



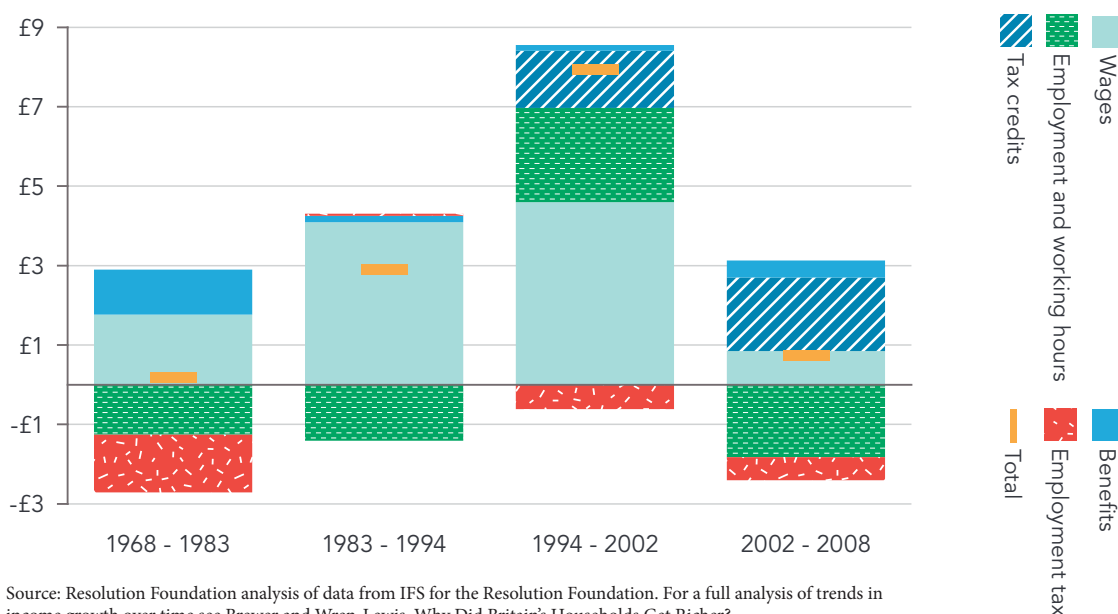
## Why do low to middle income households get better off over time?

Before looking at each key driver of income growth in turn, we look briefly at how they line up next to each other. As we have said, incomes grow for three reasons: wages grow in real terms, employment or working hours rise or fall, and help from the state, in the form of tax credits, benefits and taxes, becomes more or less generous. Figure 4.1 shows how much each of the drivers of income growth has contributed over time.<sup>[1]</sup>

As one would expect, Figure 4.1 confirms that by far the most important source of prosperity

for ordinary working households is rising hourly wages. When hourly wage growth is weak, as in the turbulent 1970s, household incomes struggle to grow. When wages rise strongly, as they did in the 1980s and late 1990s, prosperity rises on the back of that growth. Because around four-fifths (78 per cent) of workers in low to middle households are in the bottom half of the wage distribution, earning less than £26,200 a year before tax, it is wage growth in the bottom half of the workforce that is of paramount importance.<sup>[2]</sup>

**Figure 4.1: Growth in UK household income by source, £ per week, low to middle income households**



Source: Resolution Foundation analysis of data from IFS for the Resolution Foundation. For a full analysis of trends in income growth over time see Brewer and Wren-Lewis, *Why Did Britain's Households Get Richer?*

Figure 4.1 also shows the importance of changes in overall employment levels and working hours. Dividing up the late 20th century as we have in Figure 4.1 employment and working hours were only a positive force for these households during the tight labour market of the late 1990s. In every other period they reduced incomes – employment levels or working hours fell on average. This shows the extent to which low to middle income households are on the front line of our labour market, among the first to suffer from job losses or reduced working hours when the economy goes through a weak patch. From 1994 to 2002, wage growth and employment worked together, delivering eight prosperous years.

Finally, state support has been vital. When put in this longer-term context the 2003 to 2008 period stands out starkly as a time when state support was the only source of income growth. Working people in low to middle

income households barely saw any growth in their hourly pay over this period. Meanwhile, employment in these households fell on average, dragging down incomes, leaving tax credits to assume centre stage. While in the late 1990s and the start of the 2000s tax credits had played a healthier role of augmenting income growth, turning good growth into even stronger growth, after 2003 they became the *only* major source of income growth. In fact, even with tax credits, incomes barely grew.

### The plan for Section 2

We have seen that the long-term drivers of income growth in low to middle income Britain are wage growth in the bottom half of the wage distribution, employment and state support. We now look at each of these in turn to set the 2003 to 2008 period in a longer-term context

[1] Brewer and Wren-Lewis, *Why Did Britain's Households Get Richer?* [2] 2011 annualised gross median weekly earnings for full-time employees, *Annual Survey of Hours and Earnings*.

and to help us understand more clearly what lies behind these important sources of prosperity. We find worrying evidence that these three motors of living standards have faltered.

In **Chapter 4** we examine the falling share of GDP that is reaching wages in the bottom half of the wage distribution. We ask how much Britain's performance owes to structural changes over which policymakers have relatively little influence – such as technological change and globalisation – and how much it owes to a failure to shape these factors through domestic policy choices.

In **Chapter 5**, we look at the distribution of employment. Which groups have been most important for low to middle income households and look likely to

be most important in future? Have these groups now reached a natural plateau in employment in the UK or is there room for improvement? Are there particular groups that would like to work more but that face particular barriers?

Finally, in **Chapter 6** we consider the role that state transfers have played in supporting household income growth over time. As we have seen, state transfers were the principal source of income growth between 2003 and 2008. Now fiscal constraints mean that the government has much less freedom to compensate for weak earnings growth in the bottom half of the wage distribution through the tax and benefit system. We discuss some of the strategic questions this poses.