

Riders on the Storm II: Middle Income Households since 1999

SMF Briefing Paper

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Introduction

In April this year, we published *Riders on the Storm*, an analysis of how middle income households fared in the four years since the financial crisis in 2007. We used the Family Resources Survey and the British Household Panel Survey in this work. The latter is a longitudinal survey that allows us to track the income and expenditure of the same households over time. This provides, among other things, useful evidence about income mobility. It also allows us to track the incomes of the same households over time. In our new work, we have extended the analysis, going back in four year steps to capture how middle income households were doing in 2003 and 1999.

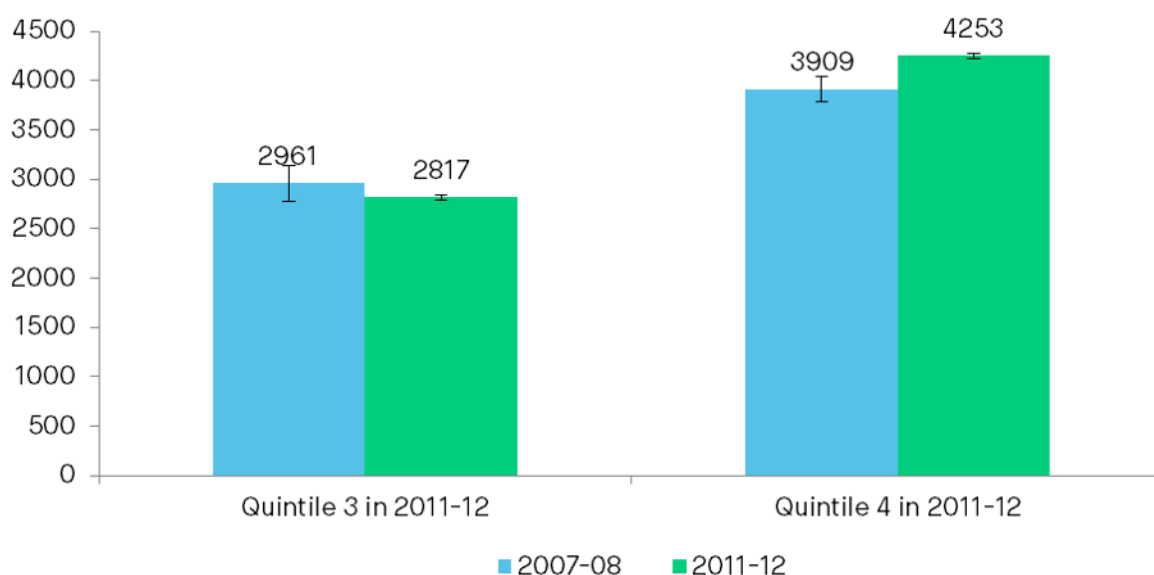
To be clear on terms, by middle income households, we refer literally to households in the middle 20% of the income distribution. We also look at other quintiles for comparative purposes.

Key findings from *Riders on the Storm: Middle income households since 2007*

Our original report, *Riders on the Storm: Britain's middle income households since 2007*, sought to explore how the middle fared in the four years after the 2007/08 financial crisis. It used the British Household Panel Survey to match households in 2007 and 2011.

We found that in 2011 middle income households earned between £26,100-£41,200 and had an average income of £33,600. We found no significant change in the real incomes of these households compared to pre financial crisis.

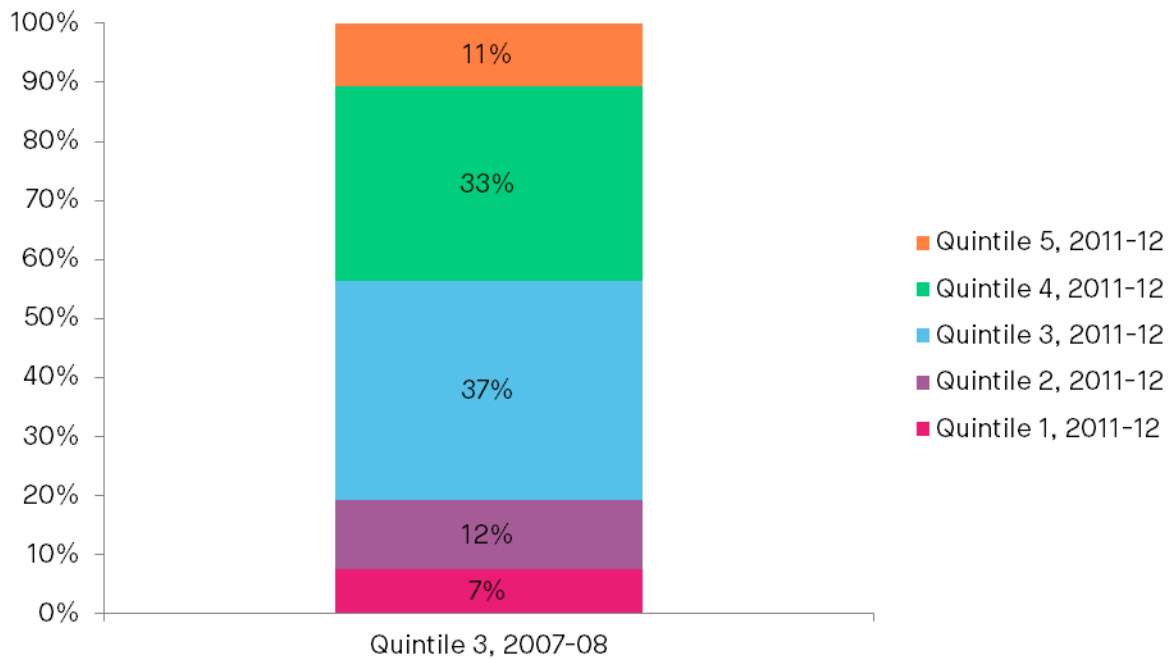
Chart 1: Average Original Monthly Household Income before taxes and benefits (in 2011 prices £)



Source: Social Market Foundation, *Riders on the Storm: Britain's middle income households since 2007*, 2014

The proportion of middle income households climbing up the income distribution into the top two quintiles actually outnumbered the proportion of falling households. More than 10% of the middle in 2007/08 made it into the top income bracket by 2011/12.

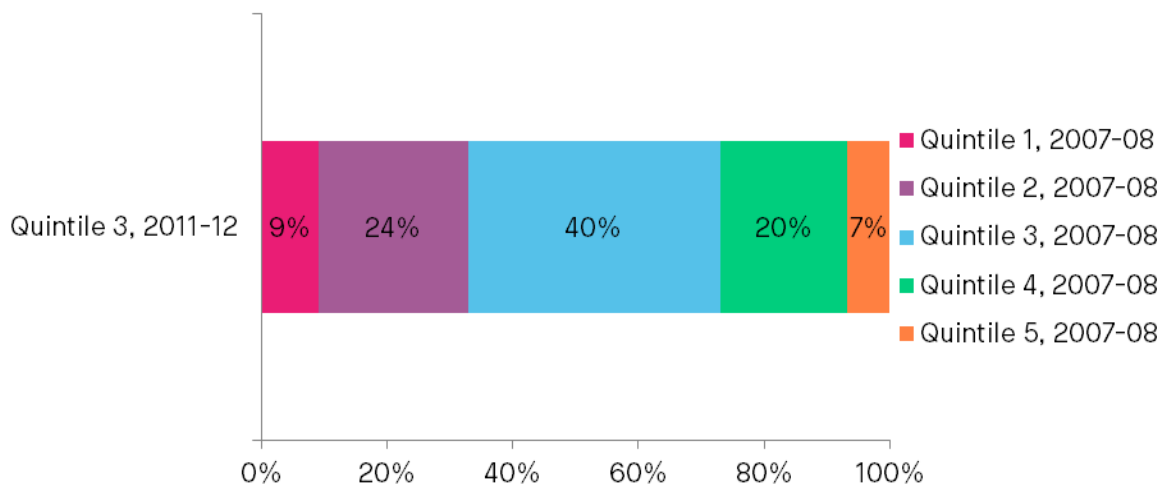
Chart 2: Where 2007/08 Q3 ended up in 2011/12



Source: Social Market Foundation, *Riders on the Storm: Britain's middle income households since 2007*, 2014

We also found that, despite the impact of the recession on the bottom two income quintiles, around 1 in 10 from the bottom of the 2007/08 distribution made it into Q3 by 2011-12.

Chart 3: Where 2011/12 Q3 was in 2007/08



Source: Social Market Foundation, *Riders on the Storm: Britain's middle income households since 2007*, 2014

Our findings in *Riders on the Storm* left us with many questions for follow-up analysis:

- Was the degree of mobility witnessed between 2007/08 and 2011/12 unusual?
- What has been the longer-term evolution of incomes for the middle?
- Were 2011's middle income families spending a larger proportion of their income on essentials compared to previous periods?

Incomes

The starting point is what has happened to the incomes of middle income households over the years between 1999 and 2011. The two surveys illustrate different issues and so we present them both.

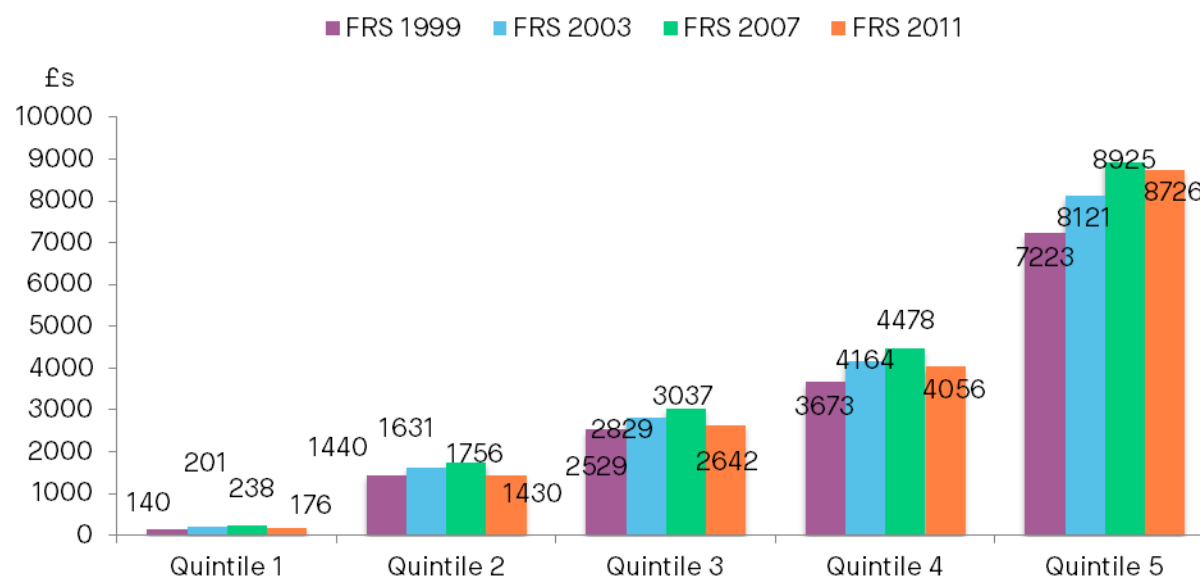
Looking first at the Family Resources Survey, average monthly incomes for each of the quintiles are shown in the chart below. These are cross-sectional averages; they do not describe the incomes of the same households over time.

We observe 4% growth in real incomes during the period 1999-2011 for the middle quintile. The second quintile, the 20% of households just below the middle, saw no real income growth at all. The 20% above the middle saw their incomes rise by 10% and the top quintile enjoyed real income growth of 20%. In other words, income growth is sharper when we look higher up the income distribution.

Within this period, there is also a marked difference between 1999-2007 and 2007-2011. Unsurprisingly, real incomes grew strongly in the earlier period, by 20% for middle income households, then fell off after the financial crisis, dropping by 13% for the middle.

While this pattern is repeated in all quintiles, it is striking that the post-crisis fall is the smallest for the top 20% and this is the only quintile that records a higher average income in 2011 than in 2003.

Chart 4: Average Original Monthly Household Income (in 2011 prices rounded up)



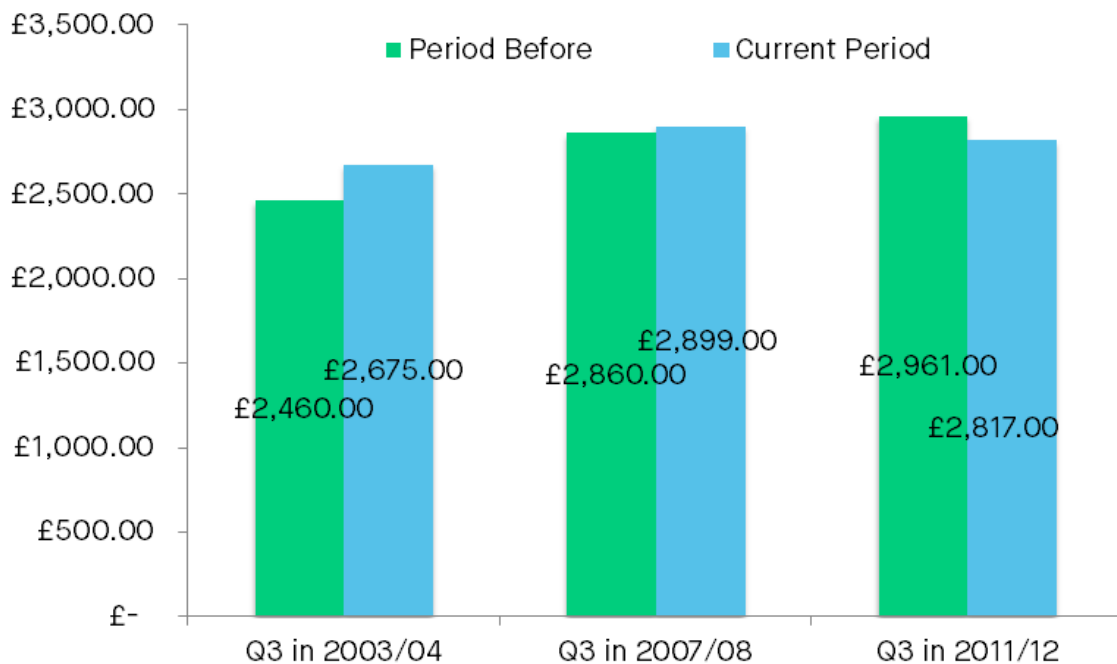
Source: Family Resources Survey

Turning to the British Household Panel Survey, this allows us to track what has happened to the incomes of the same households over time. As we commented in our earlier work, the problem of the type of averages analysis presented above is that this does not capture the experience of any specific households; it merely describes what has happened to a statistically defined middle the composition of which changes over time.

By tracking middle income households over time, we found in our previous report that those in the middle by 2011 had experienced no significant change in real terms income between 2007 and 2011, as shown by the third group in the chart above. Now going further back, we can follow middle income households during the periods 1999 to 2003 and 2003 to 2007. The change in income in all three periods is small: but there is a marked change in trend. A decade ago, being in the middle meant that you had most likely seen growth in income: in more recent years, that has not been the case.

Some level of income growth over a four year period might be expected as people age, become more experienced and have access to better jobs. In addition, our analysis suggests that in many cases, income growth may have been driven by having an additional member of the household in work. So the change over the last decade may be evidence of a wider shift, suggesting lower levels of income progression due to wider changes in the labour market; or it may be a temporary effect caused by the nature of the pre-2007 boom and the crisis that followed it.

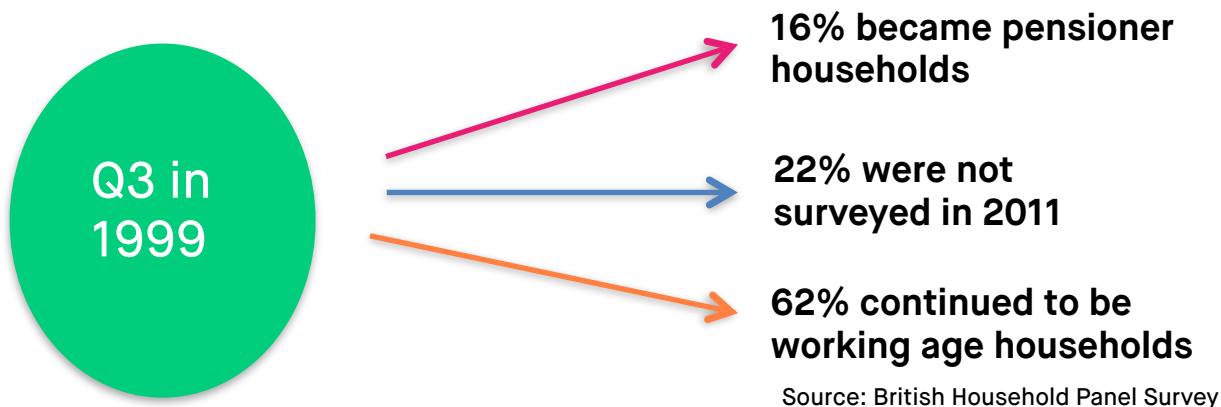
Chart 5: Average Original Monthly Household Income (in 2011 prices £ rounded up)



Source: British Household Panel Survey

Turning to the British Household Panel Survey, this allows us to track what has happened to the incomes of the same households over time. Q3 in 1999 had an average monthly original income of £2,243. By 2011, this had grown to £3,090 – a 38% increase over the 12 year period.

Figure 1: What happened to 1999's Q3 by 2011?

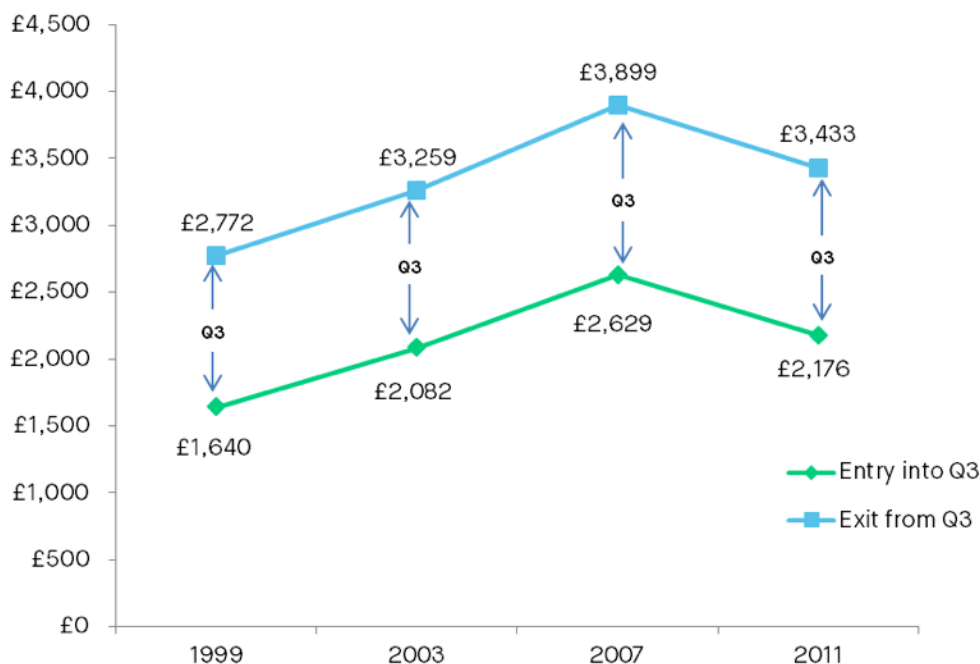


Income mobility

We looked at mobility defined as shifts between the income quintiles. This is a measure of how well people are doing relative to others.

The first step in testing mobility in our analysis is to determine the thresholds for entering or leaving a quintile. We have to use the British Household Panel Survey to study mobility because it is the only survey of the two that goes back to ask questions of the same households in each wave. We can see the change in income needed to enter and leave the middle 20% in the chart below: throughout 1999-2007, as incomes grew, staying in the middle meant rising incomes. In contrast, in 2007-2011, a middle income household could see no growth or even a small drop, and would still be able to stay in the middle of the income distribution.

Chart 2: 1999-2011 Monthly Household Income for Q3 (in 2011 prices)

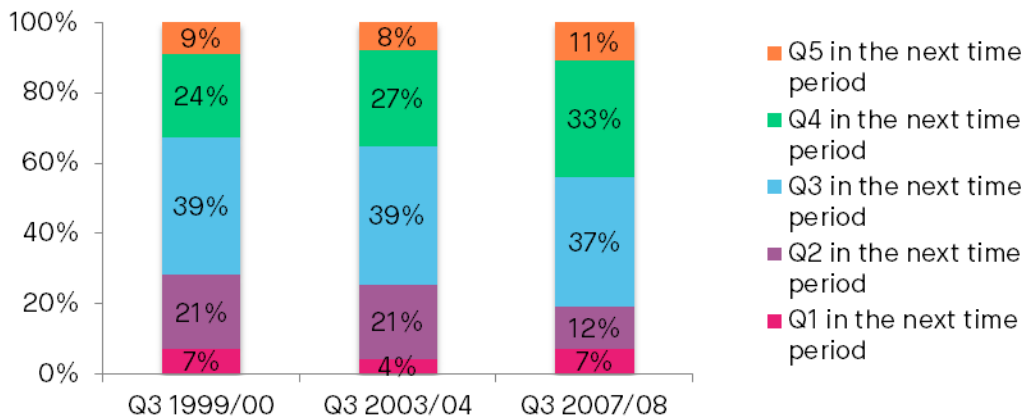


Source: British Household Panel Survey

We have looked at income mobility in two ways. The first is to look at where the middle income households in one survey have got to in the distribution four years later. The most striking finding is the similarity in income mobility across the years we looked at: movers always outnumbered those that stayed in the middle. Substantial income mobility is not unusual.

There have however been some smaller changes in recent years. The chart below shows that the probability of middle income households rising into the higher quintiles increased during the period we studied, from 33% of these middle income households climbing into the higher quintiles between 1999 and 2003, to 35% climbing between 2003 and 2007 and then 44% between 2007 and 2011.

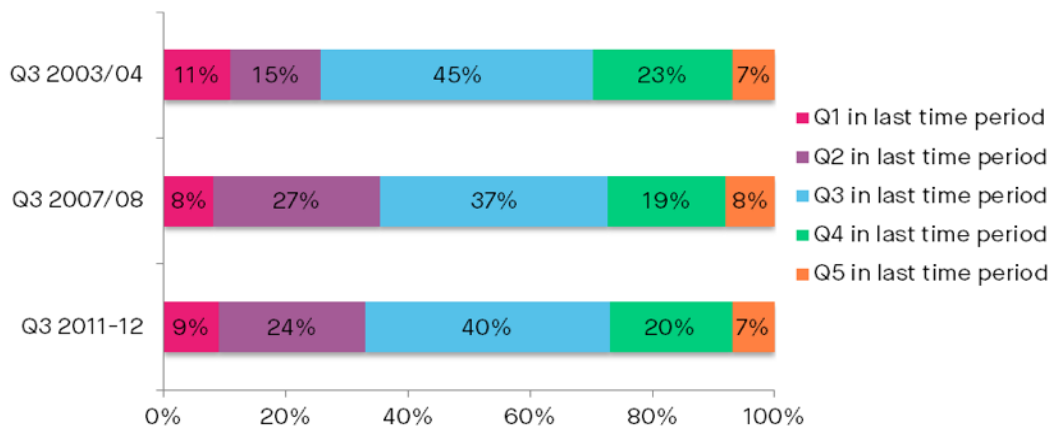
Chart 3: Probability of Q3 moving to other quintiles in the next time period



Source: British Household Panel Survey

The second way of looking at income mobility in our analysis is to ask where the middle in each year we looked at has come from. Where were they in the income distribution four years previously? The chart below shows that 26% of the middle income households in 2003 had been in one of the lower quintiles four years previously; this proportion of climbers rose to 35% of the middle by 2007; and fell back slightly to 33% by 2011.

Chart 4: Where households in Q3 were positioned in the last time period



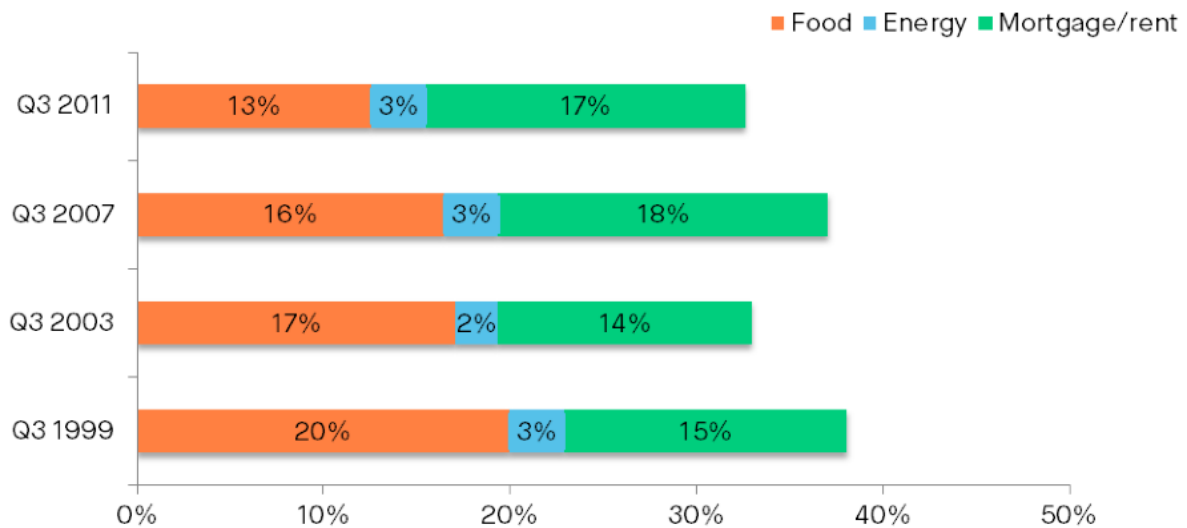
Source: British Household Panel Survey

By contrast, the proportion of climbers into the top quintile has remained largely the same during the entire period. 42% of the top quintile in 2003 had come up from lower down the income distribution; the proportion of climbers was 44% in 2007; and 43% in 2011.

Cost of living

We also looked at the proportion of income spent on essentials, defined as food, energy and housing. Looking specifically at middle income households, they spent 38% of their income on essentials in 1999. This dropped, before slightly rising in 2007-08 and then falling down again by 2011-12.

Chart 5: Proportion of Q3 household income spent on essentials



Source: British Household Panel Survey/Understanding Society

In other words, middle income households are spending proportionately less of their income on essentials at the end of this period compared to the beginning. The difference was as large as 7% in 2003 and fell back to 5% by 2011. Nevertheless the value of that rise in disposable income since 1999 is worth around £160 per month in 2011.

The Social Market Foundation

The Social Market Foundation (SMF) is an independent public policy think tank. It won “UK & Economic Think Tank of the Year” in 2012. It is not politically aligned and has members of all political parties on its Board. Its work spans public service reform and the social market economy, and champions ideas that marry a pro-market orientation with concern for social justice. Since its inception in 1989, the SMF has gained an enviable reputation for the rigour of its research, driving policy debate based on sound argument and clear evidence. The SMF has a strong track record in related policy areas, including analyses of the road network, integrated transport, the role of regulation and regulators, and investment in regulated sectors.

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