



# PERSPECTIVE

## CENTRE FOR POLICY STUDIES

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### *Why do we feel so broke?*

**CHARLIE ELPHICKE**

#### **SUMMARY**

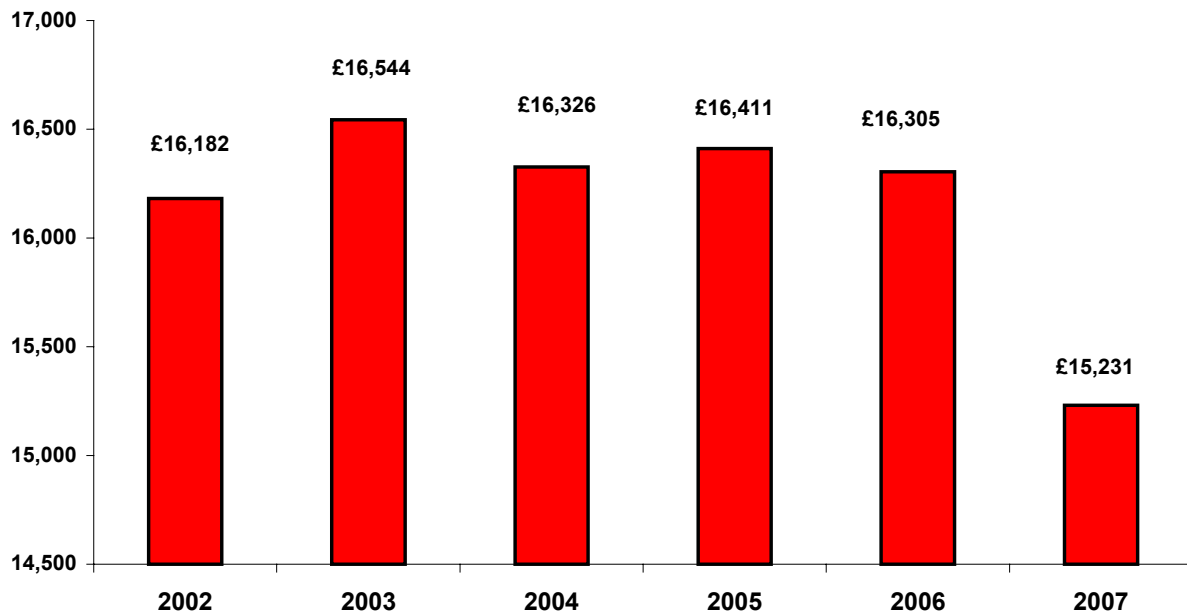
- Average household taxes are up by £7,800 a year in nominal terms since 1997. (The aggregate total increase in the household tax burden – including business taxes – is nearly £10,000 since 1997).
- Until recently, the average family was able to absorb these tax increases partly through increased disposable incomes and partly through increased personal debt.

However:

- Since 2005, increases in household disposable income after tax and housing costs have stagnated.
- Average earning households have been hit particularly hard. For them, disposable income after tax and housing costs has fallen by £950 since 2002.
- The rate of increase of household debt has slowed sharply (particularly for general unsecured debt and credit cards).
- Taxes have been increasing at a greater rate than earnings for some years. This trend looks set to continue.

#### **FALLING AVERAGE HOUSEHOLD EARNINGS AFTER TAX AND HOUSING COSTS**

All figures nominal



See Table Two on page 4 for details of sources and methodology.



# PERSPECTIVE

- The costs of running a home have routinely been increasing at rates of up to 10% a year for average households with average mortgages.

The combination of stagnating earnings, sharp increases in tax, excessive debt, rising effective interest rates and growing household running costs means that British households are more vulnerable to, and less prepared for, any economic downturn. The Government's increases in taxation and the recent availability of easy credit is a potentially toxic mixture.

## HOUSEHOLD DISPOSABLE INCOME STAGNATES

In the five years between 1997 and 2002, ONS figures suggest that real household disposable income after taxes and housing costs grew by a total of £70 per week, rising from £20,321 in 1997 to £23,986 in 2002.

The rate of growth has nearly halved in the five years from 2002 to Q3 2007, which saw a rise of £42 per week, rising from £23,986 to £26,162 in Q3 of 2007 (see Table One overleaf). Real household disposal income stagnated in 2006 and to Q3 of 2007, which saw rises of £4 per week and £0 respectively.

These ONS figures are confirmed by the Department for Work and Pensions (DWP) publication, *Households Below Average Income* (2006) which shows weekly income after housing costs rising by just £16 between 2002/03 and 2005/06 in real terms.

## AVERAGE EARNERS HIT HARDEST

However, a couple on median average income has even less disposable income after tax and housing costs than suggested by data above. Table Two illustrates how this couple will have seen their nominal disposable income (after tax and housing costs):

- Increase by £3,600 (or 21%) between 1997 and 2002.
- Fall by £950 (or 6%) since 2002.

Note that in real terms, the fall in income since 2002 would be greater.

## WHY HAVE AVERAGE EARNERS BEEN HIT HARDEST?

This fall in average household income since 2002 is the result of:

- weak increases in gross earnings;
- increased taxes falling heavily on average earning families;
- significant increases in housing costs.

While the largest fall for average earners occurred in 2007, income after tax and housing costs is broadly flat between 2002 and 2006. This is also the conclusion of the *Households Below Average Income* (DWP, 2006) which shows median real income after housing costs rising from £299 a week in 2002/03 to £310 a week in 2005/06.

## THE PRESSURE OF INCREASED TAXATION

The tax burden per household is up by £7,800 for the average household since 1996/1997 in nominal terms. This has squeezed disposable income, which as Table Three shows, has gone down from 71% of gross income in 1997 to 67% today.

## THE PRESSURE OF RISING HOUSING COSTS

The data in Table Two show how housing costs have doubled for the average mortgage paying homeowner in the last ten years.

In the five years since 2002, the costs have gone up by nearly 80%. Mortgage interest payments have gone up most of all – over 100% – followed by electricity and gas bills which have risen by 68% and 52% respectively.



# PERSPECTIVE

## **HOUSEHOLD DEBT AND AFFORDABILITY**

Household debt has increased sharply since 2002. The total debt (including mortgages) per household has gone from £34,019 in 2002 to £55,554 in Q3 of 2007, as shown in Table Four (an increase of 63%).

Household debt as a proportion of household income has gone from 66% ten years ago, to 83% five years ago, to 108% today. The increase has been dramatic and has left households very exposed to any significant increase in interest rates.

Yet household debt has in practice been fairly affordable until recently. Comparing mortgage interest inflation to nominal household gross income ten years ago (see Table Four) provides a snapshot of mortgage affordability compared with ten years ago. Mortgages were even more affordable five years ago and affordability remained around the same level as ten years ago in 2005. In 2007, the position changed dramatically, with the effective cost of a mortgage to gross household income rising by 25%. This provides some indication of how the affordability of mortgages changed for the worse in 2007. In effect, a £3,000 mortgage annual interest cost in 2006 had become a £4,000 annual interest cost by Q3 of 2007. Given many households fixed their mortgages for two years in 2005, only now is the increased cost of mortgages beginning to be felt directly by households.

## **HOUSEHOLD DEBT – SECURED VS UNSECURED**

Unsecured debt, especially credit card debt, has until recently been out of control: in the five years to 2002, credit card debt increased by a nominal 159%. Yet the figures in Table Four show that, aside from a splurge in 2003, credit card debt has risen by 15% since 2002 (compared with a 71% rise in mortgage debt over the same period).

And since 2005, credit card debt has been falling – and fell by nearly 7% between 2005 and Q3 of 2007. Households appear to have headed the warnings with a reduction of credit card debt (assuming that the basis of collection of the ONS figures is consistent and comparable). No doubt, many households have been obtaining mortgage advances with the purpose of paying off credit card debt.

Personal unsecured debt in general also appears to be under control. Unsecured personal debt rose by 86% in the five years to 2002. Yet unsecured debt has risen much more slowly since 2002, increasing by 31% up to Q3 of 2007, less than half the rate of increase seen for mortgage debt over the same period. Since 2005, the rate of increase has slowed to less than 5% as at the end of 2007 Q3, around a quarter of the rate of increase in mortgage debt. Unsecured debt as a percentage of mortgage debt was 21% ten years ago in 1997 – it is now 19%.

Mortgage debt has grown more quickly. Annual increases between 2002 and 2006 ranged from over 10% to nearly 15%.

The level of debt means that households are not as prepared for more difficult times as they might otherwise be.



# PERSPECTIVE

## TABLES

**TABLE ONE: REAL HOUSEHOLD DISPOSABLE INCOME AFTER TAX AND HOUSING COSTS IS STAGNATING**

£, real	1997	2002	2003	2004	2005	2006	2007	% Increase		
								1997-2007	2002-2007	2005-2007
Real household disposable income (ONS NRJR)	25,209	29,146	29,854	30,358	31,253	31,535	31,591	25.32	8.39	1.08
Increase in NRJR (%)		15.62	2.43	1.69	2.95	0.90	0.18			
Real housing costs (ONS ZAVO)	4,888	5,160	5,204	5,302	5,313	5,379	5,429	11.07	5.21	2.20
Increase in ZAVO (%)		5.57	0.84	1.89	0.20	1.26	0.93			
Real disposable income after housing costs	20,321	23,986	24,651	25,056	25,940	26,155	26,162	28.74	9.07	0.85
Weekly real increase after tax and housing costs		£70	£13	£8	£17	£4	£0			

Sources: Real household disposable income is drawn from ONS NRJR series (2007 to Q3 only, annualised). Real housing costs (i.e. housing, oil, gas, electricity) from ONS series ZAVO (again, 2007 numbers to Q3, annualised).

**TABLE TWO: THE AVERAGE HOUSEHOLD GETS POORER SINCE 2002**

£, nominal	1997	2002	2003	2004	2005	2006	2007	% Increase	
								1997-2007	2002-2007
<b>Household Income:</b>									
Man's gross earnings	18,559	22,435	23,264	24,222	25,064	25,599	26,297	42	17
Man's tax	4,749	5,471	5,731	6,186	6,406	6,485	6,643	40	21
Woman's gross earnings	4,909	6,180	6,407	6,837	7,346	7,524	7,903	61	28
Woman's tax	341	312	357	428	534	496	546	60	75
Total household tax	5,090	5,782	6,088	6,615	6,940	6,981	7,188	41	24
Child tax credit	0	545	545	545	545	545	545		
<b>Household earnings after tax:</b>	<b>18,378</b>	<b>23,378</b>	<b>24,128</b>	<b>24,989</b>	<b>26,015</b>	<b>26,687</b>	<b>27,557</b>	<b>50</b>	<b>18</b>
<b>Cost of running average home:</b>									
Mortgage interest payments	3,310	3,582	3,778	4,628	5,335	5,769	7,500	127	109
Council tax	687	964	1,069	1,149	1,201	1,255	1,321	92	37
Water and other charges	206	220	229	241	265	283	305	48	38
Repairs and maintenance	741	1,040	1,103	1,171	1,238	1,300	1,376	86	32
Home insurance	173	212	229	246	252	260	272	57	28
Electricity	387	355	348	380	421	512	541	40	52
Gas	271	277	282	303	347	458	466	72	68
<b>Total cost of running an average home:</b>	<b>5,775</b>	<b>6,651</b>	<b>7,039</b>	<b>8,118</b>	<b>9,059</b>	<b>9,837</b>	<b>11,780</b>	<b>104</b>	<b>77</b>
<b>Household earnings after tax and housing costs</b>	<b>12,603</b>	<b>16,182</b>	<b>16,544</b>	<b>16,326</b>	<b>16,411</b>	<b>16,305</b>	<b>15,231</b>	<b>21</b>	<b>- 6</b>

Notes and Sources: All figures are nominal. Data based on a family where a man is in full-time employment, with a wife or partner in part-time work (both earning median average amounts). They are assumed to have one child and are running an average home with an average mortgage and average home running costs. Data for household earnings are from ONS, *Annual Survey of Hours and Earnings 1997-2007*, 2007. Taxation has been calculated using appropriate Income and NIC tax rates and allowances for each year. Mortgage interest payments assume a typical mortgage of £125,000 in 2007 at 6% interest. All other data are based on latest available information from the following sources and have been deflated using RPI inflation relevant components: DOBQ, DOBR, DOBS, DOBT, DOBV, DOBX and DOBY. Council tax data are from [www.local.odpm.gov.uk/finance/ctax/data/ctax078t1.pdf](http://www.local.odpm.gov.uk/finance/ctax/data/ctax078t1.pdf); water charges data from [www.uswitch.com/Water/Questions-And-Answers.html](http://www.uswitch.com/Water/Questions-And-Answers.html); repairs and maintenance data from [www.statistics.gov.uk/pdfdir/efsh0107.pdf](http://www.statistics.gov.uk/pdfdir/efsh0107.pdf); home insurance data from [www.statistics.gov.uk/pdfdir/efsh0107.pdf](http://www.statistics.gov.uk/pdfdir/efsh0107.pdf) – typical home insurance of £5 a week; electricity and gas data from [www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2007263](http://www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2007263)



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**TABLE THREE: THE TAX SQUEEZE ON DISPOSABLE INCOME BITES...**

	1997	2002	2003	2004	2005	2006	2007
Household (nominal) income before tax (RPHP) (£)	31,705	41,016	42,933	44,842	47,857	50,045	51,689
Household taxes (nominal) (£)	9,126	12,426	13,079	13,968	15,276	16,299	16,938
Household (Nominal) disposable income (RPHQ) (£)	22,578	28,591	29,854	30,874	32,580	33,746	34,751
Proportion of household income that is disposable (%)	71.21	69.71	69.54	68.85	68.08	67.43	67.23

Source: RPHP and RPHQ ONS time series data divided by 24.8 million households in the UK (household numbers derived from ONS, *Effect of Tax and Benefits on Household Income, 2007*).

**TABLE FOUR: ...WHILE HOUSEHOLD DEBT HAS SHARPLY INCREASED**

	1997	2002	2003	2004	2005	2006	2007 Increase (%)			
							1997- 2007	2002- 2007	2005- 2007	
Mortgage debt per househ'd (ONS AMWT & BoE)	17,393	27,225	31,234	35,384	38,993	43,498	46,671	168.34	71.43	19.69
% increase in mortgage debt per household		56.53	14.73	13.29	10.20	11.55	7.29			
Non mortgage debt per household (ONS VZRI)	3,655	6,794	7,266	8,003	8,496	8,571	8,882	143.00	30.74	4.55
% increase in all non mortgage debt per household		85.87	6.95	10.15	6.15	0.89	3.63			
Credit card debt per household (ONS VZRJ)	734	1,900	1,921	2,219	2,338	2,208	2,182	197.18	14.84	-6.66
% increase in credit card debt per household		158.78	1.12	15.46	5.37	-5.54	-1.19			
Total debt per household	21,048	34,019	38,500	43,387	47,488	52,070	55,554	163.94	63.30	16.98
% increase in total debt per household		61.62	13.17	12.69	9.45	9.65	6.69			
Percentage of non mortgage to mortgage debt	21.0	25.0	23.3	22.6	21.8	19.7	19.0			
<b>Percentage of household debt to household income (RPHP)</b>	<b>66.4</b>	<b>82.9</b>	<b>89.7</b>	<b>96.8</b>	<b>99.2</b>	<b>104.0</b>	<b>107.5</b>			
Mortgage interest inflation (DOBQ)	180.7	195.6	206.3	252.7	291.3	315	409.5			
Mortgage interest compared to household income (%)	57.0	47.7	48.1	56.4	60.9	62.9	79.2			

Sources: data from ONS time series to Q2 of 2007 and from Bank of England to Q3 of 2007 ([www.bankofengland.co.uk/statistics/li/2007/oct/lendind.pdf](http://www.bankofengland.co.uk/statistics/li/2007/oct/lendind.pdf))



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*Support towards the research on which this report is based was given by the Institute for Policy Research.*

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© Centre for Policy Studies, February 2008

ISBN 978-1-905389-68-1

Printed by the Centre for Policy Studies, 57 Tufton Street, London SW1P 3QL