The squeeze on incomes and policies to help the low paid

Andrew Hood
Are real pre-tax average earnings rising?

- Different measures give different answers

- Relative to CPI...
  - Govt figures (from ASHE) show small rise from Apr 12 to Apr 13
  - Latest weekly earnings data (Nov 13) shows 1% annual fall
  - OBR forecasts imply real earnings now rising

- What’s the bigger picture?
  - Real weekly earnings 8.6% lower than October 2007
  - Earnings only one component of total household incomes
Average real net household incomes since 2007–08

- Mean
- Median

Note: Incomes deflated using the CPI
Source: Table 6.1 in Green Budget document

© Institute for Fiscal Studies
Real income change by percentile since 2007–08

Notes and sources: see Figure 6.1 in Green Budget document

© Institute for Fiscal Studies
Changes in real annual incomes since 2007–08

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>10th percentile</td>
<td>£12,000</td>
<td>£12,347</td>
<td>£11,711</td>
<td>-£289</td>
</tr>
<tr>
<td>50th percentile</td>
<td>£24,719</td>
<td>£23,989</td>
<td>£23,210</td>
<td>-£1,509</td>
</tr>
<tr>
<td>90th percentile</td>
<td>£50,763</td>
<td>£48,455</td>
<td>£46,349</td>
<td>-£4,414</td>
</tr>
</tbody>
</table>

Note: Incomes deflated using the CPI
Source: Data underlying Figure 6.1 in Green Budget document
Has inflation differed for rich and poor?

• Low income households spend more of budget on food and energy
  – Energy prices up 60% since 2008
  – Food prices up 30% over the same period
  – Consumer Prices Index up 20%

• High income households spend more on mortgage payments
  – Mortgage costs down 40% since 2008

• We calculate specific inflation rates for different groups based on spending patterns
  – Since 2008, average annual inflation 1 percentage point higher for poorest fifth of households than richest fifth
Real income change by percentile since 2007–08

Cumulative income gain

Percentile

2007–08 to 2013–14

Notes and sources: see Figure 6.1 in Green Budget document
Difference in real income changes for households in top and bottom income quintiles since 2007–08

Before adjusting for inflation difference: 6 percentage points
After adjusting for inflation difference: 0 percentage points

Notes and sources: see Figure 6.11 in Green Budget document
Why have living standards fallen?

- Fall in living standards so far driven by decline in real earnings
  - Real weekly earnings 8.6% lower than October 2007

- Has led to policy focus on helping those with low and middle earnings

- 2 different ways to do this:
  1. Increase their take-home pay through tax and benefit changes
  2. Directly increase their earnings
Increasing the income tax personal allowance

• Allowance in 2014–15 to be £2,545 higher than inherited plans
  – Costing £10.7bn a year, and taking 2 million people out of income tax

• Further increases poorly targeted on low-income working families
  – Only 15% of gains from increase to £12,500 would go to working families in bottom half of income distribution

• Why?
  1. 1 in 6 workers already pays no income tax
  2. Gain for low income families often largely offset by lower benefits
  3. Helps low income individuals in high income families
  4. Cuts taxes for individuals with unearned income eg. pensioners

© Institute for Fiscal Studies
Cutting National Insurance contributions

• Raising NICs thresholds a better way to help the low paid

• 1.2 million workers to pay NICs but no income tax in 2014–15

• Cutting NICs only reduces taxes for earners
  – so it would do more to strengthen work incentives

• Aligning thresholds simplifies the direct tax system facing workers
Increasing Universal Credit work allowances

- In-work benefits are a more targeted way of supporting low income working families
  - withdrawn as family income rises
  - gets round issue of direct tax cuts reducing benefit entitlements

- Under Universal Credit, could help working families by increasing the work allowances
  - no gain for non-working families
Impact on working families by income decile

Notes and sources: see Figures 7.9 and 7.10 in Green Budget document
Increasing Universal Credit work allowances

- In-work benefits are a more targeted way of supporting low income working families
  - withdrawn as family income rises
  - gets round issue of direct tax cuts reducing benefit entitlements

- Under Universal Credit, could help working families by increasing the work allowances
  - no gain for non-working families

- But there are drawbacks
  - weakens work incentive for slightly higher earning families
  - non take-up means not all eligible families will benefit
Increasing pre-tax pay

Why do some workers have low hourly pay in the first place?

1. Low productivity
   - Policies should focus on improving productivity eg. education, training
   - Higher minimum wages reduce employment

2. Employer power leaves pay lower than productivity warrants
   - eg. costs of moving job gives current employer power
   - Higher minimum wages may not reduce employment
Raising the National Minimum Wage

• Minimum wage has risen slightly compared to average earnings since the recession, but has fallen by 5% in real terms

• Pressure for real increases to restore pre-recession value
  – ‘I want to see above-inflation increases in the minimum wage, precisely because the British economy can now afford that’
  George Osborne, 16 January 2014

• Broad consensus is that so far there has been little evidence of negative employment effects...

• ...but any large increase would carry risks
The Labour Party’s “Make Work Pay” contracts

• Employers that increase pay of all workers to Living Wage in 2015–16 get one-year 32p tax rebate for every £1 of extra wages

• May incentivise some employers to raise pay voluntarily

• Still a trade-off between higher wages and lower employment
  – eg. higher cost of employing a new worker below the Living Wage

• Could distort other employer decisions eg. timing of pay increases
Conclusions

• Big squeeze on real household incomes across the distribution

• One response is to help low paid through tax and benefit system
  – NICs cuts are better than further increases in the personal allowance
  – In-work benefits more targeted, but have their drawbacks

• Policies to increase pay directly, whether compulsory or voluntary, likely to face trade off between earnings and employment
  – Big increases always come with risks

• Increasing productivity must play role in long run policy