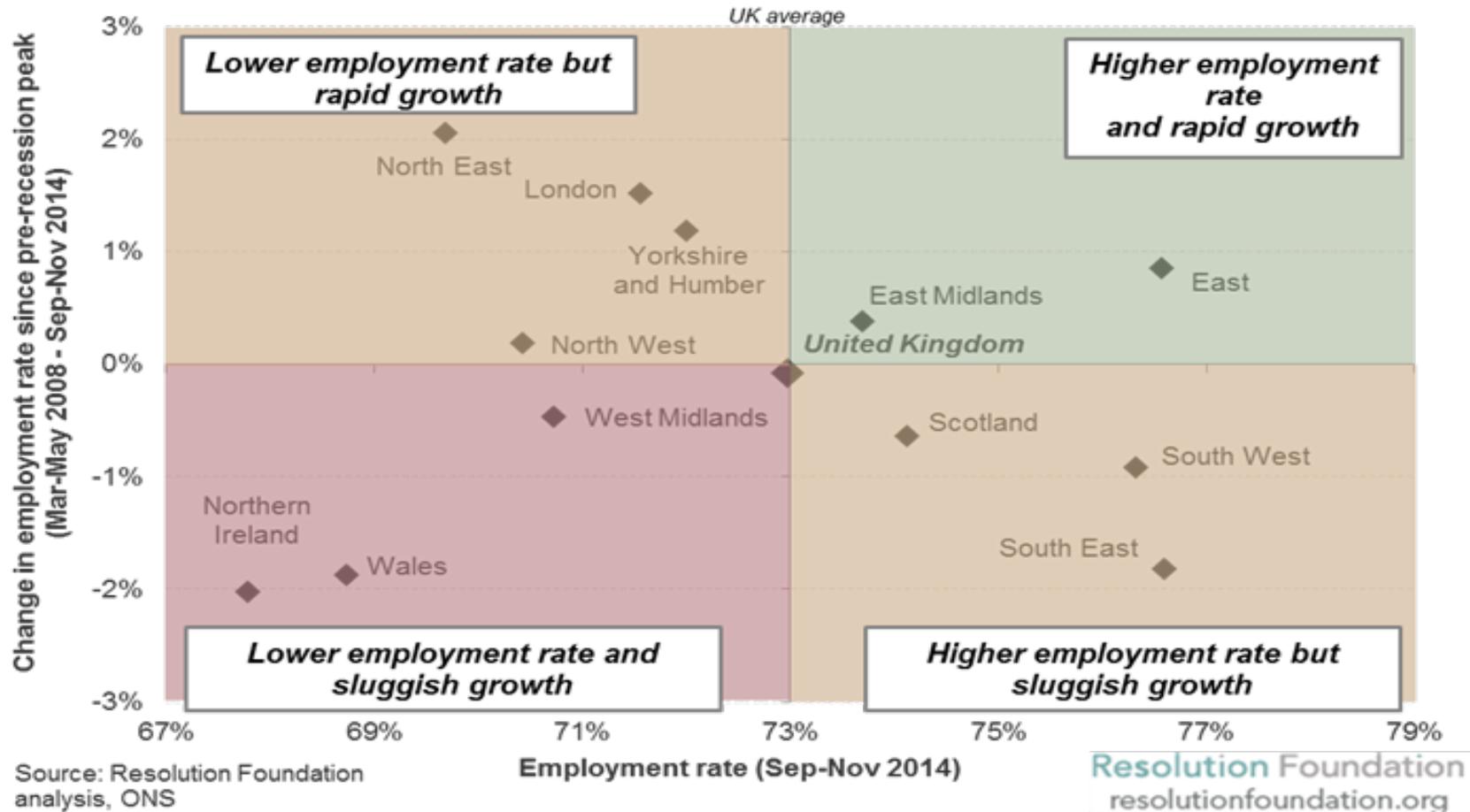
The performance of employment has been the great success story of recent years



Different stories in different regions.....



Regional employment performance since the recession
16-64 employment rates and strength of recovery since pre-recession peak



Unemployment – how low can we go?

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- 'World has changed'.....Labour market flexibility, long-term welfare reform, pension inadequacy and legacy of stagnant incomes and high household debt means a big shift in NAIRU: could take us to towards 1970s levels of unemployment....

Versus

- 'As you were'.....Vacancies rising, skill shortages growing.....meaning we're about to bump into NAIRU (c.5.5%)



But: split between employees/self-employed a factor in driving overall employment growth



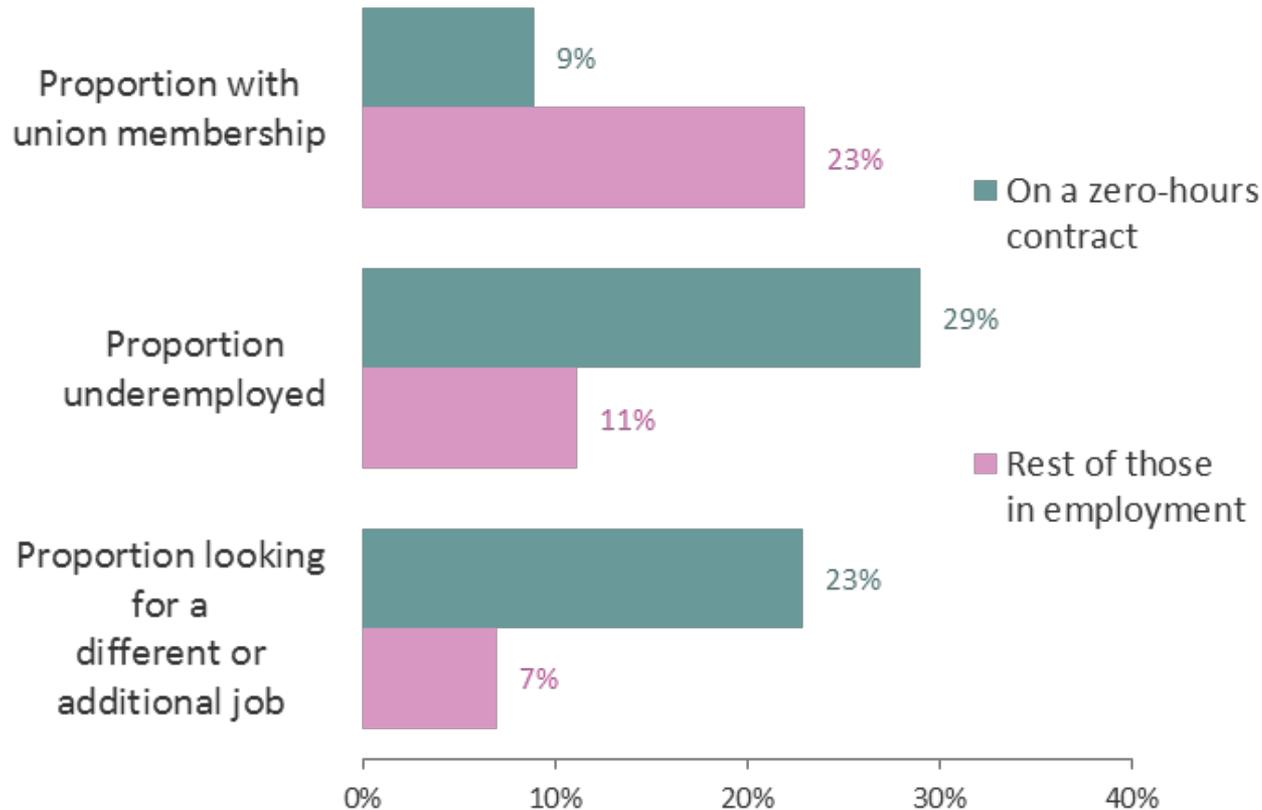
More recently:

- *Big shift to full-time since 2013 – finally more now than pre-recession*
- *Flat-lining of self-employment – actually fallen 79,000 over last two quarters*
- *Numbers part-time were flat across 2014*

Important to focus on job quality too....



Characteristics of ZHC workers compared to non-ZHC workers, 2013 Q4



1.8m contracts guarantee minimum hours (0.7m workers);

3.0 million under-employed;

1.7 million temporary employees



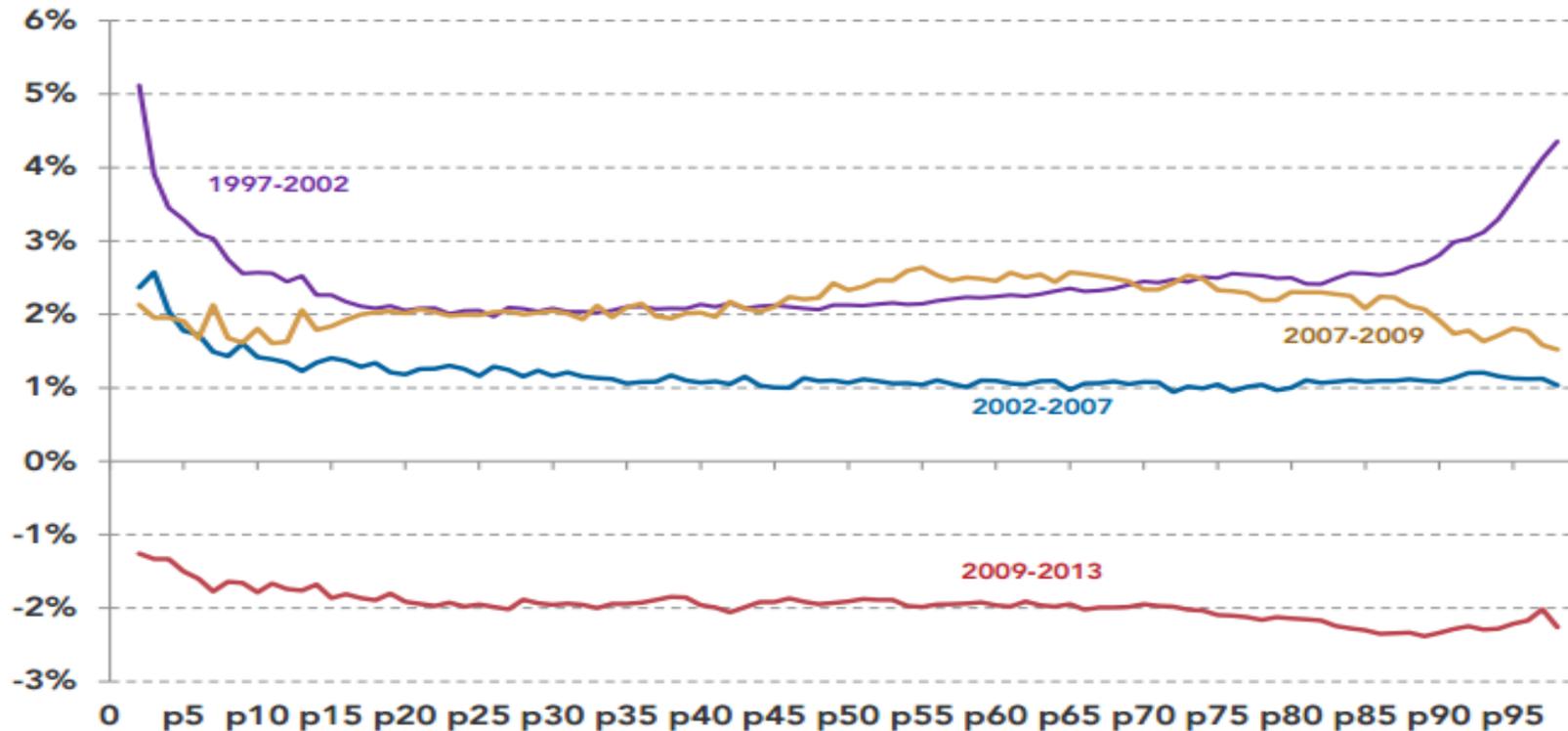
Wages

The three phases of wages since 1997.... What's next?



Average annual growth in hourly earnings excluding overtime by earnings percentile: UK 1997-2013

Average annual real-terms growth (RPIJ-adjusted)



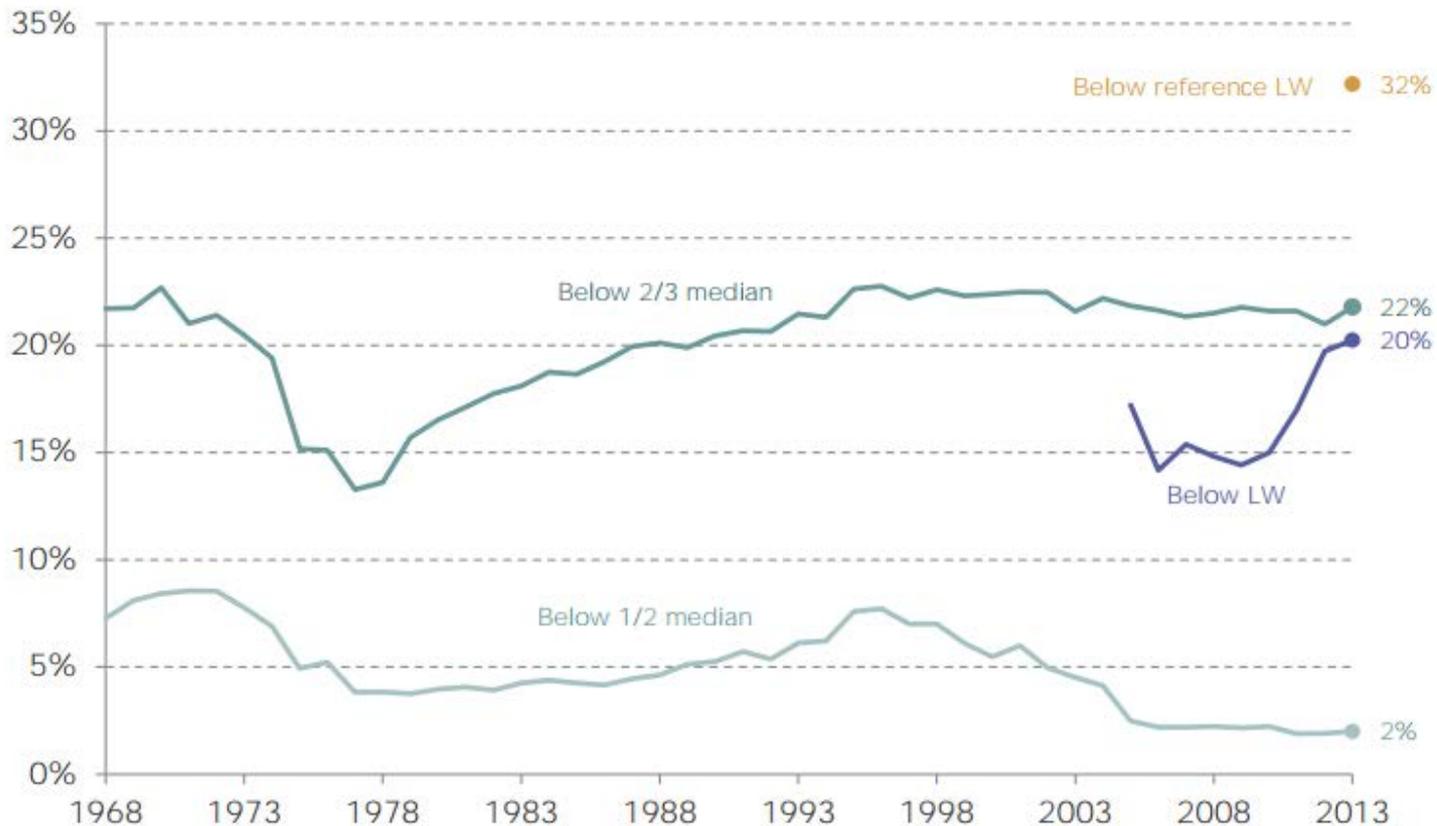
Source: RF analysis of ONS, Annual Survey of Hours and Earnings

Notes: Growth rates are calculated to account for discontinuities in the series in 2004 and 2006. First and 99th percentiles are removed due to statistical uncertainty.

5 million+ employees are low paid...and a spike in the numbers below the Living Wage



Proportion of all employees below selected low pay thresholds: GB 1968-2013



Source: RF analysis of DWP, Family Expenditure Survey (1968-1981); ONS, New Earnings Survey Panel Data (1975-2013); and ONS, Annual Survey of Hours and Earnings (1997-2013)

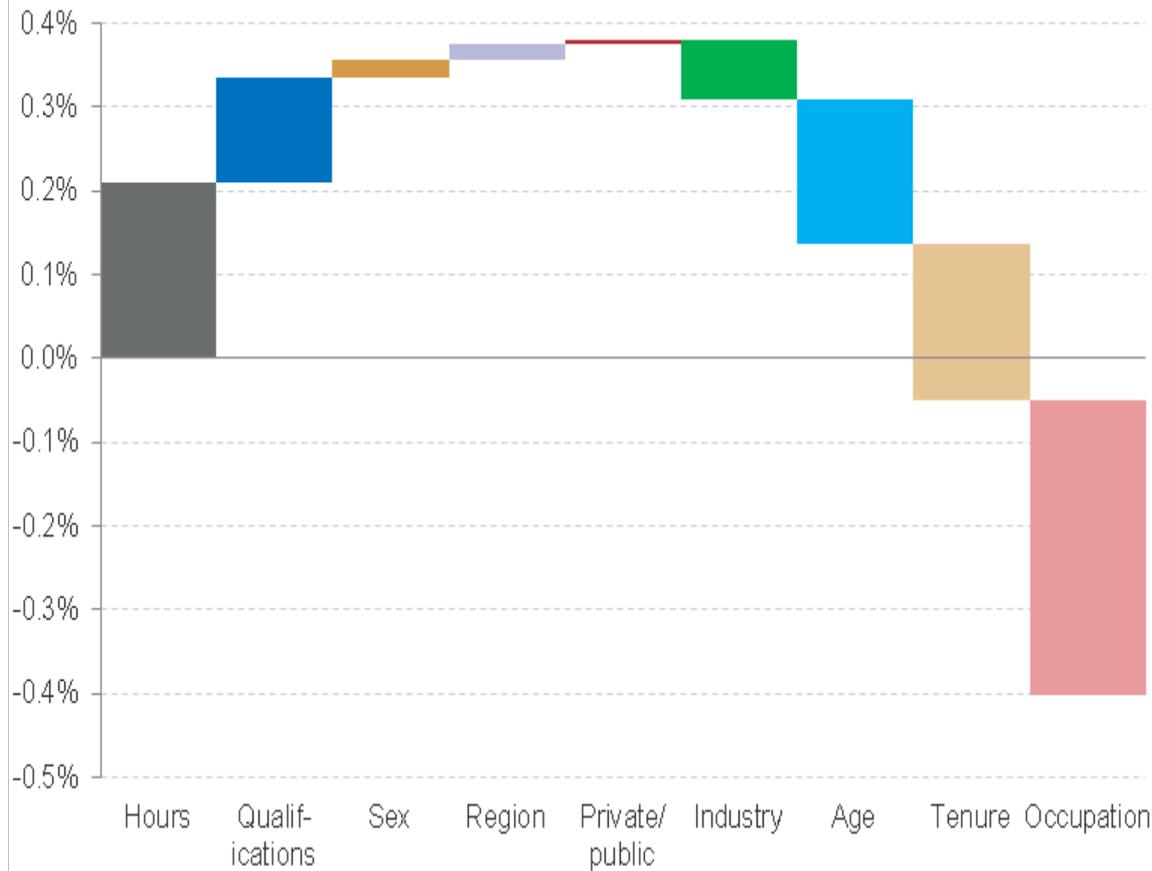
Compositional changes normally boost wages ...but not in 2014...



Changes in occupational mix, tenure and age were particularly marked: dragging down pay



Compositional effects on annual changes in nominal average weekly pay: Q2 2014

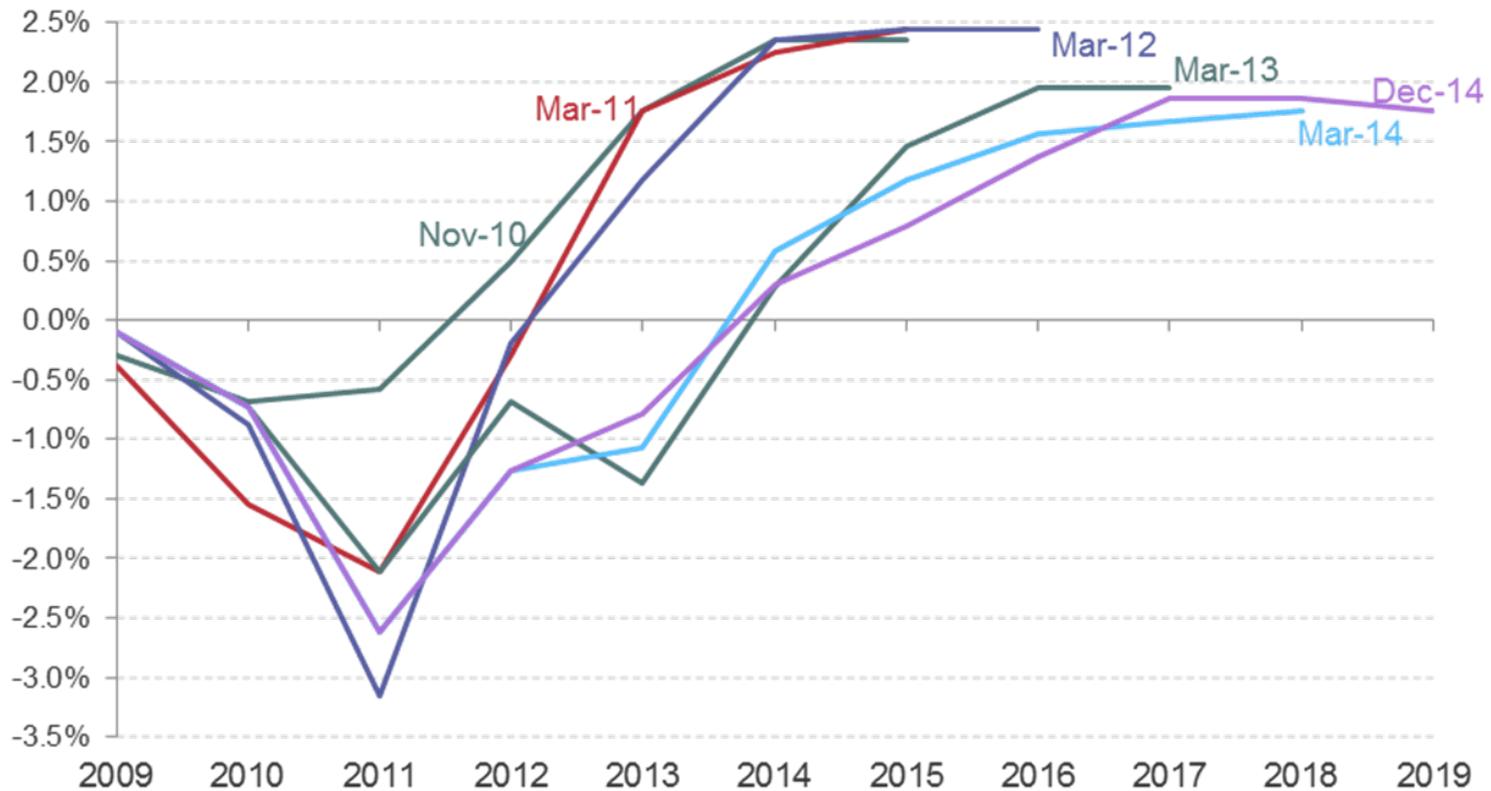


Very likely that at least some of these compositional changes – especially the rapid growth of younger and less experienced workers – will tail off this year, meaning that real wage growth is likely to remain positive

Meaning long-forecast sunshine on real wage growth looks like it has, belatedly, arrived



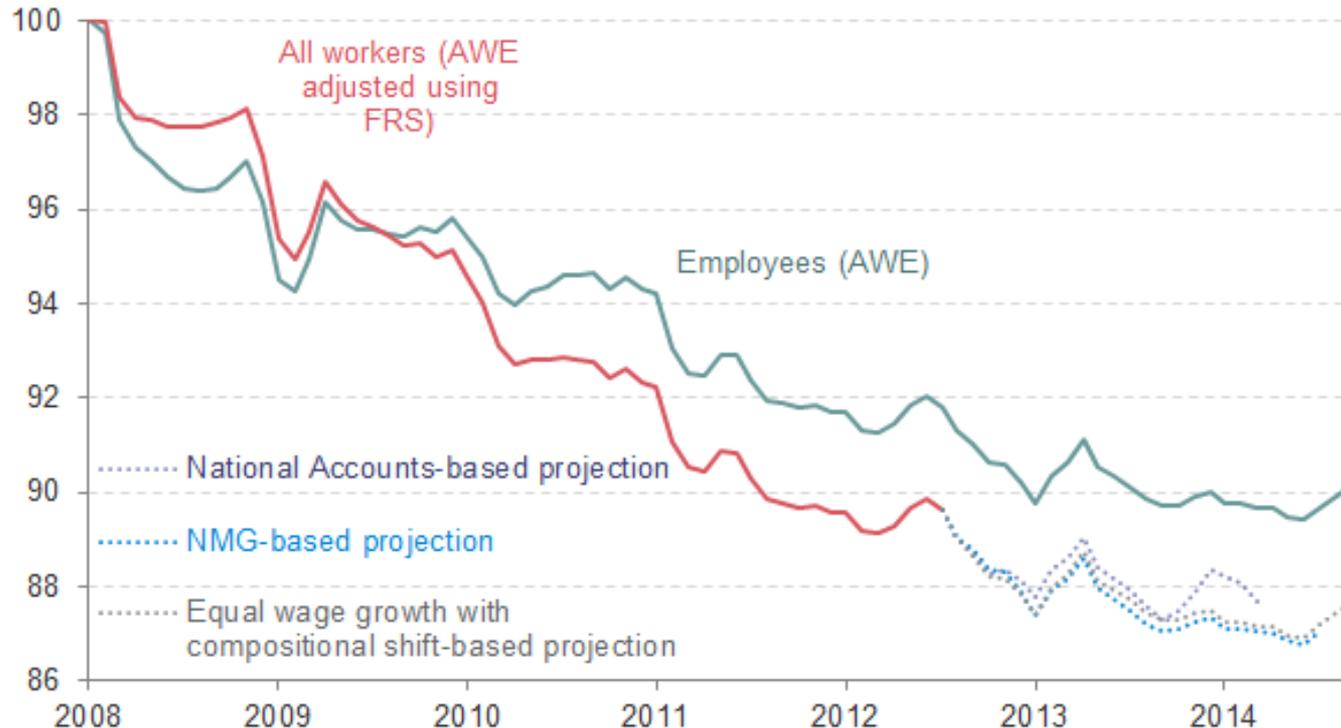
Successive OBR projections for real average earnings growth: 2009-2019, CPI adjusted



But remember: none of our measures of earnings include 4.5 million self-employed....



'All worker' earnings (inc. self-employed) compared to employee earnings
Index of real average weekly earnings, total pay (CPI adjusted, Jan-Mar 08=100)



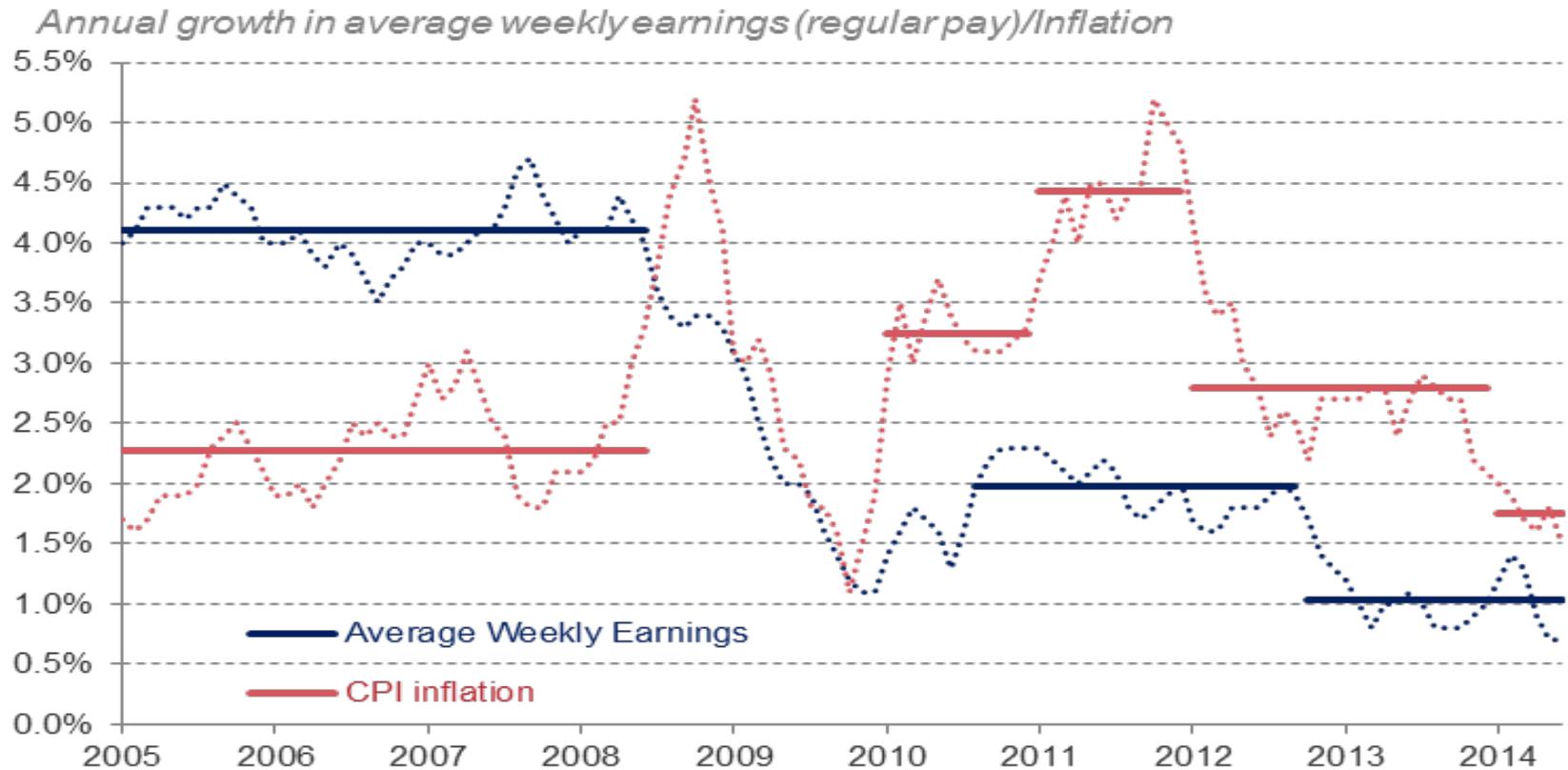
Including the self-employed would have deepened the earnings squeeze by 20%+.....

Source: Resolution Foundation analysis of ONS and Bank of England

Resolution Foundation
resolutionfoundation.org

@resfoundation

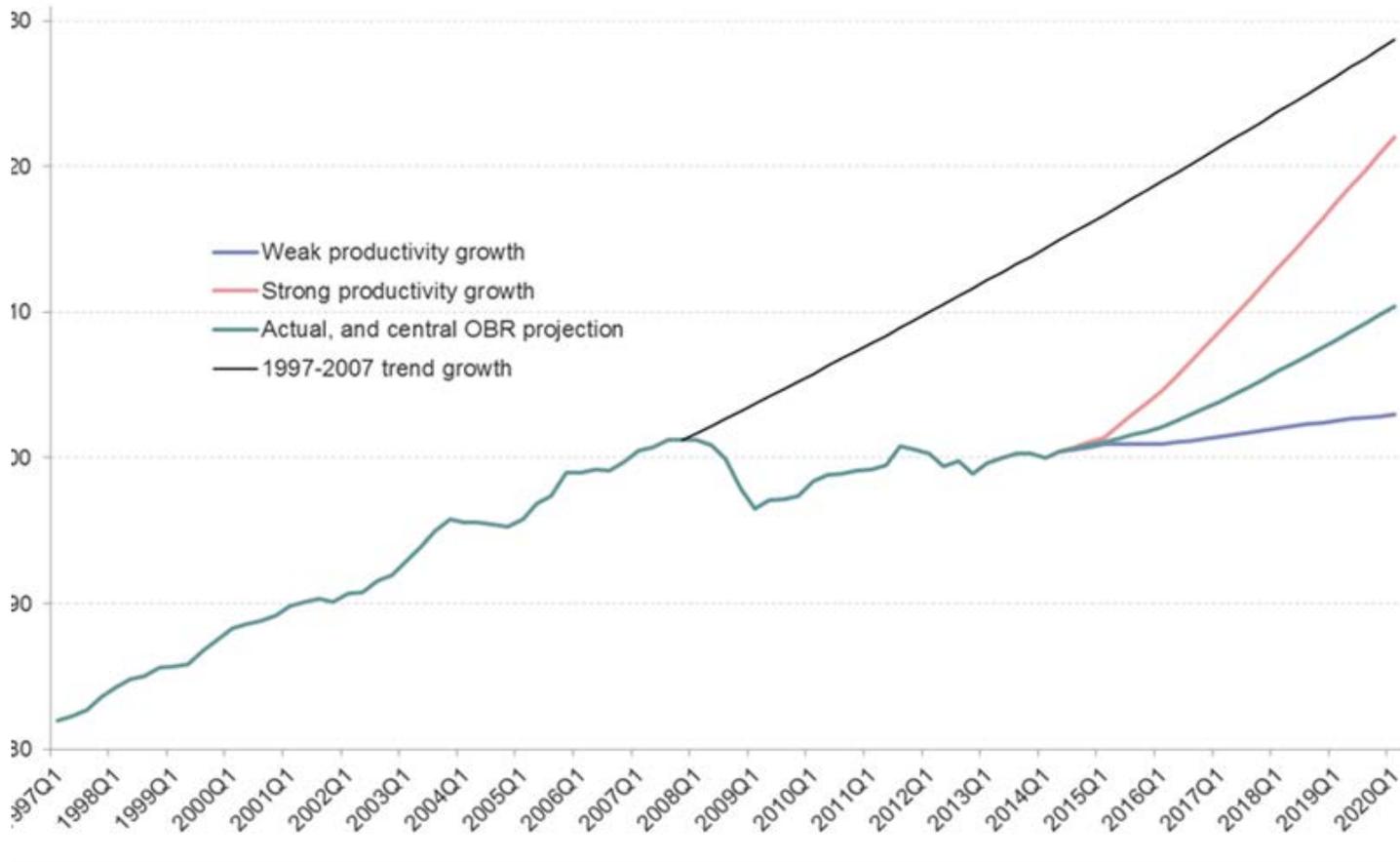
Bigger picture: downward shift in nominal wages from 4% to 1% - what happens when inflation returns to normal?



Biggest driver/uncertainty of all is productivity growth



Productivity per worker under OBR central, strong and weak scenarios, 2008=100





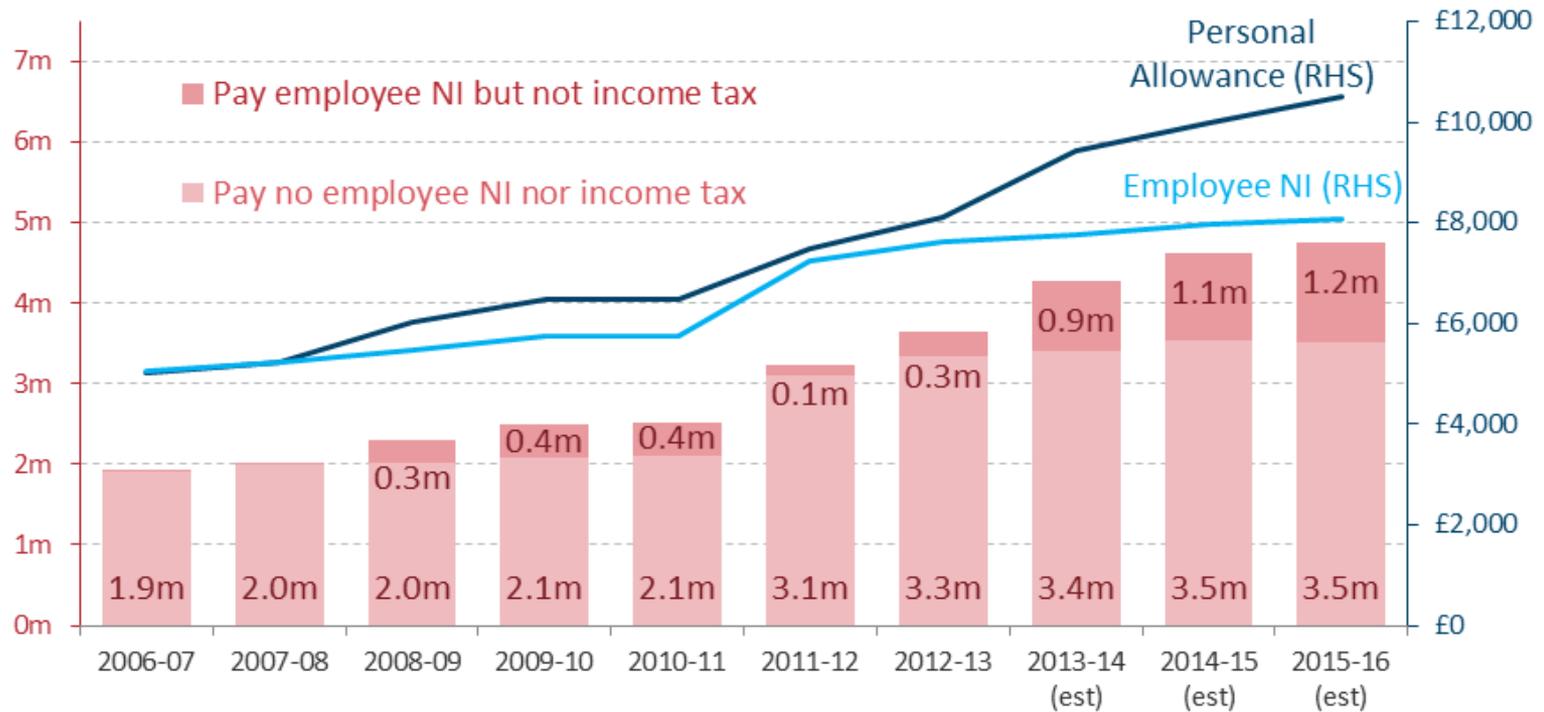
Tax and welfare

The hike in the PTA has been very ambitious, expensive, regressive and odd re NI



Number of employees earning less than personal allowance and/or employee NI threshold

Personal allowance/Employee NI threshold



Overall tax / benefit changes since 2010 have shifted resources upwards to the top-half (so says the LSE)



Percentage change in household disposable income by income vingtile group due to policy changes 2010 to 2014-15

(a) Compared with May 2010 policies uprated to 2014/15 using CPI



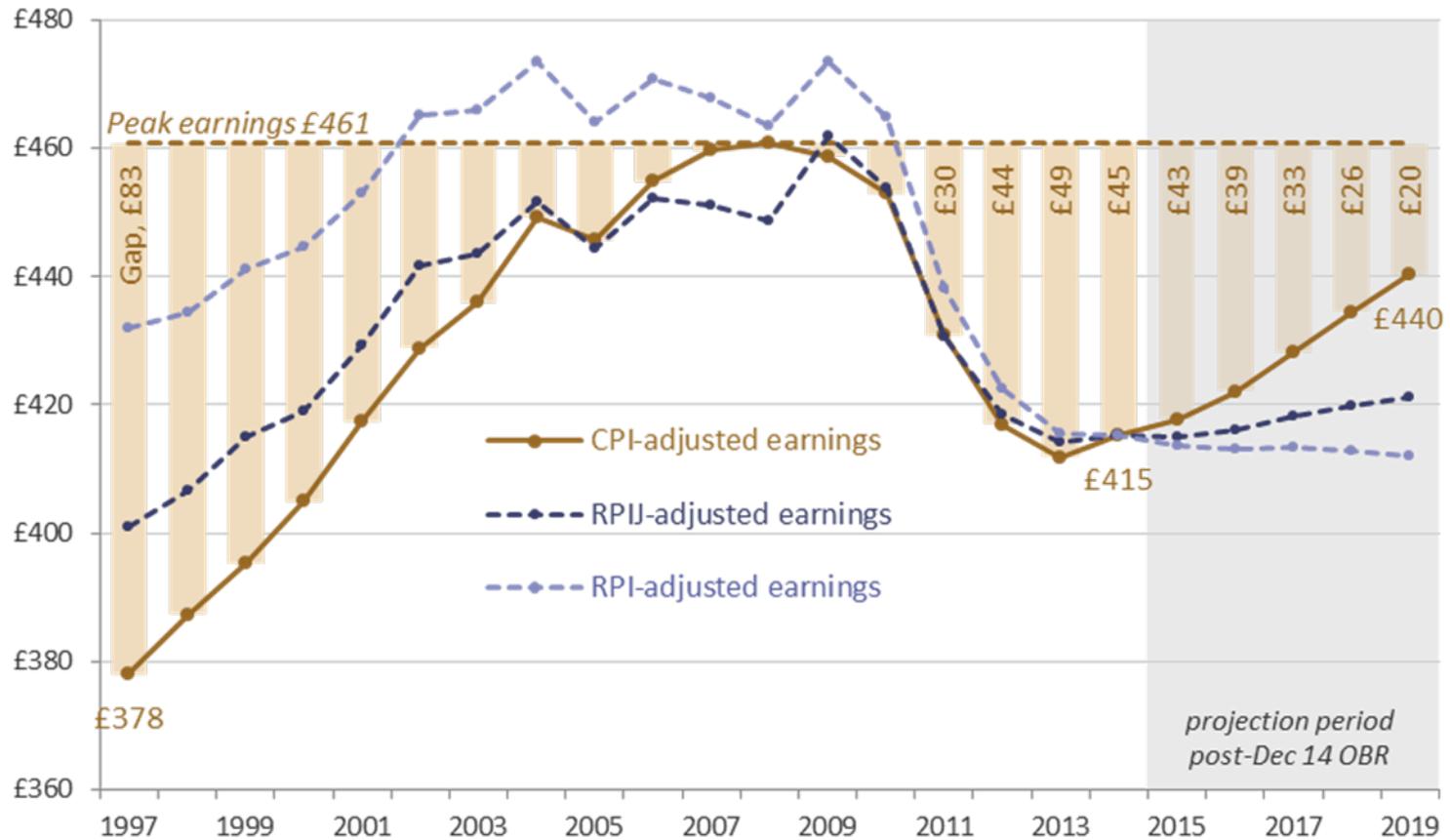
What's in store?



Wages: a very long road back to where we were....



Median weekly earnings: all employees (2014 prices)



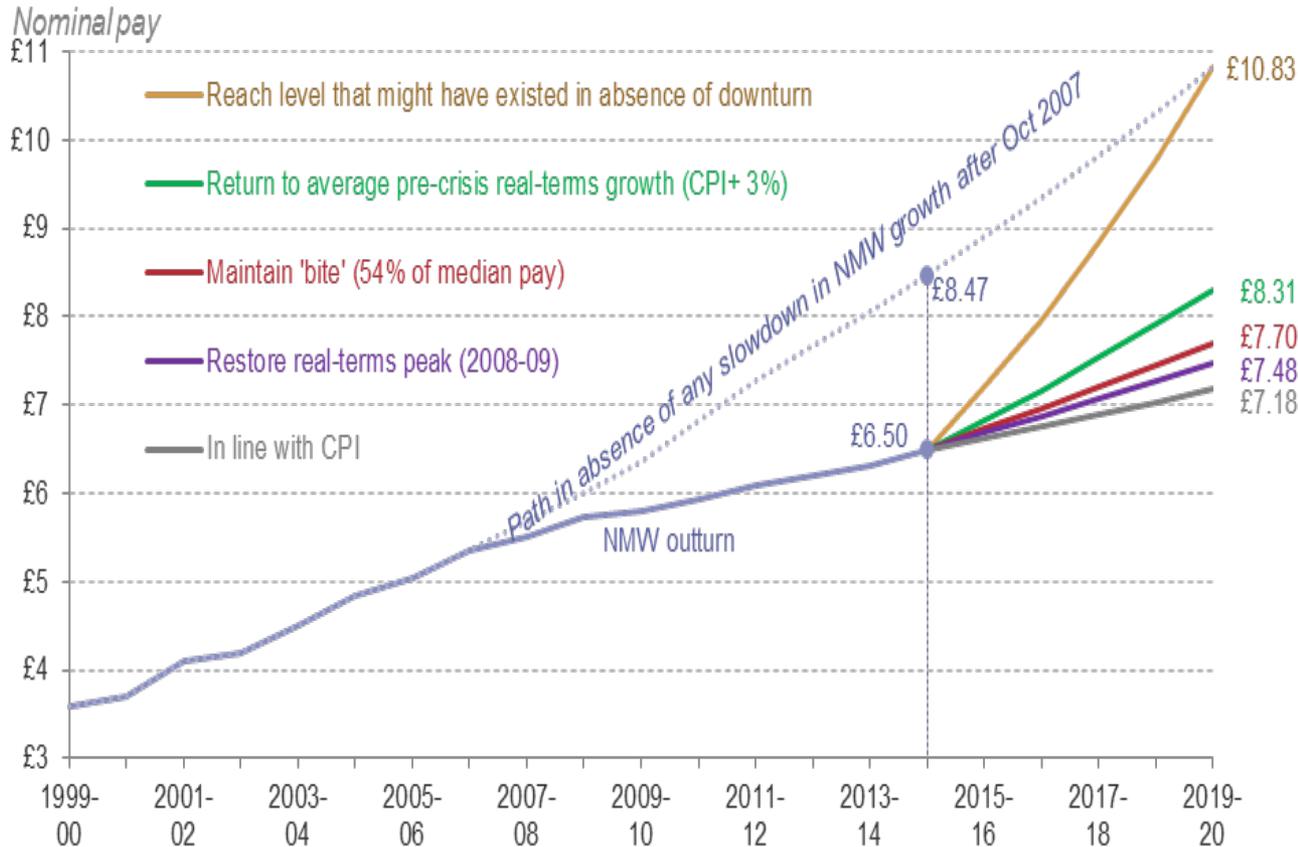
And on low pay.....?

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@resfoundation

Minimum wage: real recovery – likely to end up c.£8 - but won't make up the lost ground

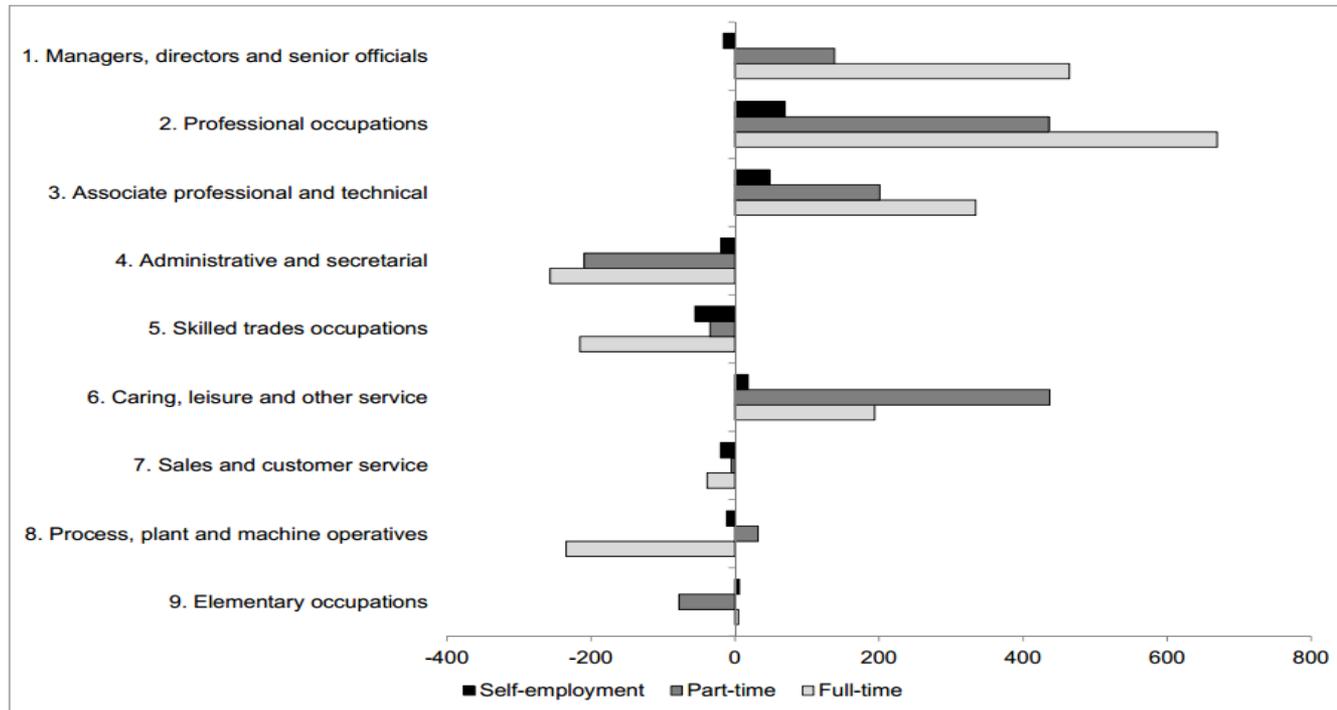


- Role, remit and ambition of LPC?
- Extension of LW?
- Prioritise progression?

Employment: Combined effects of globalisation, technology, skill-formation likely to continue to polarise the jobs market

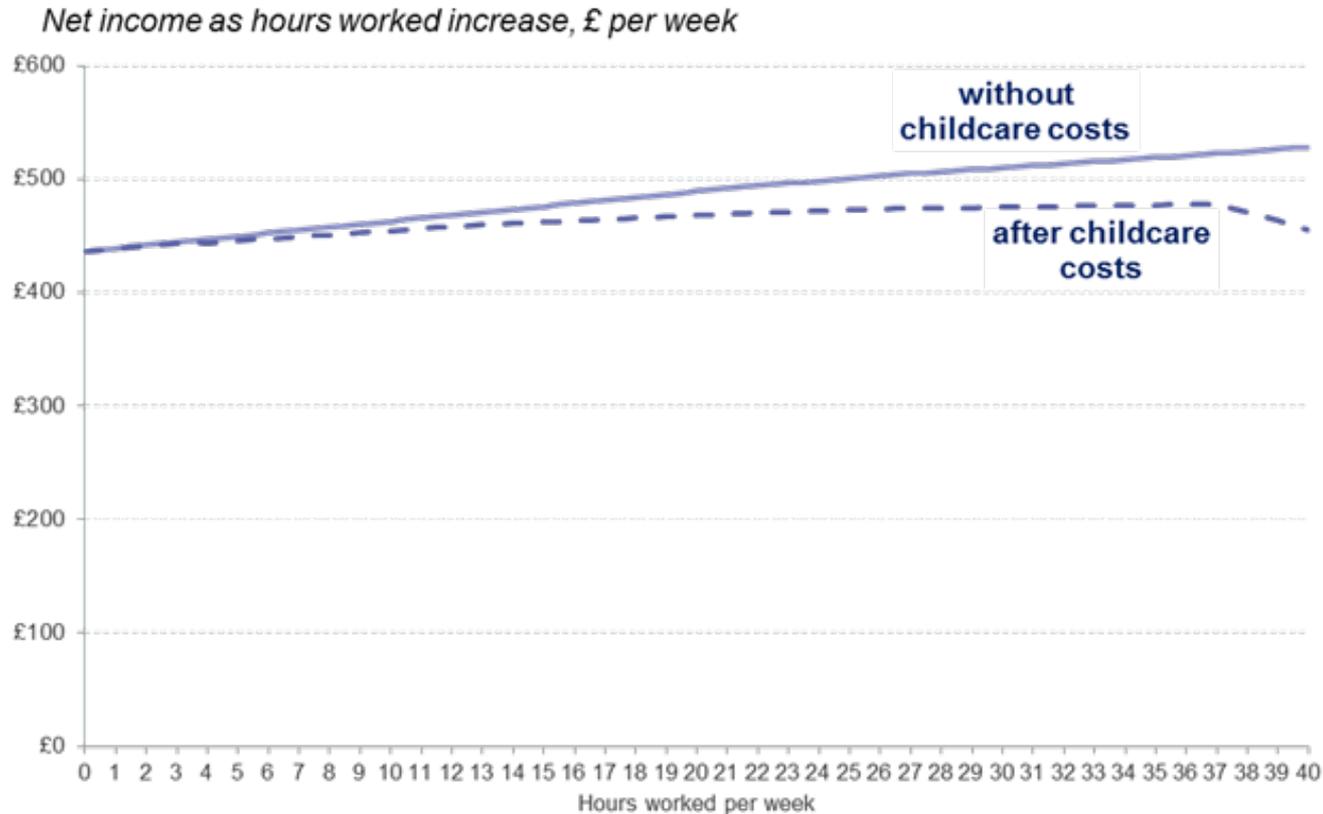


Occupational Change by Status, 2012-2022, Total Employment (000s)



Source: IER estimates, MDM revision 12015.

Employment: incentives for some groups like 'second earners' remain incredibly weak....

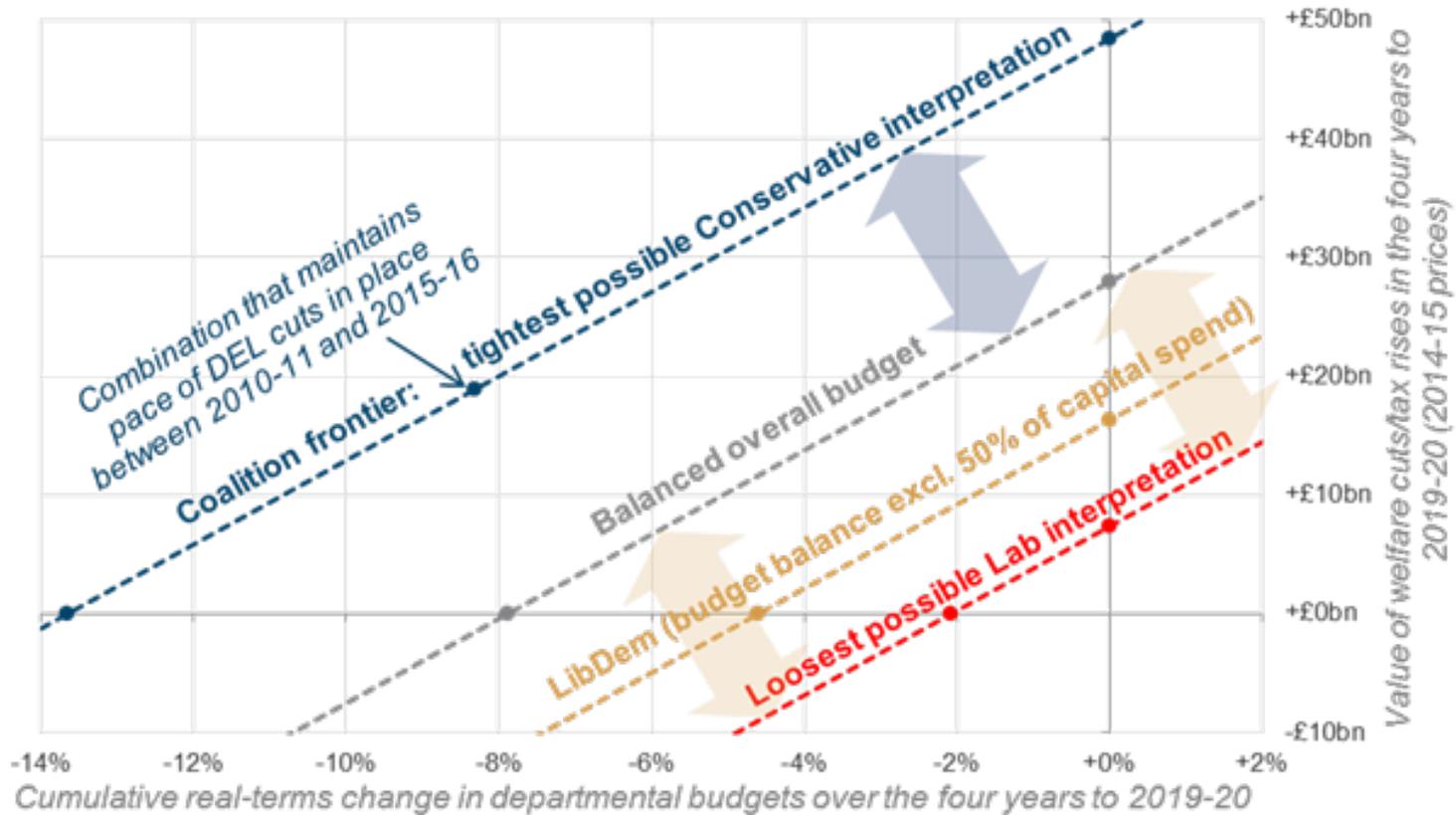


*Notes: Main earner works full-time, earning £7.50 an hour; second earner on £7.50 an hour
Couple have two children, aged 1 and 3*

The fiscal outlook will vary greatly depending on who wins in May.....



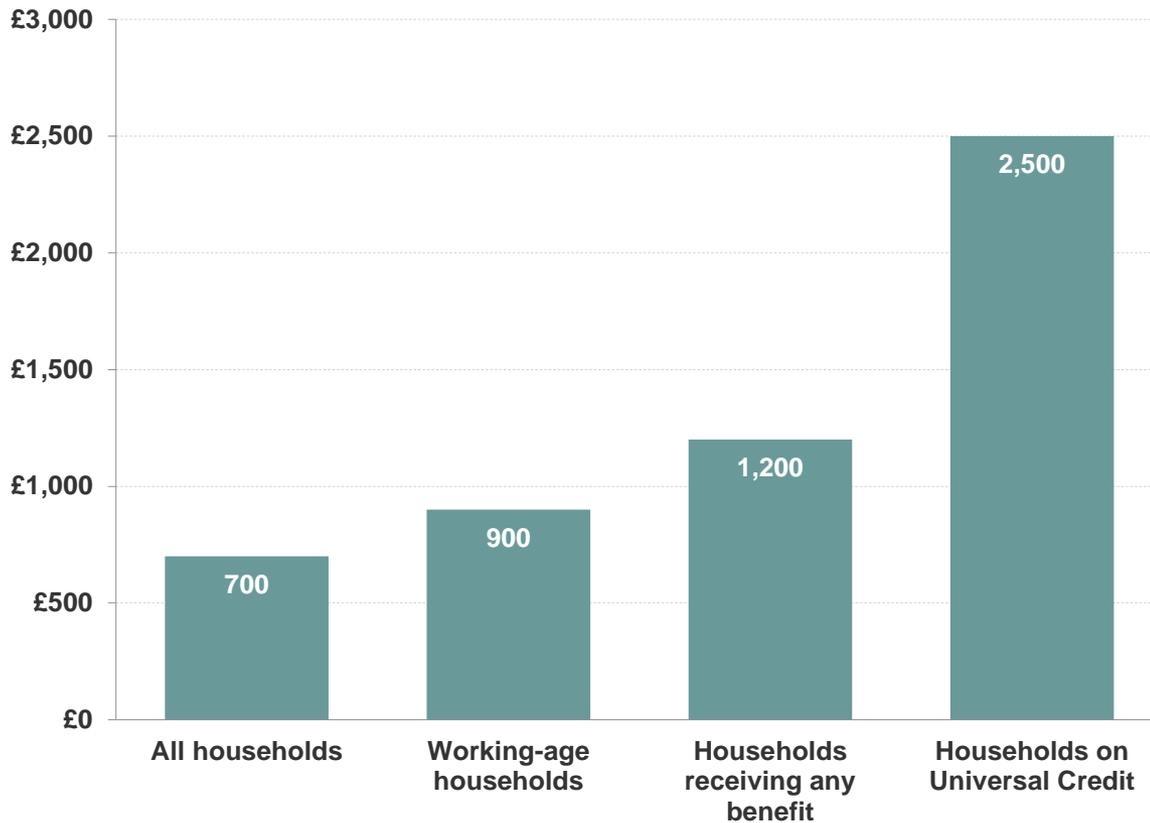
Fiscal choices: interpreting how much tightening is in store after 2015-16



The (big) implications of cutting welfare (AME) so public service (DEL) cuts are no faster than the 2010-2015 rate



Indicative approximate cost (£) of welfare cuts to households



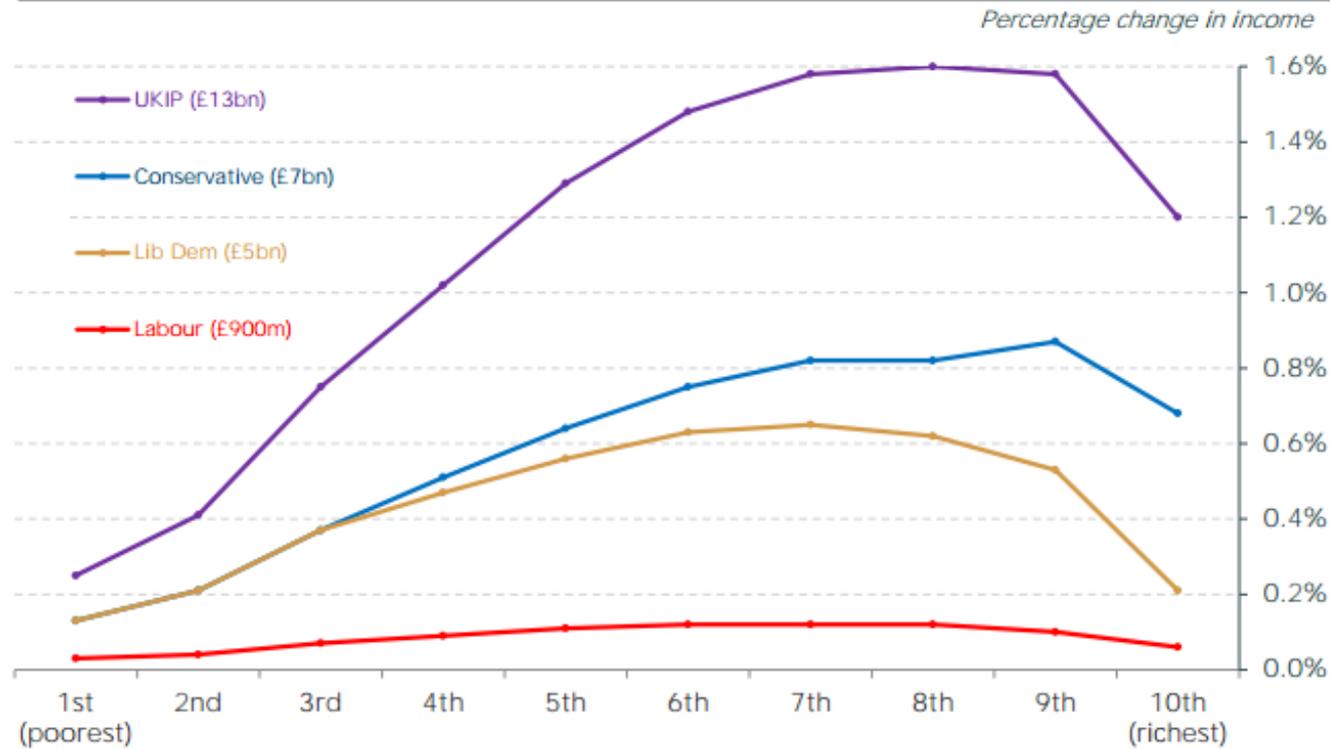
Possible implications of £20bn welfare cuts for households during 2015-20

It all depends who pays....

All main parties want to cut taxes..... but by very different amounts....



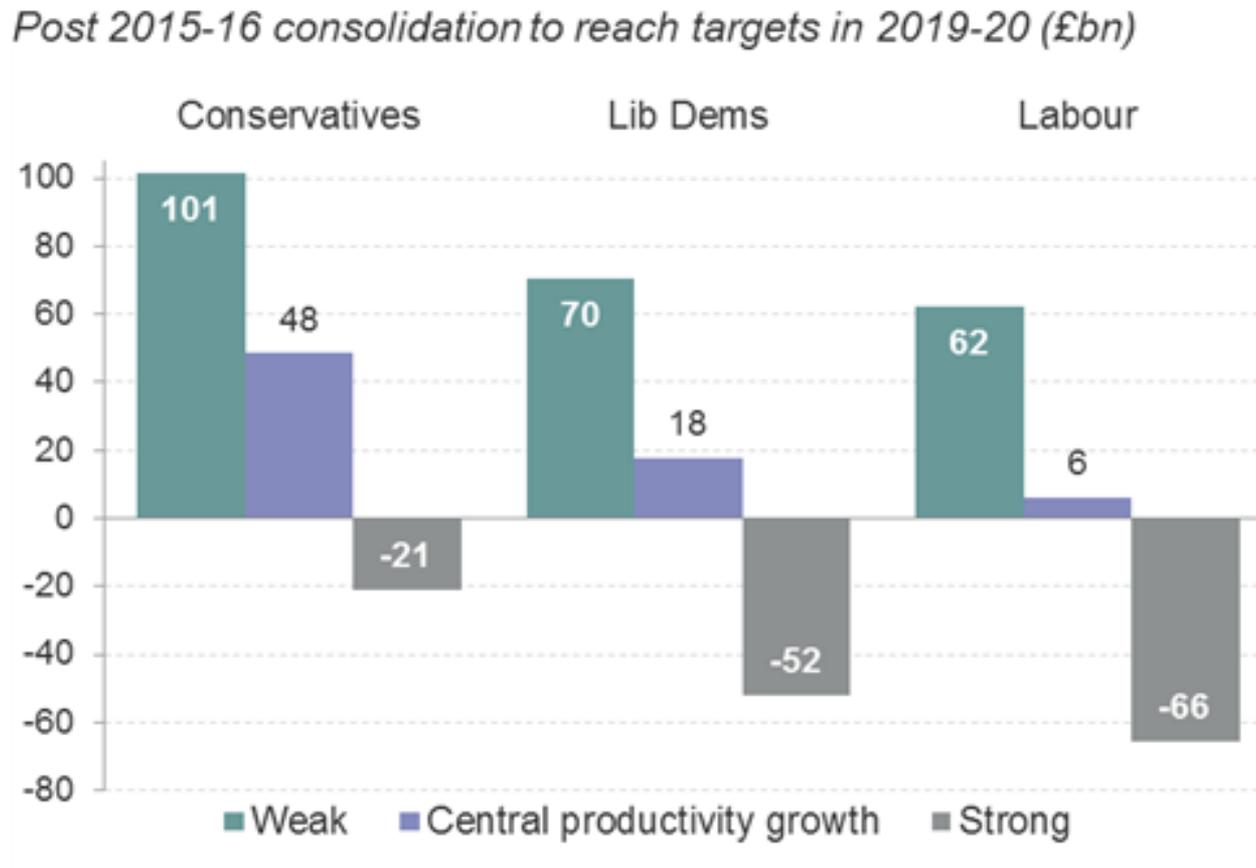
Who really gains from each party's proposed tax cuts?



Notes: All figures are modelled for 2020-21. Conservative proposal raises the personal allowance to £12,500 and the higher rate threshold to £50,000. Liberal Democrat proposal raises the personal allowance to £12,500. UKIP proposal raises the personal allowance to £13,500 and introduces a 35p tax band between £47,000 and £61,000. Labour proposal re-introduces the 10p starting rate of income tax on the first £340 of income above the personal allowance. Labour and Liberal Democrat approaches are modelled in the absence of the marriage tax allowance.

Sources: RF analysis using IPPR tax benefit model

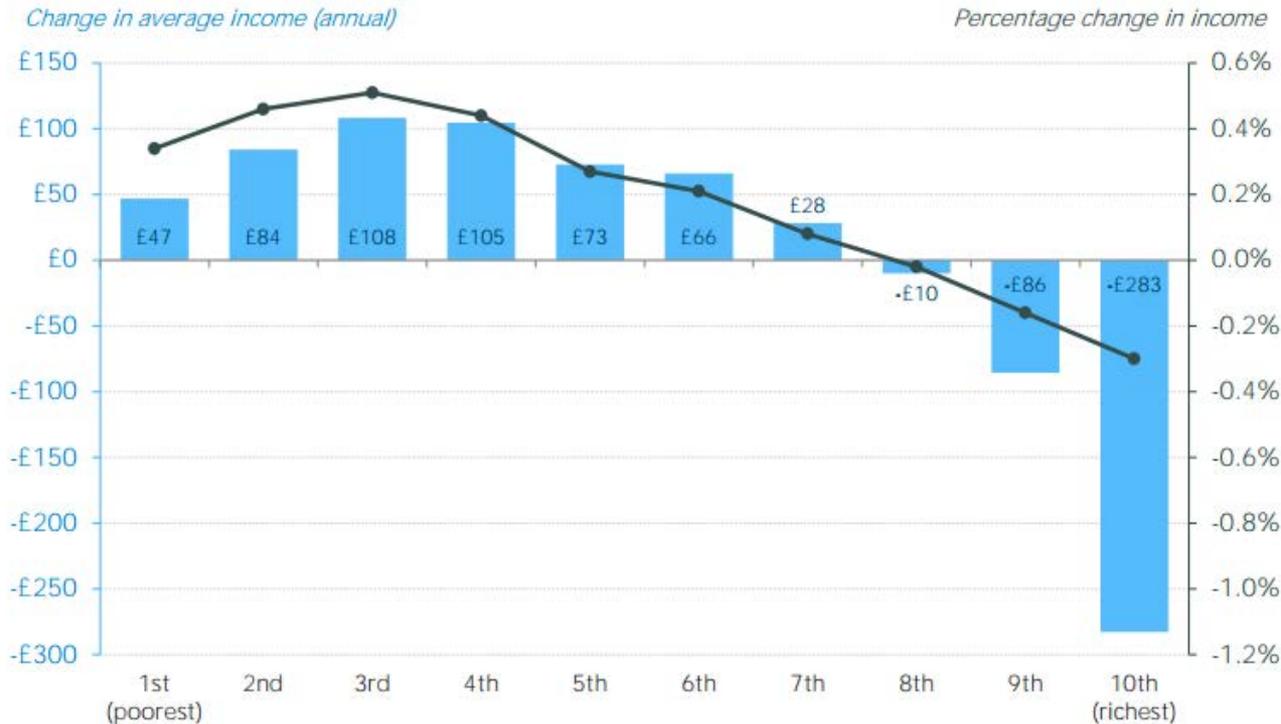
MASSIVE PINCH OF SALT WARNING.....all deficit plans are enormously sensitive to productivity scenarios.....



It's all about choices: on welfare / tax allowances - what happens if we reverse the current strategy?



A funded tax-reform package



- Raise the NI threshold to align it

- Big boost to work allowances in UC

- Freeze PTA for several years to fund

Notes: Package consists of a 20 per cent boost to UC work allowances, freezing the personal allowance for three years after 2015-16 and raising the employee NI threshold to the same point, freezing the basic rate limit for two years after 2015-16, and levying NI on earned income above the state pension age. All changes are relative to projections for 2020-21

Sources: RF analysis using the IPPR tax-benefit model

Outlook?

The logo consists of the letters 'RF' in a bold, teal, sans-serif font, enclosed within a thin teal rectangular border.

- **Growth** context looks relatively benign – oil-boost, investment recovering
- Biggest Q is on **productivity**; also a Q about how effectively future prod'y gains reach the median worker (inequality, non-wage comp etc)
- **Wages** bound to recover: question is do we return to 2003-07 or 1997-02? And unemployment could reach a low point (compared to recent decades)
- **NMW**: make up some lost ground – but incremental & far below what it would have been
- In terms of **inequality**, hard not to be pessimistic: earnings inequality likely to grow, ditto HH income inequality if there are deep cuts to W-A welfare
- The scale of the **fiscal differences** are very significant – but so are the fiscal uncertainties