abrdn Financial Fairness Trust

Addressing the needs of financially squeezed households above the poverty line

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Introduction

The impact of today's living standards crisis is felt across most of society. With energy, food and other bills rising much faster than incomes, people already in poverty face the risk of severe material hardship, including cold and hunger. In addition, many more households from across the income spectrum are having to cut back on consumption, as real incomes fall. For some who are well off, this may mean giving up non-essential things, like an additional holiday. Yet for others, with below-average but not the lowest incomes, it may mean neglecting material and social needs. From April 2023, for example, some members of this group face energy bills over twice as high as in 2021, but receive no help from the government in meeting them.

The evidence shows that both financial difficulties and material hardship are spreading up the income scale. While the consequences of today's crisis are clearly worst for those in poverty, newly analysed data from the Financial Impact Tracker survey run by the Financial Fairness Trust suggests that over one in five people up to around median income are being badly hit, double the rate before the crisis. These results are summarised later in this paper.

Such findings must be seen alongside the wider challenges facing people whose incomes are too high to benefit substantially from targeted support, but not high enough to sustain a decent living standard, or too unstable to guarantee it over time.

For such individuals and households, the erosion of real income through inflation is only one of many factors that undermine stable and decent living standards and reduce financial security. Others include the inaccessibility of home ownership (or, for many, a social housing alternative), the inadequacy of investment in their pensions, the precarity of work and the soaring cost of childcare. While the immediate living standards crisis may prove relatively short-lived, these wider influences are causing a financial squeeze for many on middle incomes, of which the difficulty in coping with the current crisis may just be a symptom.

Nearly thirty years ago, Will Hutton (1994) described a society where, in between the upper 40% of the population, whom he labelled as "privileged" and the bottom 30% described as "disadvantaged and marginalised", the middle 30% were characterised as "insecure". In the 2010s, the "squeezed middle" was identified as a struggling group with below-median income missing out on public support, and later, Theresa May championed a "just about managing" group with some overlapping characteristics.

Two difficulties with such characterisations from the point of view of policy actions is that they are very broad and that they can be vaguely defined. The Resolution Foundation describes its interest in "low to middle" income households as covering those that have someone in work but have below median incomes. Some of these households are significantly below the poverty line; others close to average income. The issues they face range from staying afloat and avoiding debt to more "aspirational" goals including social mobility. Theresa May cited "paying your mortgage", "job security" and "getting your kids into a good school" as concerns of people who are only just about managing, yet these challenges are also felt by many with above-average incomes. The term "low to middle income", which broadly describes the groups of interest to abrdn Financial Fairness Trust, has also commonly been used in the present crisis to describe households hit hard by the rise in living costs. However, there is no clear-cut framework of policy responses to their situation.

Yet there are good reasons for wanting to address the needs of such households more systematically. For politicians, these often focus on the electoral importance of the support of millions of voters who are not in poverty but feel left behind by economic growth, particularly those in certain key swing constituencies and in areas of the country such as northern and coastal towns that appear to have fallen behind. Beyond such electoral considerations, there is an underlying issue about where to target state help. The tax credit and Universal Credit systems have accepted, for example, that redistribution to low-income families should not only be focused on those without work, but also cover working families a considerable way up the income scale. But how sharply that help should be withdrawn as earnings rise requires a view of at what income the state should no longer be concerned about protecting families against the consequence of insufficient income. It also requires a view on whether helping some people who are not presently in hardship is worthwhile as a preventative strategy to help them avoid falling into a cycle of poverty and debt. Prevention can also reduce future government obligations, for example for people who may otherwise fall back on means-tested benefits. Questions about whom to help can also be asked about other areas of policy including for example housing, where various forms of state intervention, ranging from help-to-buy to policies promoting affordable rents, can potentially help those unable to access decent homes entirely through their own means in a free market.

It is important that decisions about whom to help should be evidence based. The state should care about helping groups whose limited means put them at risk of financial strains or hardship that society considers to be damaging.

This paper therefore suggests a clearer basis for considering how people on a wider range of incomes than previously supported may need help from the state – albeit at a less intensive level or in different forms than may be needed by households in poverty. It does so first by considering evidence that people on modest but not very low incomes are facing difficulties, using new evidence from the current cost of living crisis. It then considers a range of areas of policy in which such extra help may particularly address this group's needs. The idea is not to produce a manifesto but a framework for bringing the needs of this group into sharper focus.

Terminology

A non-trivial difficulty with such exercises is finding the right terminology for the group in question. While in principle imperfect labels do not have to be taken too literally if well defined, in practice the term used may influence the meanings that commentators and the public assign to it. An important problem with the "squeezed middle" in this respect was that, in a society where nobody likes to admit to being "poor" or being "rich", most people tend to think of themselves as being in the middle. Consequently, the discourse sometimes related to concerns of "middle class" families, which could be fundamentally different from those struggling to get by in low-paid and insecure employment. Similarly the use of the term "low to middle incomes" to describe those impacted most by the current cost of living crisis could refer to up to two thirds of the population if society is divided into three equal- sized income groups of low, middle and high.

There are no perfect solutions to this, but one useful formulation, used below, is the term “financially squeezed”. This describes a group who are squeezed in two ways. One is the squeeze originally referred to in the term “squeezed middle”: people whose earnings are too high for them to get a large part of their income from the state but not high enough to produce a decent living standard without such help. The other is that competing demands undermine financial well-being, defined by abrdn Financial Fairness Trust as:

> “…the ability to meet current financial commitments and needs comfortably (having enough income for more than life’s essentials) and the capacity to do this in the future (including the ability to deal with financial shocks), resulting in feeling financially comfortable and secure."

In this sense, financially squeezed households are unable to meet all of these conditions simultaneously - for example, in order meet everyday needs they are unable to save and provide financial security for the future.

A more specific definition is also needed, to distinguish this group from those on lower and higher incomes who are also facing various pressures. The following may be a useful way of defining this group.

Taking into account household composition, households face a financial squeeze if their incomes are at levels:

- Significantly above the poverty line, or some other threshold prioritised for help.
- Associated with substantially increased risk of financial strain and/or material hardship compared to people in the top half of the income distribution.
- Associated with long-term uncertainties related to key determinants of living standards including job security, housing security and pensions security.
- Associated with significant constraints on people’s opportunities, for example their ability to save and to develop their careers.

Financially squeezed households and four key areas of public policy addressing constraints on living standards

Poverty is traditionally used as a term to describe situations where people’s financial resources are insufficient to meet their needs. Yet both financial stress and material hardship clearly exist on a continuum. In the UK today, while some people have difficulties meeting the most basic human needs such as putting food on the table, a much wider number have difficulties meeting a range of material and social needs on an ongoing basis. Research into a Minimum Income Standard (Davis et al., 2022) shows that members of the public have a well developed concept of what you require as a minimum both to meet material needs and to have the opportunities and choices required to participate in society. Even households who at a point in time may have sufficient income to meet such a standard may have so much instability and uncertainty in their lives that they lack the security of knowing that this can be sustained over the longer term (Hill and Webber, 2022).

The following discussion considers four important areas in which public policy can potentially help improve the lives of financially squeezed households: support for incomes; work and childcare; housing; and lifetime assets and indebtedness. A key aspect of the financial squeeze on families above the poverty line but with below median incomes is that it is hard to meet expectations in multiple areas simultaneously – such as being able to afford decent housing while still saving for retirement, paying off student debt and meeting everyday spending needs.

In each of the four areas, financially squeezed households are presently facing significant difficulties and risks, which could potentially be mitigated by public policy – albeit with less intensive intervention than is needed by households in poverty. The following is not intended to be a comprehensive list of such policy themes. However, they are some key determinants of the well-being of people on such incomes. Moreover, unlike say health, education and transport, much state intervention in each of these areas has focused on targeting worse-off households (albeit with some more "universal" elements such as the state pension and child benefit, which remain available for the great majority of families). This raises issues about how far up the income scale this help should be available. Moreover, the constraints on people's ability to access decent incomes, rewarding employment, adequate housing and sufficient savings for pensions are all closely linked to each other, as is clear from the following analysis.

Support for incomes

In the years immediately after the Second World War, the main mechanism for sustaining adequate incomes at acceptable levels for working-age people was the pursuit of full employment. Social security protected them from loss of income in periods of unemployment and sickness, and family allowances provided some extra help, regardless of income, towards the cost of bringing up children (but no additional support was targeted at low income working families). Today, in contrast, Universal Credit, like the tax credits that preceded it, works on the assumption that pay alone is often not enough to provide workers and their households with a decent income, and that universal child benefit is not enough to meet the needs of children in low-income families. At present, around half of children live in families receiving either Universal Credit or tax credits, mostly with at least one working parent. This support is a response to huge changes in labour markets and family structures which mean that "working households" come in many shapes and sizes, with aspects such as part-time or sporadic work, lone parenthood and high childcare costs constraining net household earnings.

But who needs this help, and how much? While policy details such as income disregards and taper rates can seem highly technical, they are crucial in determining how much help people on different incomes can get from the state, if any. For many working families entitled to Universal Credit, once the income taper is applied, the entitlement is quite low.

There is in fact no well-formulated rationale for how soon or how quickly support is withdrawn with rising earnings, which result rather from ad hoc public policy decisions. This suggests that we need a more open and evidence-based debate about which income groups are facing substantial enough challenges making ends meet that they require significant extra help from the state. In the current cost of living crisis, this issue has come into sharper focus for two notable reasons.

First of all, the evidence is that the number of people facing a financial squeeze, with incomes significantly above the poverty line but still risking serious financial strain or significant material hardship, has increased substantially. Evidence from the abrdn Financial Fairness Trust's financial impact tracker, shows, for example, that among the one-fifth of households with below median income (i.e. between the 30th and 50th percentiles):

- Over one in five (21%) were in" serious financial difficulties"[1] in October 2022, twice the rate a year earlier.
- This risk was over twice as great as on average for someone in the top half of the income distribution (9%).
- Pressures on this group's spending affected their ability to meet their most basic needs. One in four (26%) of this group said they were struggling to pay for food and other essentials.
- Respondents in this income range reported widespread negative impacts on their living standards. Half had cut back on holidays and on saving and said the cost of living affected their ability to keep their homes warm and comfortable. Over one in six (18%) reported an effect on the number of meals they eat.

1 Defined as having a low composite score on seven survey questions that cover the extent to which households could meet their financial obligations and the resources they had for dealing with an economic shock. See Kempson, Finney and Poppe (2017) Financial Wellbeing: A Conceptual Model and Preliminary Analysis.

These pressures on households just below the median are not necessarily "typical", in that they are occurring at an unfavourable point in time, where inflation has recently exceeded household income growth. However, the effect that this has had on these groups suggests that they are exposed to the effects of hard times more than might have been assumed – a significant proportion have been unable to absorb the shock to living standards, for example by drawing on savings or reducing discretionary spending. It is also important to point out that even above the median, significant numbers are experiencing greater financial stress. For example, in the sixth income decile (from the median to the 60th percentile of income), 15% were in severe financial difficulty and 27% were behind with at least one bill in October 2022. The issues discussed in this paper thus affect those around the middle of the income distribution, not all of them below the median.

A second reason why the situation of households with incomes close to the median is coming into sharper focus regards the issue of what level of income should qualify for means-tested support through Universal Credit. This has acquired added importance because of the way that additional support through ad hoc "cost of living payments" have been structured. For simplicity, and with some justification, the greatest level of support, linked to higher energy costs in particular, has been given to those already receiving a means-tested benefit such as UC.

This is a quick and efficient way of identifying those with the greatest need without carrying out any additional income assessment. However, such rough and ready methods could potentially become more than an emergency response, if they are used regularly to fine-tune social security entitlements. The Chancellor has already announced a second year of such support, restricting it entirely to those on qualifying benefits. This is problematic partly because the flat-rate amount (£900 in 2023/24) is not sensitive to household size and thus to the level of need. An additional difficulty, particularly important to households on below-average but not the lowest incomes, is that the amount only goes to those who already qualify for UC under the existing means test. Unlike the £20 a week uplift in standard rates of Universal Credit during the pandemic, it does not enable more people to qualify.

The consequence of this is to create a cliff-edge, whereby someone with just too much income to qualify will end up significantly worse-off than someone whose income is just low enough to get a very small UC award. As an illustration, a family with combined income entitling them to £55 a year in Universal Credit will also receive £900 including the cost of living payment; but if their post-tax earnings were to rise by £100 a year, the 55% taper would reduce their UC entitlement to zero, and they would not receive the £900, making them £855 a year worse off overall as a result of raising their earnings (since they would gain £100 from the pay rise but lose £55 in UC plus £900 in cost of living payments).

The exceptional nature of the current cost of living crisis makes it hard to predict whether such policy measures will indeed become a permanent part of our system. However, this episode has illustrated the risk of policies that may fully exclude those on limited but not the lowest income from any help, while the evidence outlined above shows how those affected may well risk hardship. Other policies may potentially dovetail with direct financial help for people on Universal Credit to intensify such cliff edges. For example, there have been calls for greater energy discounts for those on low incomes through social tariffs: these could either replace or supplement cost of living payments if energy bills remain high. Social tariffs for other essentials such as broadband could also be extended.

One hazard of having introduced Universal Credit as a single main means-tested benefit for working age adults is that it could be used to access so many different entitlements that this creates a single very large cliff-edge. Nowhere is this greater than for families with children in Scotland, who receive the Scottish Child Payment of £25 per child, per week if they are on Universal Credit, but lose it the moment they come off UC. For a Scottish family with two children whose earnings rise just to the point where UC entitlement reaches zero, this adds a further £2,500 a year in abrupt reduction in income in the illustration given above. One alternative approach is to build all such income entitlements into UC itself, so that they are incorporated into the amount that is tapered, rather than disappearing abruptly once other UC entitlements run out.

A further hazard of making UC the passport to most forms of help is that those disqualified by its savings limits can be excluded from all benefits – even though they may still face hardship as a result of low income.

Work and childcare

The phenomenon identified by Will Hutton three decades ago, of a large section of the working population lacking security or stability, has taken new forms in the age of zero-hours contracts and growing self-employment, and remains a key issue for financially squeezed households. This insecurity can be a barrier to saving for the long term, and in some cases cause some households to dip in and out of poverty. Of course, some well-off people experience insecurity and some people work in stable jobs on relatively low incomes. However, unlike better-off groups, those on relatively modest incomes typically have few if any savings and income or significant “discretionary” spending that can be reined in, making the consequences of instability more serious. Access to stable and flexible work with opportunities to progress is arguably the single most important factor that could improve the lives of such households.

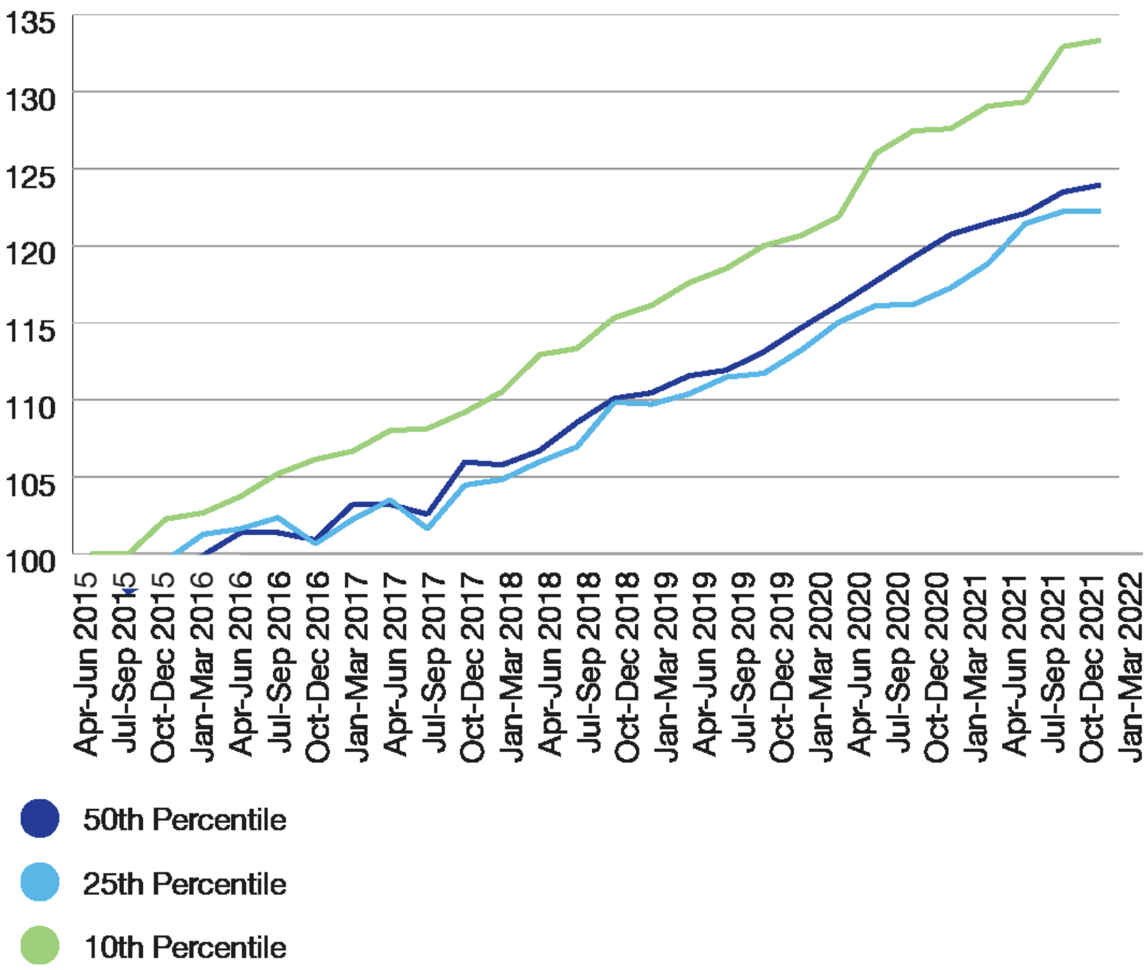
There are many aspects of the work environment and opportunities that could be improved. Particularly important for financially squeezed groups are:

- The conditions under which people are employed or contracted if they are not in career jobs. It would be unrealistic to hope for a return to an age when work was dominated by full-time stable employment (which was largely male); rather, policy can help to improve conditions in the situations in which people work today. Improved employment rights in non-standard employment is an important part of the policy agenda. The rights and entitlements of self-employed people could be improved. People who work irregular or part-time hours could be given greater agency over their working patterns.

- Opportunities to work and fulfil family responsibilities. This requires those with restrictions related to health, disability and caring roles to be able to work flexibly and with appropriate support. A particular barrier remains a lack of adequate, affordable childcare. For many middle-income households even in well-paid jobs, footing the cost of childcare can mean a parent gains little in net terms from working when their children are very young, but they may still choose to work to maintain a career in this period. For households with more modest earnings potential, the reality is often that if a parent does not have access to free family-provided childcare, they simply cannot afford to work when their children are young. The extension of a 30-hours a week free childcare entitlement in March 2022, available to all households other than where someone earns at least £100,000 a year, could make a major difference to these families, provided that the supply of places and subsidy levels are sufficient to make this free offer a reality. This is a good example of a decision by government to extend help to people on a wide range of incomes, rather than restricting it to the worst off.

- Opportunities for progression. Many people in poorly paid jobs feel trapped with little opportunity to move to better employment. The theory that the labour market has “hollowed out”, eliminating intermediate jobs in favour of high-level and low-level ones, is not fully supported by the evidence. What is more clear-cut from the long-term evidence is that the proportion of professional and higher-skilled jobs has increased, that the pay penalty for not accessing them has become greater and that those with low educational qualifications find it hard to do so. This means that even though jobs in the “middle” (neither routine nor professionals/senior managers) continue to exist, such as supervisory jobs, they may not pay much more than routine ones. One possible unintended consequence of a focus on minimum pay is that, while the minimum wage has increased relative to the median since it was rebranded the National Living Wage in 2015, wages at the 25th percentile have not – as shown in the graph below. This suggests significant compression of wages within the lower half of the pay distribution. One policy implication is that a higher pay floor does not replace the need for measures to provide better quality jobs that workers are able to progress to, or to help them acquire the skills and competencies that aid such progression. Another policy issue raised is whether steps could be taken to maintain wage differentials that reflect such progression within particular industries, for example through wages councils.

Change in hourly pay by percentile, 2015-22. April-June 2015 = 100
Source: ASHE



- Opportunities to sustain employment in later life. As noted below, people on below-average incomes are finding it harder to acquire the pension and housing assets that will enable them to achieve acceptable living standards in retirement. For this group, a crucial factor will be the timing of retirement. In a future dominated by defined contribution pensions, the longer that people continue to earn, allowing their investments to build and shortening the period that they need to be drawn down, the smaller the risk that pension income will fall short of needs or expectations. Having choices about how much to work during this period will, like opportunities to work part-time and to use affordable childcare, help give people agency over the right balance between earnings from work and the benefits of leisure.

Housing

Access to stable and affordable housing now varies greatly not just across income groups but also across age cohorts. Only just over a third of people now own their homes by their early 30s, compared to nearly two-thirds in 1990. For people near the middle of the income distribution, home ownership aged 25-34 dropped from over half to around one in four in the same period (Corlett and Odamtten, 2021). These dramatic changes mean that while people with lifetime incomes between the 30th and 50th percentiles could realistically aspire to be home owners in the 1980s and 1990s, those presently aged under 40 may well be tenants for their whole lives. This is not historically unusual, since up until about 1970 only a minority of people owned their homes. But in the immediate postwar period, large-scale expansion of social housing had helped improve conditions among tenants in a way that has not been repeated in the intervening period.

Recognising this change fully requires a massive rethink of policies affecting access to affordable and stable housing. In the 1990s, it was assumed that about two thirds to three quarters of people would be home owners, with social housing (then about 20% of tenancies) providing for most of the rest, with a small private rented sector providing for under 10%. Today, nearly a quarter of non-pensioners rent privately, rising to nearly four in ten 25-34-year-olds, and social renting provides for only about one in six of each of these groups. With households on the lowest incomes most likely to access social housing, those on modest incomes depend heavily on private renting as the dominant tenure.

In this context, measures to improve access to social housing or to owner occupation are likely to have only limited benefits to people on modest incomes – with the former being prioritised for the many low income households who require it, and the latter being too expensive in many parts of the country, even with help-to-buy subsidies. Policy solutions therefore need to address the needs of private tenants. Since some people on modest incomes, especially families with children, receive Universal Credit, means-tested benefits can be part of this. The key issue here is that most claimants' rents are above their local housing allowance, limiting the support available, and measures to address this would help. But more broadly there is also a need to address the high-rent, low security environment presently provided by this sector. The issue of security has already been put on the agenda through planned legislation banning no-fault evictions. While full-scale regulation of rents through rent controls is highly unlikely in the foreseeable future, regulation of tenure security is necessarily linked to constraints on rent increases (since otherwise a very sharp rent increase can be used as a de facto eviction tool). The Scottish Government has recently capped rent increases, and the UK government's plans include new protections against unfair rent rises.

Lifetime assets and indebtedness: student loans and pensions

Ideally, individuals and households should be planning for the long term when thinking about their living standards, rather than just surviving day to day. In recent years, people have been encouraged to invest in themselves by borrowing money to acquire educational qualifications, and to invest in pensions from an early stage in their working lives in order to secure decent pension incomes. While many other aspects of savings, assets and debt contribute to financial well-being, these are two long-term aspects influenced heavily by government policy, and which potentially contribute substantially to the level of regular payments made by financially squeezed households.

The taking on of student debt should, in principle bring net gains to individuals over their lifetime, since they are only paid off when earnings rise about a certain level, and it is assumed that additional earnings are associated at least in part with the higher qualifications gained. A key problem with this, however, is that repayment terms are constantly being changed. For example, despite originally having promised to earnings-uprate the earnings threshold above which 9% of income is repaid, the government has now frozen this threshold, meaning that the proportion of income repaid will rise. It has also extended for new students the period that repayments are levied before the loan is written off. For the lowest earners, this will not matter because they still fall below the threshold. High earners can expect to pay the loan off relatively quickly. But for middle earners these changes greatly increase, over a working life, the amount of earnings exposed to an additional 9% tax rate.

In recent years, the minimum state pension for someone with full contributions has increased substantially, providing a better baseline for building adequate retirement income. However, this still leaves pensioners short of meeting their minimum needs without private pensions to top up the state pension. Salary-based pension schemes have declined, and the money invested in most auto-enrolled pensions is much lower than is needed for a decent pension. For workers around the middle of the wage distribution, fewer than one in ten are meeting a contribution benchmark projected to attain a "living pension" (Cominetti and Odamtten, 2022).

The following graph shows a very stark contrast in this respect between the situation facing those with substantial earnings and those who have been on out of work benefits for substantial periods of time. For the latter, weekly income rises rapidly at the point they reach pension age, although it still remains about £30 a week short of meeting minimum needs according to the Minimum Income Standard. In contrast, for anyone retiring from a job with median earnings the state pension on its own will bring income from above to below what is needed. In all the cases shown, some private pension income is required to provide a dignified standard of living, but for those with more adequate previous earnings, the reduction in living standard without these top-ups will be greater.

Source: minimumincome.org.uk.

Notes: All cases assume private renting. For working age unemployed case, partial contribution to council tax and to rent (based on estimated LHA shortfall) bring net income to below standard Universal Credit entitlement. Pensioner calculation assumes full contribution record.

An important feature to note in these calculations is that they are based on private renting, and the assumed income on a state pension includes nearly £100 a week in Housing Benefit. This amount reduces by 65p for every £1 of private pension income, while council tax support reduces by 20p. These clawbacks mean that even to make up the £30 shortfall in minimum income, about £8,000 a year private pension is needed.

The interaction between housing and pensions for people retiring on below-average incomes in the future will thus be important. Renting rather than owning pushes up costs; the state helps cover these costs for those with the lowest incomes, but someone with modest pension savings may be not much better off as these benefits are sharply withdrawn. Those with enough pension provision to provide a moderate or comfortable income will avoid such traps. Those who have had only modest incomes in working life are unlikely to have built up that amount of pension savings. Thus, in the journey to retirement, as in the journey through working life, financially squeezed households face serious constraints in their ability to improve their lives and achieve long-term security.

Conclusion – taking account of financially squeezed households in public policy

This paper has shown how households who are closer to the middle than the bottom of the income distribution can face a financial squeeze preventing them from attaining secure access to a decent standard of living. This creates a case for using public policies to alleviate this squeeze and promote greater security. The case may emanate partly from society's belief that such outcomes are desirable in their own right, and partly in order to prevent worse outcomes in cases where, for example, households run up unsustainable debts as a result of the pressures outlined above.

The extent of direct help for households on middle incomes will depend partly on broader attitudes towards the social settlement between groups on different income levels, mediated by the state. In an uncertain world where people's incomes vary over time, broad-based state support that is not just targeted at the poorest may be seen as being in everyone's interests. Nevertheless, finite public resources need to be targeted wisely in ways that can best help alleviate the financial squeeze, especially at times of life when needs are greatest – for example by enabling parents with young children to work by supporting childcare. Some measures, such as those that promote better housing and job security, or require employers to contribute more to worker pensions, may not require major additional public resources. In other cases, such as setting the terms on which student loans must be repaid, financial fairness to people facing a financial squeeze may come at some public cost – in this case resisting the temptation to save public money by making graduates pay more. The argument of this paper has been that the consequences of such decisions on households who are above the poverty line but still financially stretched need to be taken more systematically into account.

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