



RIDERS ON THE STORM

Britain's middle income households since 2007



Nida Broughton, Onyinye Ezeyi, Claudia Hupkau

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EXECUTIVE SUMMARY

In the years since the financial crisis, households across the income distribution have seen a combination of wage stagnation and a rise in the cost of living. Working age households in particular have been adversely affected by real declines in their main source of income.

Much analysis has focused on lower income households. But more recently, the so-called “cost of living crisis” has pushed the political focus onto the “squeezed middle”. Households in the middle and fourth quintile of the income distribution have annual incomes between around £26,100 and £63,000. They receive some cash benefits, but given the pressure to reduce public spending, they are unlikely to be prime candidates for more state transfers, leaving them more reliant on their own resources in coping with the recent economic climate.

So how well have they fared? Is it indeed the case that they have been squeezed? How successfully have they coped with rising prices whilst incomes have stagnated?

The SMF’s analysis draws on the British Household Panel and Understanding Society surveys to follow specific households through time, from the brink of the downturn in 2007–08 to 2011–12, the latest wave of available data. We complement this with data from other national surveys to look at specific types of spending in more detail.

What is most striking is that middle income households today are not the same households that were in the middle going into the downturn. The next most striking finding is the very diverse experiences of the middle. Of those who were in the middle in 2007–08:

- 6% had dropped into the bottom fifth of the distribution by 2011–12



- Just over 10% had climbed up to the top fifth of the distribution by 2011–12
- Overall the households that climbed up the distribution outnumbered those that fell.

Correspondingly, today's middle income households have seen a diverse range of journeys to where they are now. Of those households in the middle quintile in 2011–12:

- One in 10 were in the bottom fifth of the income distribution four years earlier
- One in five were in the second to bottom quintile four years earlier
- 17% were previously higher up the distribution and dropped down.

Overall, this combination of climbers and fallers meant that those in the middle by 2011–12 saw their average real income remain roughly the same since 2007–08. Meanwhile, the quintile just above – the fourth quintile – saw a real increase. In contrast, those who were in the bottom two quintiles by 2011–12 had seen falls in real income.

Moving up into and remaining in the middle has been made possible through higher employment levels. Households in the middle today are more likely to have two earners rather than one compared to 2007–08. They have managed spending on food – switching to cheaper items – to avoid the 25% increase in food prices over the period. Childcare is still problematic for many, with a heavy reliance on grandparents compared to those on higher incomes. But they have also been helped by low interest rates, which have kept housing costs down among the large number of home owners in this category.

For many middle income households, there are rising costs to come when interest rates go up again. With competing pressures

on public spending, there is less scope for more state help. But this does not mean that nothing can be done. One area of policy where these households can be helped to do more with less is in consumer markets. Those in the middle today have displayed significant resilience thus far in coping with the downturn. But there are markets where more needs to be done to help these households help themselves in securing better value for money.

Substantial progress has already been made on making switching processes easier. Now, the bigger gains are likely to come from helping consumers easily compare products and services. This means ensuring there is sufficient information easily available, that product features and pricing are transparent, and that it is easy to use information that does exist to calculate likely savings from switching.

For middle income families in particular, managing childcare costs is difficult. This is not helped by the fact that childcare is one area where information that allows parents to compare providers is very sparse. Whilst there is some information on quality, comparing prices and value for money is much harder. Helping parents access this information will help them make better choices about what childcare is best for them.

There is also a need to ensure that consumers have access to the right information and that product features and pricing are transparent. As interest rates rise again, the middle is likely to see further pressure on their spending. Last year saw rises in tracker mortgage rates despite the Bank of England base rate remaining the same. It is vital that there is sufficient clarity from banks and regulators as to what consumers should expect from different types of products so that they can make informed choices about how to manage the future rise in mortgage costs. Measures such as the implementation of the Financial Conduct Authority's Mortgage Market Review will help with this.

Finally, making information easy to access and use to calculate savings is vital. Consumers could greatly benefit if they had better access to their own data to compare prices and providers, as is happening through the midata initiative. Even better would be the development of services that allow consumers to compare how much they are spending compared to the average, as an indicator of the level of savings possible to achieve by switching. Other products and services – beyond energy, mobile phones, current accounts and credit cards – should be considered as part of the midata strategy. These include telecoms and broadband more generally; savings products and groceries. Government, regulators and industry will need to ensure that major players in the industry act together, whether this is achieved through voluntary agreement or compulsion.

But pushing data alone will not always be enough. Even when the right information is available and easily comparable, evidence suggests that prompts may be needed to encourage switching. New, innovative apps that scan the market and alert consumers to new deals may be developed. Where this does not happen, other measures should be considered. The model of renewal notices in the car insurance market, which consumers say prompts them to shop around, could be considered for other sectors, and if combined with easy to use usage data, could be very powerful.

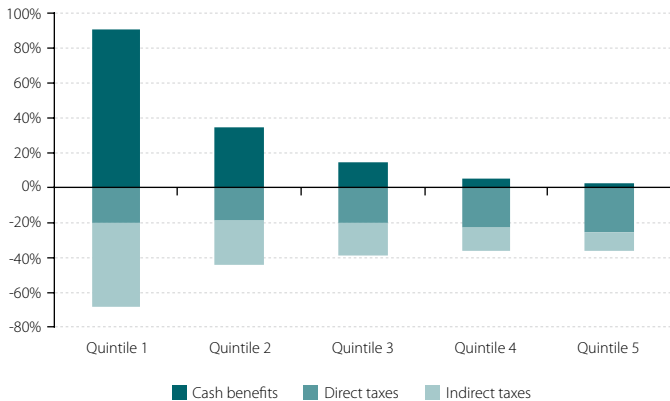
Given that Government is less than halfway through its spending cuts programme, there will be many competing pressures on public expenditure. But this does not mean that middle income households cannot be helped. These households have shown remarkable resilience so far, demonstrating that under the right circumstances, and with the right information to hand they can manage their finances and cope with being under pressure. There should be greater focus on equipping the middle to negotiate consumer markets where it is harder to secure better value for money. Making this happen is likely to require action from Government, regulators and industry.

1. WHY WORRY ABOUT MIDDLE INCOME HOUSEHOLDS?

Households across the income distribution have seen a combination of wage stagnation and rises in the cost of living since 2008. The period 2010 to 2013 in particular is the longest sustained period of falling real wages in the UK on record.¹

Working age households have borne the brunt, and specifically have been adversely affected by the fall in real wages. Among these working age households, those in the middle fifth receive less state help in the form of benefits compared to lower quintiles, although they do receive some, as shown in Chart 1.1. Instead, they have been more reliant on their own resources to cope with the downturn.

Chart 1.1: Benefits and taxes as a proportion of original income



Office for National Statistics, "The effect of taxes and benefits on household income, 2011–12", released 10 July 2013
 Note: Non-retired households, quintile groups ranked on equalised disposable income

The middle, and to some extent the fourth, quintile is of specific interest. Unlike the very top quintile, they are less likely to have been able to accumulate savings to help negotiate the downturn.

¹ Office for National Statistics, "An examination of falling real wages, 2010–2013", 31 January 2014, http://www.ons.gov.uk/ons/dcp171766_351467.pdf

The middle is also subject to broader economic and long-term pressures driven by globalisation and technological change. There has been a “hollowing out” effect, whereby the proportion of jobs in low wage and high wage occupations has risen and the proportion in middle wage occupations has fallen. Whilst this effect is likely to be relatively small on a year-to-year basis, evidence suggests that the recession accelerated the decline in middle wage jobs.²

This report examines the reality of the “squeezed middle”: looking at who the middle are, where they were in 2007–08 and how they coped with the downturn. To do this, we use longitudinal data – from the British Household Panel (BHPS) and Understanding Society (US) surveys,³ that follow specific households over time. We compare income and spending in two years: 2007–08, on the brink of the downturn, and 2011–12, the latest data available. Where longitudinal data is unavailable, we complement this analysis with data from the Family Resources Survey (FRS)⁴ and the Living Costs and Food Survey (LCFS).⁵ Full detail on methodology and sources are included in the Annex to this report.

We find that those in the middle by 2011–12 were precisely those families that had weathered the downturn relatively well. Employment for these households held up – and sometimes increased – and they were able to manage spending to minimise the effect of rising prices. But many of these households will see rising costs in the future; when interest rates rise, mortgage costs, which have been kept low, are likely to rise again. The final section

2 Paul Sissons, *The hourglass and the escalator* (London: The Work Foundation, 2011)

3 University of Essex. Institute for Social and Economic Research and National Centre for Social Research, *Understanding Society: Wave 3, 2011–2012* Colchester, Essex: UK Data Archive SN: 6614; *British Household Panel Survey: Wave 17, 2007–08* Colchester, Essex: UK Data Archive SN: 5151.

4 Department for Work and Pensions, National Centre for Social Research and Office for National Statistics. Social and Vital Statistics Division, *Family Resources Survey, 2007–08 and 2010–2011*. Colchester, Essex: UK Data Archive, SN: 7085, <http://dx.doi.org/10.5255/UKDA-SN-7085-1>

5 Office for National Statistics and Department for Environment, Food and Rural Affairs, *Living Costs and Food Survey, 2011* Colchester, Essex: UK Data Archive, August 2013. SN: 7272, <http://dx.doi.org/10.5255/UKDA-SN-7272-2>

of this report looks at what policymakers can do to ease financial pressures in the future.

The report is set out as follows:

- Chapter 2 sets out what the middle looks like, and how it has changed since 2007–08, looking at trends in income.
- Chapter 3 shows how middle income households coped with the downturn, by keeping money flowing in and managing spending. It also looks at the effect of the downturn on their well-being and prospects for the future.
- Chapter 4 discusses the main policy lever available to help middle income households given the tightening in public finances: making consumer markets work better.

2. WHO IS IN THE MIDDLE, AND HOW HAS THE MIDDLE CHANGED?

This chapter sets the scene, showing what the middle looks like in terms of employment and occupations, and how the middle has changed since the downturn.

In our analysis, we focus on working age middle income households, defined as the middle fifth or middle quintile. We also look at the quintile just above, quintile 4. More specifically, we rank households by their original income, before taxes and transfers, from the top income households in quintile 5 to the bottom income households in quintile 1. The purpose of using the original income measure as opposed to other measures of income is to better understand the underlying trends and changes that middle income families underwent.

In our dataset in 2011–12, middle quintile households had an average annual original income ranging between £26,100 and £41,200. On average, original income of these households was £33,600. Those in the fourth quintile had an average annual income of £51,100, with a range of between £41,200 and £63,000. This section sets out the key characteristics of middle income households, based on analysis of the BHPS and US.

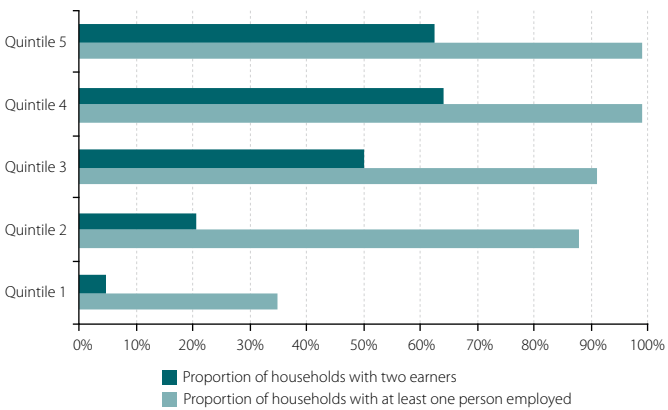
WHAT THE MIDDLE LOOKS LIKE

The majority of middle income households – 91% – had at least one person in employment in 2011–12. In addition, around half of these households had two wage earners. Looking at the proportion of doubler-earner households across the income distribution in Chart 2.1, it is clear that having dual income sources from two earners is a key factor that helps households reach the higher end of the distribution. Where households in the middle fifth differ from the quintile just below them is in the much higher

rate of double-earner households: 50% compared to just 21% in the second quintile.

In contrast, the fourth quintile has even higher rates of double-earner households compared to the middle – 64% . This is likely to be at least partly due to the fact that whilst middle and fourth quintile households are as likely as each other to have children, the middle quintile are slightly more likely to have children under 10. The presence of younger children may make it harder for households in the middle to have two adults working, and as we will see later on, is likely to create particular childcare challenges for these households.

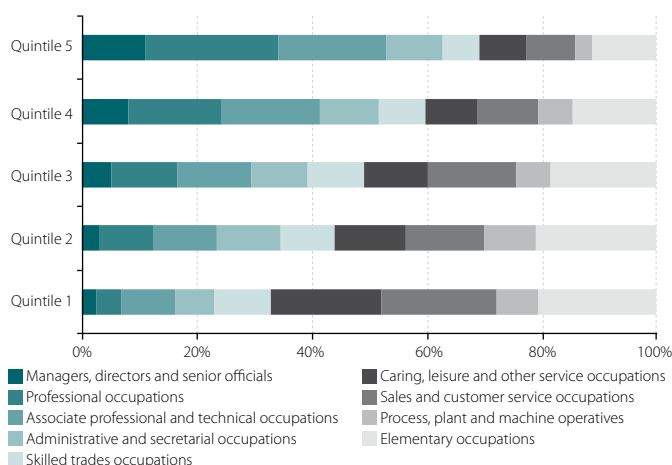
Chart 2.1: Proportion of households with individuals in employment



SMF analysis of Understanding Society, 2011–12, Wave 3

In terms of occupations, the middle quintile has much in common with the quintiles below. A substantial number of individuals in the middle and fourth quintiles are in occupations likely to be low-wage. Half of individuals in middle income households are in the four lowest skill occupations, as shown in Chart 2.2. As such, those in the middle are strongly affected by labour market conditions in the lower wage occupations.

Chart 2.2: Proportion of individuals split by occupation



SMF analysis of Understanding Society, 2011–12, Wave 3

HOW THE MIDDLE HAS CHANGED SINCE 2007

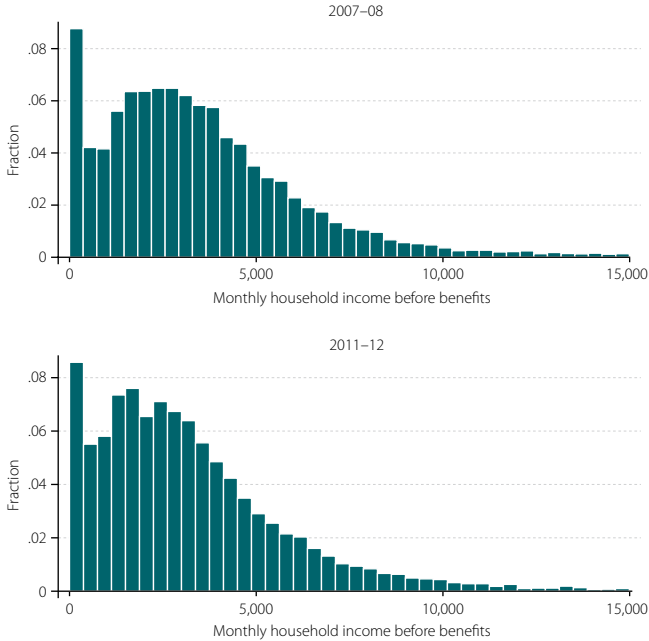
Real wages have seen a substantial decline following the crisis and downturn. But in the last few years, different households have had varying experiences of the downturn. This means that in addition to the overall stagnation of wages, the *shape* of British society has changed.

Chart 2.3 shows the UK's income distribution for working age households in 2007–08 and 2011–12. While at the very top the distribution has hardly changed, the middle and bottom have shifted to the left, meaning that real incomes have decreased for all but the top deciles. As of 2011–12, the average household in the middle quintile had real income of 13% per cent less than the middle quintile in 2007–08 – before taxes and benefits, as real earnings fell.⁶ Because incomes have become more skewed

⁶ The ONS has calculated that disposable income of non-retired middle quintile fell by 6.4%. Disposable income is the amount of money that households have available for spending and saving after direct taxes (such as income tax and council tax) have been accounted for. It includes earnings from employment, private pensions and investments as well as cash benefits provided by the state; Office for National Statistics, "Middle Income Households, 1977–2011/12", 2 December 2013, http://www.ons.gov.uk/ons/dcp171776_341133.pdf

towards the bottom, it is now “easier” to get into the middle fifth in terms of absolute income required.

Chart 2.3: UK income distribution in 2007–08 and 2011–12



SMF analysis of Family Resources Survey 2007–08 and 2011–12. Restricted to incomes between 0–15000 to exclude outliers. 2011–12 prices

This has a number of implications for attempting to understand how the middle has changed. The fall of many people to the bottom of the distribution means that households in 2011–12 needed a lower income to be classified as in the middle. The gap between low and middle income has narrowed.

If all household incomes had shifted downward by the same amount, there would be no difference between the households that were in the middle in 2007–08 and those that were in the middle in 2011–12. But this was not the case. Many of the households

that previously formed part of the middle have themselves moved elsewhere in the distribution, as shown in Chart 2.4. The middle of 2007–08 is not the same as the middle of 2011–12.

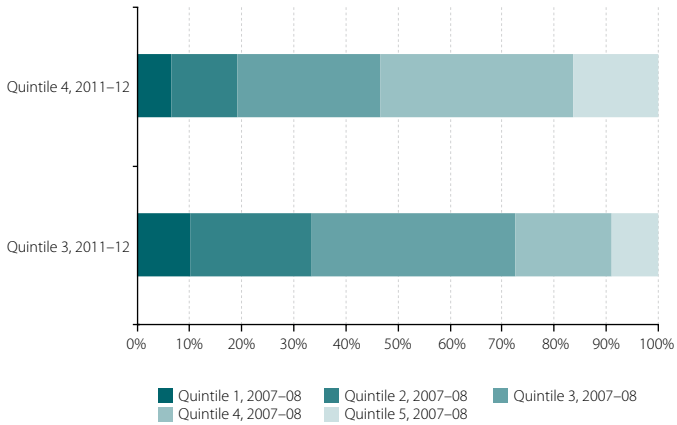
Chart 2.4: Where the 2007–08 middle and fourth quintiles went



SMF analysis of British Household Panel Survey, 2007–08, Wave 17; Understanding Society, 2011–12, Wave 3

In fact, one in 10 of those classified as being in the middle in 2007–08 made it all the way to the top quintile four years later, and 31% made it into the fourth quintile. 6% fell into the bottom quintile, but overall, the “climbers” from the middle income quintile outnumbered the “fallers”.

What of the households that were in the middle coming out of the downturn? The so-called “squeezed middle” of 2011–12 is a mixed group. Over a quarter were made up of households that used to be in the top two quintiles. But there has been remarkable upward movement too, with one in 10 of them coming from the bottom quintile, as shown in Chart 2.5.

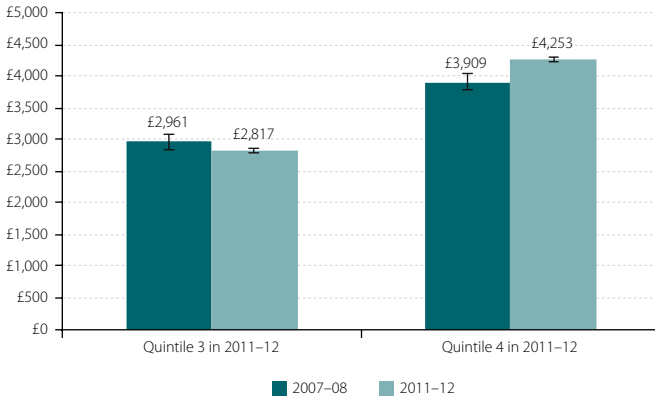
Chart 2.5: Where the 2011–12 middle and fourth quintiles came from

SMF analysis of British Household Panel Survey, 2007–8, Wave 17; Understanding Society, 2011–12, Wave 3

Overall, this combination of climbers and fallers means that those in the middle as of 2011–12 saw – *on average* – no significant change in income. It has become in a sense easier to enter the middle quintile: the income threshold is lower than it used to be. This means that although the climbers outnumber the fallers, the climbers did not require as big an income rise as they would have previously needed to be considered middle income. But as we shall see in the next chapter, employment played a significant part in helping households climb into and remain in the middle.

At first this may seem counter-intuitive given the fall in real income between the middle quintile in 2007–08 compared to the middle quintile in 2011–12. But this real income fall is a snapshot analysis, that does not reflect the fact that many of those in the middle by 2011–12 were not in the middle four years previously: they were the downturn’s success stories, moving up to the middle from the bottom quintiles. Tracking actual households over time allows us to better understand where the middle of today comes from, compared to a snapshot analysis. The households in the middle by 2011–12 were often the households that had seen improvements in their financial situation compared to the average.

**Chart 2.6: Original monthly income before taxes and benefits
(2011–12 prices)**



SMF analysis of British Household Panel Survey, 2007–08, Wave 17; Understanding Society, 2011–12, Wave 3

Error bars represent 95% confidence intervals

Quintiles are defined based on the 2011–12 income distribution. The chart compares the incomes of the same group of households in 2007–08 and 2011–12.

The rest of this report looks at how those in the middle today have coped with the downturn – how they have managed to maintain their incomes and keep a lid on spending during a time of rising prices.

3. COPING WITH THE DOWNTURN

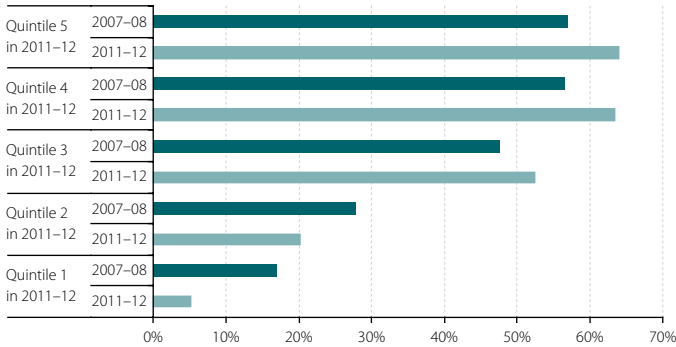
This chapter looks at how those in the middle today coped with the downturn, and how this affected their well-being.

KEEPING MONEY FLOWING IN

Those who were younger when the recession hit were more likely to have moved up to the middle quintile by 2011–12 – most likely due to the fact that they were on low wages at the start of their careers, and saw income increases as they progressed on. But this “career lifecycle” effect explains the smaller part of the change in households’ relative positions.

Employment – and especially employment of a second household member – is the main driver affecting a household’s position in the income distribution. Many middle income households in 2007–08 which lost a second earner fell down the income scale. In the group of households that climbed up from the bottom two quintiles into the middle, the proportion of double-earner households rose from 35% to 49%. In contrast the group that fell down from the top quintiles into the middle saw their proportion of double earner households drop from 72% to 62%.

Overall, one in 20 of those in the middle by 2011–12 had become a double-earner household over the preceding four years. The majority of these new second earners – two thirds – had full time jobs.

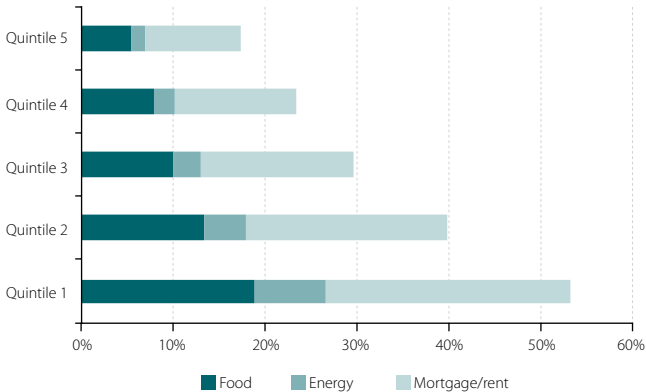
Chart 3.1: Proportion of households with two earners

SMF analysis of British Household Panel Survey, 2007-08, Wave 17; Understanding Society, 2011-12, Wave 3

KEEPING COSTS UNDER CONTROL

Essentials

Middle income households spend around 30% of their gross income on essentials – food, mortgage and rent, and energy. Mortgage and rent is the largest of these, and varies substantially across the UK. Those on middle incomes in the North East and North West spend about 15% of their gross income on these housing costs; in London, this rises to 22%.

Chart 3.2: Spending on essentials as a proportion of gross income, 2011-12

SMF analysis of Understanding Society, 2011-12, Wave 3

But during the downturn, middle income households have been protected from rising housing costs. Over half of these households own a house with a mortgage, and 15% own outright. Historically low interest rates mean that their housing costs have either remained steady or declined since 2007. The Bank of England base rate was over 5% in 2007; in contrast it has been 0.5% since 2009.

Where households have felt the pinch is on food. Food prices rose by 25% from 2007 to 2011 and the cost of meals from restaurants and cafes rose by 16%.⁷ However, middle income households cut back on expensive items and switched to cheaper ones, keeping the spending rise across groceries and meals to 10% – below inflation. Households that fell down from the top quintiles kept the food spending rise even lower.

They have also felt the pinch on energy. Whilst we cannot compare energy spend directly because of temperature differences in the two years we look at, we do know that the price of electricity, gas and fuel rose by 35% from 2007 to 2011, on the CPI measure of inflation. Data from the ONS (not specific to middle income households) suggests that spending increased sharply over the period 2007 to 2009. After 2010 total spending remained steady – but partly due to reduced consumption as a result of milder winters. More generally, over the past decade, households have been reducing energy consumption through energy efficiency measures and simply using less in response to higher bills.⁸

A similar story is apparent for transport spending, where costs have increased by around 24% over the period we look at, on the CPI measure of inflation. ONS analysis of general household spending

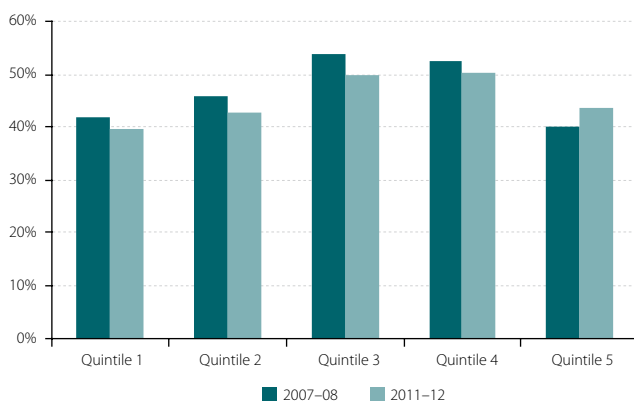
7 ONS, "Consumer Price Inflation Reference Tables", January 2014, <http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/january-2014/consumer-price-inflation-reference-tables.xls>.

8 Office for National Statistics, "Household energy spending in the UK, 2002–2012", 3 March 2014, <http://www.ons.gov.uk/ons/rel/household-income/expenditure-on-household-fuels/2002---2012/full-report--household-energy-spending-in-the-uk--2002--2012.html>

finds that spending on transport has seen a general decline over the past decade. This is likely to be at least partly due to consumers responding to higher fuel prices by cutting car use and switching to public transport; and switching to more energy efficient cars.⁹

In many middle quintile households, two adults go out to work. But with less income than the top quintile, middle income households are the most reliant on informal sources of childcare such as grandparents, as shown in Chart 3.3. Those on higher incomes, in the top quintile, are in contrast able to rely more on formal childcare.¹⁰

Chart 3.3: Proportion of households using grandparents for childcare



SMF analysis of Family Resources Survey 2007-08 and 2011-12

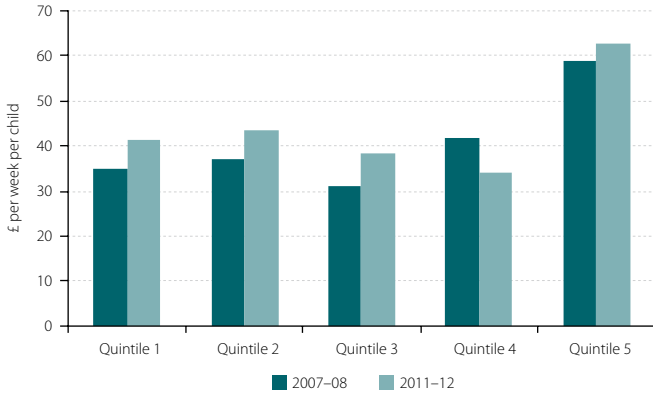
Whilst the proportion that rely on grandparents has slightly fallen since 2007, those who rely on informal care have been using more of it, at least in part due to rising childcare costs. The effect is most clear for those with children under the age of two. Charts 3.4 and 3.5 show trends in spending and hours used. Whilst parents in the middle quintile have barely increased the number of paid-for hours

⁹ Office for National Statistics, "Family Spending", 11 December 2013, <http://www.ons.gov.uk/ons/rel/family-spending/family-spending/2013-edition/index.html>

¹⁰ Note for childcare costs, we rely on FRS data. FRS does not follow households longitudinally. Comparisons are therefore made between quintiles as defined in 2007-08 against quintiles as defined in 2011-12.

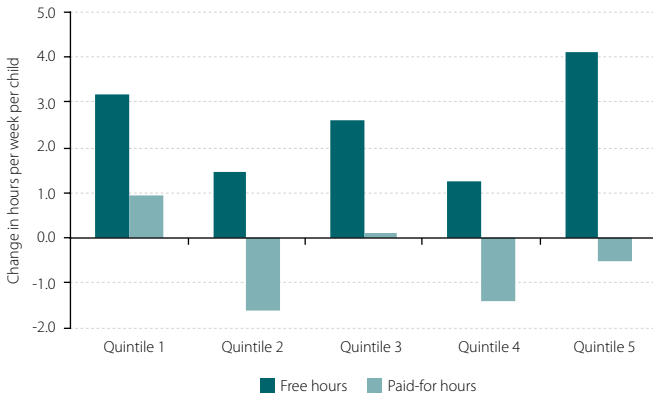
of care they use, they were paying 22% more for childcare in 2011–12 compared to 2007–08, in real terms. And research by the Family and Childcare Trust show that nursery costs for this age group have continued to rise.¹¹

Chart 3.4: Change in spending for children aged under two



SMF analysis of Family Resources Survey 2007–08 and 2011–12.

Chart 3.5: Change in hours of childcare used for children aged under two, 2007–08 to 2011–12



SMF analysis of Family Resources Survey 2007–08 and 2011–12.

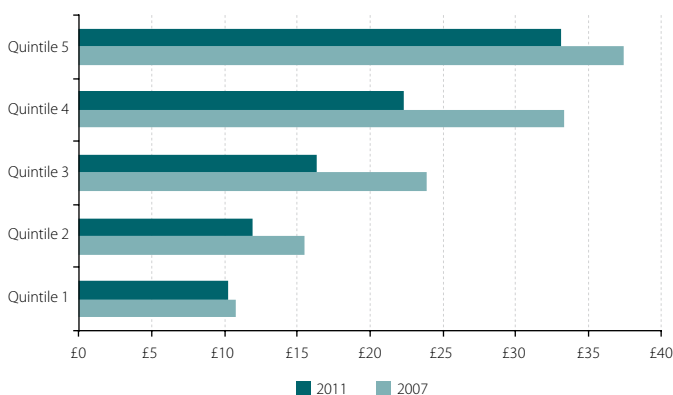
11 Jill Rutter and Katherine Stocker, *Childcare costs survey 2014* (London: Family and Childcare Trust, 2014)

Non-essentials¹²

Households have reduced spending on leisure goods but not leisure services. As shown in Chart 3.6, the drop in leisure goods spending has been especially sharp for the middle and fourth quintiles. In the case of leisure goods – which include products such as television sets, phones, newspapers, books, games consoles and DVDs – households have been helped by the fact that inflation has been relatively muted. Prices for audio-visual equipment for instance fell by more than 50% since 2007, general recreational items saw a price rise of only 1.5% over the period from 2007 to 2011, and other leisure goods saw a level of inflation in line with the general price increase of about 14% during that period.¹³

In contrast, leisure services – which include sports clubs, cinemas, live entertainment and leisure subscriptions and holidays – generally saw inflation above or in line with the average, making it harder to cut back, as shown in Chart 3.7.

Chart 3.6: Spending per week on leisure goods (2011 prices)

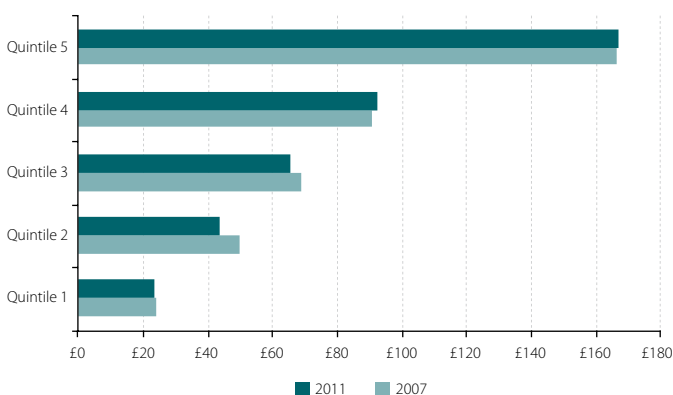


SMF analysis of Living Costs and Food Survey 2007 and 2011

¹² Note for leisure costs, we rely on LCFS data. LCFS does not follow households longitudinally. Comparisons are therefore made between quintiles as defined in 2007–08 against quintiles as defined in 2011–12.

¹³ ONS, "Consumer Price Inflation Reference Tables", January 2014, <http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/january-2014/consumer-price-inflation-reference-tables.xls>.

Chart 3.7: Spending per week on leisure services (2011 prices)



SMF analysis of Living Costs and Food Survey 2007 and 2011

THE FUTURE SQUEEZE

Overall, those in the middle today have been remarkably resilient in changing their spending habits to suit their means. But in a sense they are yet to be fully tested. Over two-thirds of middle quintile households are homeowners, and just over half have a mortgage. The high proportion of homeowners with a mortgage has helped middle income households so far; but this also means they will face rising costs when interest rates rise again.

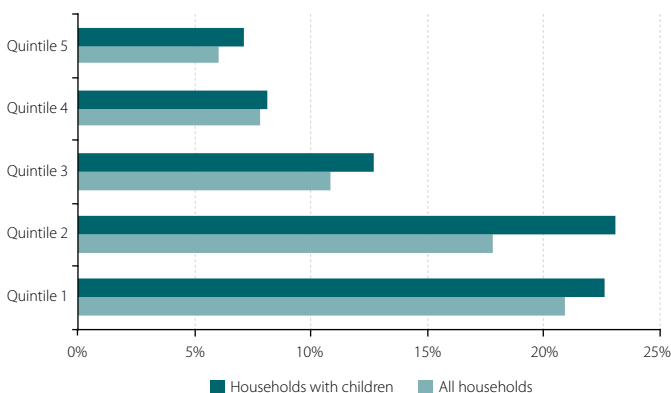
A key determinant of the impact of this squeeze will be how the Bank of England raises interest rates, and whether rates rise in tandem with income growth. Bank of England analysis recently showed that a rise in interest rates of 2.5 percentage points would increase the proportion of households with high repayments compared to incomes by 50% if incomes rise by 10%, and double the proportion if incomes remained unchanged.¹⁴ Within the middle income group, this squeeze is likely to affect 30–50 year

14 Philip Bunn, May Rostom, Silvia Domit, Nicoal Worrow, Laura Piscitelli, *The financial position of British households*, (London: Bank of England, 2013)

olds the most. This age group is more likely than older cohorts to own a home with a mortgage rather than own outright.

Even during this period of low interest rates, over one in 10 of middle income households in 2011–12 reported being behind on rent or mortgage at least once in the past year, with households with children under more pressure, as shown in Chart 3.8. Many of these households are likely to have a significant amount left to repay on their mortgages. Whilst data is not available on the middle quintile specifically, across all households, the proportion with high loan to value ratios was higher in 2013 compared to before the financial crisis. Just under a fifth have a loan to value ratio of over 75% on their outstanding debt.¹⁵

Chart 3.8: Proportion of households behind on rent or mortgage, 2011–12



SMF analysis of Understanding Society, 2011–12, Wave 3

Looking more widely, 8% of middle quintile households said they defaulted on a loan, bill, mortgage or rent in the past month.¹⁶ Middle income households have also – in part – been relying on

¹⁵ Philip Bunn, May Rostom, Silvia Domit, Nicoal Worrow, Laura Piscitelli, *The financial position of British households*

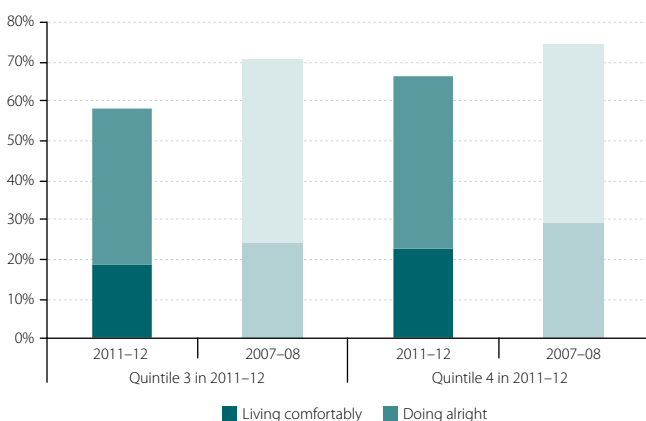
¹⁶ Which? "Consumer Insight Tracker", February 2014

credit to help fill gaps. 13% of middle quintile households took out a loan or credit card, borrowed from friends or family, or used an authorised overdraft in the last month.¹⁷

“ARE YOU BETTER OFF THAN YOU WERE FOUR YEARS AGO?”

Almost 60% of middle income households say they are “comfortably off” or “doing alright”. Having weathered the downturn reasonably well compared to other households, they are – on the face of it – fairly comfortable. But they certainly do not feel better off than they were back in 2007, as shown in Chart 3.9.

Chart 3.9: Proportion of households answering “How well are you managing financially?”



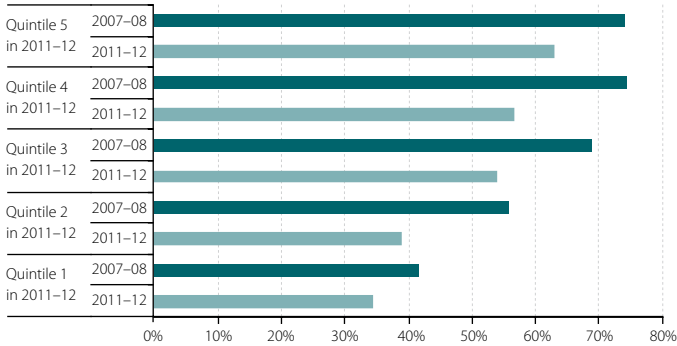
SMF analysis of British Household Panel Survey, 2007-08, Wave 17; Understanding Society, 2011-12, Wave 3. Quintiles are defined based on the 2011-12 income distribution. The chart compares responses of the same group of households in 2007-08 and 2011-12.

They are less satisfied with the amount of leisure time they have, and less satisfied with life overall. This pattern is hardly unique to the middle, as shown in Charts 3.10 and 3.11. But interestingly, our analysis shows that life satisfaction patterns do not change

17 Which? “Consumer Insight Tracker”, February 2014

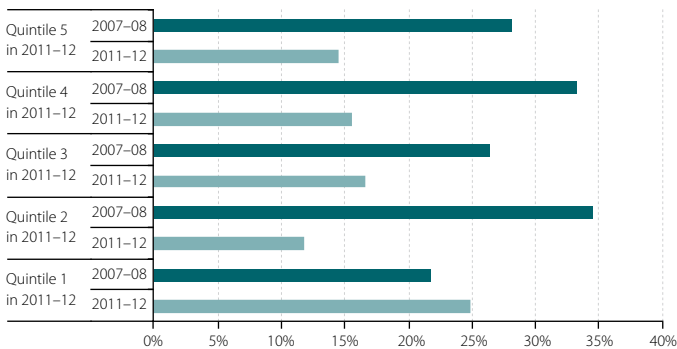
substantially depending on how middle income households' relative position in the income distribution shifted, indicating that feeling better off is not necessarily strongly driven by actual changes in income. It may instead be more related to prospects for the future: which in 2011–12 were likely to be looking gloomy compared to 2007–08.

Chart 3.10: Life satisfaction (proportion of individuals satisfied minus proportion of individuals dissatisfied)



SMF analysis of British Household Panel Survey, 2007–08, Wave 17; Understanding Society, 2011–12, Wave 3

Chart 3.11: Satisfaction with amount of leisure time (proportion of individuals satisfied minus proportion of individuals dissatisfied)



SMF analysis of British Household Panel Survey, 2007–08, Wave 17; Understanding Society, 2011–12, Wave 3

4. HELPING MIDDLE INCOME HOUSEHOLDS

Middle income families do not feel better off even though – in relative terms – they are generally the ones that have weathered the downturn well. They have kept their jobs and cut spending by switching to cheaper items and cutting back. But some of squeeze may be still to come. Depending on the recovery of real wages, many of these households could find it harder to manage their finances in the years ahead.

Despite widespread focus on the “squeezed middle”, in reality, these households are unlikely to see substantial additional state help in the form of tax breaks and credits, given the competing pressures on Government spending. But these households can be helped to do more of what they have already done well: shopping around, comparing prices and making their money go further.

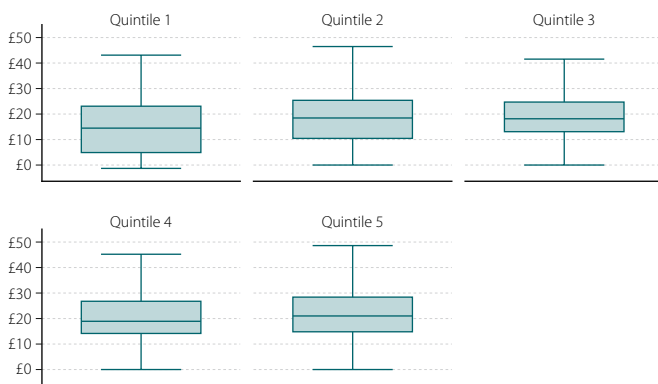
In markets where there is significant choice and competition, such as food, consumers have been able to manage price increases by changing what they buy and switching. In other markets, this is harder to do. In energy markets, despite bill increases, consumer switching has actually been falling since 2009.¹⁸ Whilst consumers have been saving money by using less energy, switching appears – in comparison – to be an untapped source for cutting costs.

Our data shows substantial variation in the amount spent per month on energy across households within the five quintiles, as shown in Chart 4.1. Variation is in part due to differences in consumption. But other statistics suggest that some households are not getting the best deal possible. Data from DECC shows that consumers could be paying anywhere between 12.79 pence per kilowatt hour to 18.69 pence per kilowatt hour for electricity depending on which tariff they pick and the payment method

18 Oliver Finlay, *Illuminating the energy market* (London: Social Market Foundation, 2013)

they choose.¹⁹ Even within regions, bill sizes can vary substantially depending on tariff.

Chart 4.1: Range in spending per week on energy across the quintiles, 2011



SMF analysis of Living Costs and Food Survey 2011.

Excludes outside values, based on ONS fuel, light and power variable

Financial services is another area where consumers are foregoing savings by not shopping around for the best deal. Around two in five savers earn interest of just 0.5 per cent or less, and one in five receive just 0.1 per cent or less a year.²⁰

So what can be done? In some markets, even where consumer engagement and switching is high, the market structure works to constrain the benefits of choice and competition. Car insurance provides a good example of a sector where consumers frequently compare prices and switch. But on investigating, the Competition Commission – now the Competition and Markets Authority – found that the way in which claims of drivers not at fault were settled by

¹⁹ Department of Energy and Climate Change, *Quarterly Energy Prices December 2013* (London: HMSO, 2013), Table 2.2.3

²⁰ Financial Conduct Authority, "Human Face of Regulation", speech by Martin Wheatley, 2013, <http://www.fca.org.uk/news/speeches/human-face-of-regulation>

insurance companies was driving up prices.²¹ Consumer action has its limits if markets are not functioning properly.

In other areas, helping consumers to get better value means helping them to do what they already do well in some markets, where prices and quality are easy to compare. Whilst in some markets, structural changes may be needed, evidence suggests that there are more gains to be made from helping more consumers to become more active.

COMPARING AND SWITCHING

In recent years, Government and regulators have moved to make switching quicker, easier and more convenient across a range of markets – energy, financial services and telecoms. This is a positive step. But the gains from making the process of actually switching smoother and faster are now close to exhausted. 85–95% of those who do switch providers – across a whole range of markets – say that the process was easy. It is only amongst those who have not switched that there are still perceptions that switching is difficult.²² Among the middle quintile specifically, the proportion that perceive switching to be easy is higher than average – across a range of products including banking and financial products, energy, telephony and broadband.²³

The big gains now are to be found in helping consumers easily compare the level of savings they can make by switching. In energy markets, for example, the strongest driver of consumer activity is the level of savings that consumers expect to make. Even perceptions of the expected length and difficulty of the switching process itself

21 Competition Commission, “CC seeks to reduce the cost of motor insurance”, 2013, <http://www.competition-commission.org.uk/media-centre/latest-news/2013/Dec/cc-seeks-to-reduce-the-cost-of-motor-insurance>

22 Ofcom, *The Consumer Experience of 2013* (London: Ofcom, 2013)

23 Which? “Consumer Insight Tracker”, January 2014

have little effect in preventing consumers from moving providers.²⁴ Government and regulators need to ensure that consumers have access to the right information to make choices, and that it is easy to use information that does exist to calculate likely savings from switching.

GIVING PEOPLE ACCESS TO THE RIGHT INFORMATION

A significant area of spending for many middle income families is on childcare. Websites exist that allow parents to search for nearby childcare options in their area, and compare Ofsted inspection reports where they are available. But comparing prices across different providers is much harder, making it difficult for parents to compare different types of childcare and decide which is best for their needs. Adding pricing data to the information that already exists on information such as Ofsted inspections could make the process of choosing childcare easier for parents.

In the context of middle income households vulnerable to increases in mortgage payments in the coming years, a key factor will be how the Monetary Policy Committee decides to raise rates. The Governor of the Bank of England has said when rates do rise, they will do so gradually.²⁵ The extent to which rates rise in tandem with wage growth will be crucial.

But beyond this, there are other ways to create more choice and ensure better value for money for consumers. There has been increased interest from the Bank of England in mortgages that would allow consumers to fix their rates for a longer period of

24 Miguel Flores and Catherine Waddams Price, "Consumer behaviour in the British retail electricity market", (University of East Anglia, 2013)

25 See, for example, Bank of England, "The economics of currency unions", speech by Mark Carney, 2014, <http://www.bankofengland.co.uk/publications/Pages/speeches/2014/706.aspx>

time, as is possible in other countries including the US.²⁶ Another way for households to manage the inevitable rate rises to come is to compare offers across mortgage providers to get better deals – whether on fixed or variable rates. There has been confusion among consumers recently over whether providers offering tracker mortgages are able to raise their rates in the absence of a Bank of England rate rise. Lack of transparency and simplicity around mortgage products will make it much harder for consumers to manage their finances when rates rise again. It is vital that banks and regulators ensure that there is sufficient clarity around these products so that consumers can make informed choices. Measures such as the implementation of the Financial Conduct Authority's Mortgage Market Review will help with this.

LIBERATING DATA

There is also much more to do on helping consumers easily manage their spending, compare products and pick the best deals using data that already exists.

Innovation in banking and use of financial data can play a valuable role here. Mobile banking innovators have already started to explore ways of using banking data to better help consumers understand and analyse their outgoings using transactional information on how they spend their money.²⁷ The midata initiative, which is designed to encourage companies to release consumer data such as usage statistics and the development of apps that make it easier to process this usage data and compare prices is also very promising step.²⁸ Building on midata, the proposal to include

26 Treasury Committee, "Bank of England Financial Stability report hearings", 2013, <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries/parliament-2010/bank-of-england-financial-stability-report-hearings/>

27 Cormac Hollingsworth and Emran Mian, *Branching out* (London: Social Market Foundation, 2014)

28 Department for Business, Innovation and Skills, "Providing better information and protection for consumers", 2014 <https://www.gov.uk/government/policies/providing-better-information-and-protection-for-consumers/supporting-pages/personal-data>



QR codes on energy bills could help dramatically increase the ease and convenience of comparing providers using the customer's own usage data.²⁹ Even larger benefits could come from services that analyse data across the market to show individual consumers how their spending compares to the average. For example, in energy markets, knowing how much more they are paying per unit consumed compared to other households in their local area could make the potential savings much more visible.

In some cases, the market will develop these new services and applications itself. But Government needs to remain aware of the fact that in other cases, relying on voluntary participation by companies will not be enough. The case of QR codes on energy bills is a recent example of where relying on voluntary action by energy companies has not worked, and Government is now consulting on modifying energy company licences to have QR codes included as part of energy bills.

There is likely to be a first-mover disadvantage from voluntarily participating in schemes such as the provision of QR codes and the midata scheme more generally. This is because the first company to release usage data to its customers is likely to be subject to more switching away to its competitors, creating a commercial disadvantage. Given this dynamic, there is a strong rationale to ensure that major players in the same industry act at the same time, whether this is achieved through voluntary agreement or compulsion.

Sectors where this scheme has the most beneficial applications are, firstly, ones where consumers tend to have ongoing relationships with suppliers, and therefore where it is highly likely that data is already being collected; and secondly, where data on

29 Department of Energy and Climate Change, "QR codes on energy bills put consumers in control", 2014, <https://www.gov.uk/government/news/qr-codes-on-energy-bills-put-consumers-in-control>

consumption or usage is needed to compare offers across different providers effectively. At the moment, Government is looking to ensure that customers of current account providers, mobile phone companies and energy providers benefit from greater access to data on their usage. The Treasury recently announced that the major current account providers will give customers their account data in a simple, standardised format that can be used in comparison sites.³⁰

But there are other products and services that the midata scheme could be expanded to. In telecoms, there are likely to be benefits from expanding beyond mobile phone companies. As mobile and landlines have increasingly become substitute products,³¹ it would be beneficial for consumers to be able to compare usage and tariffs across both the landline and mobile calls they make. Broadband is another service where consumers – if armed with better information on how much data they typically use – could make a more informed decision as to which broadband package and speed is best for them. Within the financial sector, information on a consumer's typical incomings and outgoings could help consumers better understand what types of savings products are right for them – for example instant access versus notice accounts and regular savings accounts versus those where the rate does not depend on how often money is deposited. Outside the regulated sector, supermarkets, especially those with loyalty cards, are likely to have a wealth of data that could better help consumers manage grocery spending.

JUST PUSHING DATA IS NOT ENOUGH

Policymakers should also learn the lessons from price comparison websites, which have made it easier to compare products, but

30 HM Treasury, *Budget 2014* (London: HMSO, 2014)

31 Ofcom, *International communications market report* (London: Ofcom, 2013)

do have limitations. Firstly, older consumers are less likely to use these sites.³² Secondly, there have been concerns about how well these sites capture data on actual pricing – as opposed to offering comparisons based on headline prices only, and whether in some cases conflicts of interest may mean that sites do not provide fully objective comparisons.³³ And thirdly, the effect of actively prompting consumers to compare prices should not be underestimated: consumers say that renewal notices for services such as car insurance act as a trigger for them to look at what other providers are offering.³⁴ Switching rates for car insurance are 36% – triple the rate for energy and seven times the rate for bank accounts.

Innovative applications are likely to play a significant role in making comparisons easier, and they may well also develop to act as prompts for consumers, for example by keeping track of usage and alerting consumers when deals that better fit their needs come onto the market. But where this does not happen, other measures need to be considered by Government, regulators and industry, proceeding through voluntary agreement, or compulsion if necessary. The model of renewal notices in car insurance offers a guide to what could work well for other sectors. Receiving a letter once a year as a prompt, especially if combined with an easy to use system of comparing offers using the consumer's own usage data could be very powerful.

Given competing pressures on public spending, providing substantial help to middle income households through tax reductions or more cash transfers is difficult. As recent analysis has shown, Government is still less than half way through its planned

32 Consumer Futures, *Price comparison websites: consumer perceptions and experiences* (London: Consumer Futures, 2013)

33 Financial Conduct Authority, "The FCA launches review into price comparison websites", 2013, <http://www.fca.org.uk/news/the-fca-launches-review-into-price-comparison-websites>

34 Consumer Futures, *Price comparison websites: consumer perceptions and experiences*

spending cuts.³⁵ But middle income households have shown remarkable resilience so far, demonstrating that under the right circumstances, and with the right information to hand they can manage their finances and cope with being under pressure. Food spending is one example, where they have shopped around to keep down costs in spite of rising prices. By equipping consumers to negotiate markets where it is currently harder to secure better value for money, middle income households can be helped to better manage their finances in the future. Making this happen will require action from Government, regulators and industry.

35 Institute for Fiscal Studies, "Still not halfway there yet on planned spending cuts", 2014, <http://www.ifs.org.uk/publications/7086>

ANNEX: METHODOLOGY

OVERVIEW

We use longitudinal data from the British Household Panel Survey (BHPS) and Understanding Society (US)³⁶ to follow specific households over time. We look at how households' position in the income distribution has changed, and focus on where the households currently in the middle and fourth quintiles have come from.

Our definition of quintiles is based on original income before taxes and benefits to understand underlying trends before government transfers, however, we take into account gross income including benefits when looking at the spending squeeze. We look at income, employment, spending patterns and leisure as indicators of how households have fared.

There are some areas where there is insufficient information in the BHPS and US surveys. We therefore supplement the BHPS/US analysis with additional cross-sectional analysis from the Family Resources Survey (FRS) and the Living Costs and Food Survey (LCFS), for data on childcare, leisure and energy. Because these datasets are cross-sectional, any changes over time are based on quintiles as defined in specific years, and do not follow households over time. Our analysis is based on data from the latest waves of each of these surveys, 2011–12 (BHPS/US and FRS), and 2011 (LCFS). We also use the FRS to show a snapshot of how the income distribution has changed between 2007–08 and 2011–12.

For inflation-adjusted comparisons, we use the Consumer Price Index.

³⁶ Understanding Society is an initiative by the Economic and Social Research Council, with scientific leadership by the Institute for Social and Economic Research, University of Essex, and survey delivery by the National Centre for Social Research.

ANALYSIS OF UNDERSTANDING SOCIETY AND THE BRITISH HOUSEHOLD PANEL STUDY

The main analysis presented in this report is based on data from two longitudinal datasets, British Household Panel Survey (BHPS) and Understanding Society (US). Beginning in 1991, the BHPS was a UK representative survey that followed the same set of individuals and households for eighteen consecutive years. The final wave of BHPS, Wave 18, was completed in April 2009.

Launched in 2010 as the successor to the BHPS, US is a UK representative longitudinal dataset that surveys the same individuals and households over time. Understanding Society incorporated almost 6,700 individuals that had previously been in the BHPS sample. In total, the latest wave of Understanding Society (Wave 3) contains data from 49,739 individuals and 27,783 households, and was collected between January 2011 and December 2012.

The first stage of our analysis focused on this sample of households from US. Of this sample, we excluded households that had at least one member of pensionable age (defined as 60 for women and 65 for men), as our analysis is focused on the working age population only. Accordingly, approximately 33% of the original household dataset was excluded and the resultant dataset was composed of 34,656 individuals from 18,518 households.

When we conducted our analysis, derived data on original income before taxes and benefits was unavailable. We therefore constructed our own original income variable by subtracting household monthly benefit income from the state from monthly gross household income. We used this original income variable to construct our income distribution and assign income quintiles to the households in our dataset. We then analysed household and individual characteristics within these groups to produce top-level



statistics on what middle income households looked like in 2011–12 and how they differed from households in other quintiles.

For the second stage of our analysis, we tracked households over time, comparing their situation in 2007–08 against that in 2011–12. Specifically, we matched households from Wave 17 of the BHPS to households in Wave 3 of US. We excluded households that split. We also excluded any households that contained an individual of pension age in either one of the two waves to avoid picking up any trends related to entering retirement. The resultant sample consisted of 3,166 successfully matched households with 5,931 individuals.

As with the US dataset, we allocated households a quintile based on the income distribution in the BHPS 2007–08 dataset. This meant that each of our matched households had two quintiles associated with them – one for 2007–08 and one for 2011–12.

In analysing characteristics across the two years, we made the following decisions to allow comparability:

- Food: In contrast to US, BHPS denotes household expenditure on food in ranges. We convert expenditure ranges to actual monetary values by taking the midpoint of each food expenditure band. To make food expenditure in BHPS comparable to US, we derived variables in US and BHPS that captured monthly expenditure on food and groceries as well as food bought outside the home. This required summing the two food variables in US, monthly household expenditure on groceries and monthly household expenditure on food bought outside the home (including restaurants and takeaways) respectively. For BHPS, we aggregated monthly expenditure on food consumed in the home and household expenditure on food and groceries including takeaways.
- Energy: In both BHPS and US, household expenditure on

gas, electricity and other fuels are separate variables. We generated a new variable that aggregates each component of energy expenditure to obtain an estimate of household total expenditure on energy in the previous 12 months.

- Mortgage and rent: In both US and BHPS, mortgage paid is a variable in monthly terms whilst rent paid is a variable that covers a range of time periods. Accordingly, we transformed this rent variable to monthly terms using variables detailing amount of rent paid in last instalment and weeks covered by rent paid. We then generated a new variable that captures both monthly mortgage and rent paid in last month.

ANALYSIS OF THE FAMILY RESOURCES SURVEY

The Family Resources Survey (FRS) is a cross-sectional dataset used for the analysis of household incomes, inequality and household expenditure. For the analysis in this report we used data for the years 2007–08 and 2011–12 for childcare expenditure patterns and for the analysis of general patterns in the change in the income distribution between 2007–08 and 2011–12.

The total sample size of the survey is 20,759 households for the year 2011–12 and 24,977 households for the year 2007–08. We excluded households that had at least one member of pensionable age (defined as 60 for women and 65 for men), as our analysis is focused on the working age population only. This left a sample of 16300 households for 2007 and 13581 households for 2011.

We used the FRS to show how the UK's income distribution profile changed between 2007–08 and 2011–12. To do this, we constructed household original income (before taxes and benefits) to assign quintiles. We did this by aggregating gross income from employment, self-employment, investment income, and other non-benefit income.

We also used the FRS for data on childcare. About 55% of households did not contain any children (stable for both waves of the FRS we looked at), so our analysis of childcare usage and childcare expenditure was based on about 7,340 and 6,200 households in 2007–08 and 2011–12, respectively. We then computed the average childcare cost by quintile and number of hours used, both of free of charge childcare and of paid for childcare, per child for different age groups. This calculation was based on summing expenditure across different types of childcare for each child within the dataset, as well as the number of hours used of both informal and informal childcare.

ANALYSIS OF THE LIVING COSTS AND FOOD SURVEY

The Living Costs and Food Survey is a cross-sectional dataset collecting information on the expenditures of households in the UK. It has been collected since 2008 as a replacement to the Expenditure and Food Survey.³⁷ The survey had a sample size of about 5700 households in 2011, and about 6100 in 2007. For this report we have used data on expenditure on leisure goods and services, and expenditures for internet and fuel.

As with the FRS, we excluded households with members of pension age, leaving around 4,000 households in each year we analysed. We grouped households into income quintiles using the same methodology as for the FRS, first constructing an original income variable including wages and earnings income, income from self-employment, investment income and other sources, plus income from private pensions.

Analysis of the expenditure on leisure goods and services and sub-items within this group were then performed by computing weighted averages across quintile groups.

37 For more information see UK Data Service, <http://discover.ukdataservice.ac.uk/series/?sn=2000028>.

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In the years since the financial crisis, working age households have seen wage stagnation and rises in the cost of living, prompting widespread focus on the so-called “squeezed middle”. This report looks at the reality of middle income households coming out of the downturn – using the British Household Panel Study and Understanding Society to track specific households over time.

Middle income households have shown remarkable resilience. Many have taken on more work and increased their incomes. There is a surprising amount of movement across the income distribution, with many climbing up. Middle income households have also shopped around and cut back to reduce the effect of rising prices.

But for many of these households, the squeeze may be yet to come when mortgage rates rise again. And in some markets it is much harder to compare products and secure value for money. With competing pressures on public spending, these households can nevertheless be helped by supporting them to do what they already do well – shopping around, comparing prices and switching.

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