"The economic downturn has exposed pre-existing financial vulnerabilities in households across Britain…"

IRRATIONAL OPTIMISTS

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DEMOS

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First published in 2013

Magdalen House, 136 Tooley Street,
London, SE1 2TU, UK

ISBN 978 1 909037 50 2
Series design by modernactivity
Typeset by Chat Noir Design, Charente
Printed by Lecturis, Eindhoven

Set in Gotham Rounded
and Baskerville 10
Cover paper: Flora Gardenia
Text paper: Munken Premium White

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Executive summary

This report looks at how the UK's middle earners – in particular those in the middle quintile of gross household income, earning between £31,000 and £42,300 a year – have fared in the years since the financial crisis of 2008.

The squeezed middle do not look 'poor'. They are professionally successful, they have often been able to buy a house, and they are aspirational and eager to support their children. But they are struggling now more than ever and their lives look set to get worse, not better, over the next 30 years. What is more, their outward displays of affluence have led politics into a false sense of complacency about the real squeezed middle. They are lumped – in political discourse, commentary and, too often, policy – in with those who can really afford to bear more of the brunt. They are confused with the rich when, really, they are anything but.

Analysis of data before and following the financial crash, alongside data from specially commissioned polling and evidence from a series of focus groups around the UK, is used to build a detailed picture of how these individuals and families understand their financial situation both in an immediate sense and over their life cycle, as important costs – childcare, university, pensions and social care – loom large.

This report lays out the particular challenges and threats faced by this group: including their dependency on wages, pre-2008 dependency on credit, low levels of saving and protection products, and a pervasive optimism regarding their situations, which discourages them from protecting themselves from future hardship.

Contrary to their own assumptions, it was not the financial crisis which created the difficulties faced by this squeezed middle. Yes, the financial collapse has jolted squeezed middle families, but the reality is that it has exposed and exacerbated pre-existing financial vulnerabilities more than creating new ones. The fact is that many of these families were reliant on cheap credit to keep their heads above water – that credit is no longer available and won't be for some time.

These long-term trends will continue to dog the squeezed middle throughout their life cycles – hitting them with costs and financial pressures for which they seem under prepared. And yet, our qualitative work with the real squeezed middle shows that although these issues are present in the back of their minds, preparing for them is on the back-burner. When confronted with the realities of the risks and costs that they will likely face, the real squeezed middle accept their vulnerability. But they do not plan for it and many have convinced themselves that 'something will turn up'. As one focus group respondent told us, 'It's a bit of a "let's wait and see" situation if I'm being honest.'

This 'irrational optimism' was present in our polling too. While only 22 per cent of the squeezed middle are saving what they feel they need to, 76 per cent of respondents expect to leave their child a property and/or cash assets of around £50,000. This optimism in the face of harsh facts shows up in the squeezed middle's attitudes to the macro and micro economic situation as well. When polled in 2012, 60 per cent believed that the British economy would either improve, sometimes significantly so, or remain broadly the same over the next five years, the same proportion who believed their own living standards would improve or remain broadly at their current level. In an era of falling wages and rising inflation this confidence is difficult to justify. Despite huge political controversy over the Government's failure to meet the targets of 'Plan A', only 18 per cent of respondents believe that Government will fail to meet its debt targets.[1]

There are also real concerns about whether this group fully understands the risks and costs which are increasingly theirs (rather than the state's) to meet. While only 17 per cent of the squeezed middle have made preparations for the potential need for long-term social care, 37 per cent expect to be able to help finance their child's university education and 30 per cent expect to help them buy a first home. Of course, many of us perfectly reasonably focus on preparing for different things at different stages of life. However, the under-preparedness of the squeezed middle is further exposed when we look at the results of our polling by age. Only 10 per cent of those aged 35 to 44 and earning between £33,000 and £44,000 annually have made preparations to cover the costs of social care needs later in life. Some of these people are little more than a decade away from needing to meet these costs. Equally, they assert determination to meet these and other costs independently. These are understandable and praiseworthy aspirations but in a group with relatively modest assets and an increasing amount of risk levied on them, there is a worry that these people display a set of priorities that has not adjusted to meet the realities of the economy or policy direction.

Despite their problems, the real squeezed middle are defined, attitudinally, by a set of values that are deeply admirable and hugely helpful to politicians. They are proud of their self-reliance and work ethic, and determined not to rely too heavily on the state. While 95 per cent of respondents to our poll believed that they are taxed either about right or too much, 66 per cent agreed that the level of state provision to families like their own is either about right or too generous.[2] This is not a group in search of a hand-out solution to their troubles.

The findings presented in this report suggest the squeezed middle must be helped to move from an 'irrational optimism' about their situation to a more 'reasonable hope', through policies that work with the grain of their instincts for hard work and self-reliance, but also nudge this group to take a more reasoned view about the risks they face over their life course. Simply cutting the taxes paid by the squeezed middle may alleviate the pressure in the short term, but will not help to build the long-term financial resilience that the group needs to resolve the problems they face more sustainably.

The truth is that the squeezed middle need to save more, insure more and protect themselves better – they understand this but need help to achieve it. Government has a real role to play in working with the squeezed middle to drive this crucial change.

Introduction

The economic collapse of 2008 – and subsequent recessions – have exposed long-term structural problems in the finances of the British state and British households. These problems were not originally caused by the credit crunch and banking crises but have, rather, been exacerbated and brought to the fore by those events. Because for a significant proportion of the British population as well as for the architecture of the British state, the fundamental weaknesses revealed by the sudden collapse of the banking and finance sector were a long time in the making and will take a long time to mend.

All of us now face a challenging combination of longer-term, pre-crash trends and the more immediate impacts of the downturn: the long-term stagnation of wages, the drying up of previously wide availability of credit, reduced savings rates, rising housing and living costs, demographic change leading to an ageing population, and policies since 2010 which have sought to reduce public service and welfare spending. The impacts of this combination of financial, social and political trends will continue to be felt on living standards and lifestyle choices across the majority of the UK population for many years to come, but as they are not entirely created by the recession (although recession has exacerbated many of them) they are unlikely to be resolved through growth alone or entirely ameliorated by short-term changes in public policy. They can only be addressed through sustainable reform and longer-term social change.

This report focuses specifically on a social group most affected by the combination of factors outlined above – the 'real squeezed middle'. People in this group have a number of characteristics that render them especially vulnerable to disadvantage in the face of state retrenchment, wage stagnation and long-term demographic change.

Of course, there are rival definitions and discussions of just who the 'squeezed middle' might be. But many of these analyses in fact look at the working poor. In an age of stagnating wages and rising living costs, those in low-paid work demand the attention and concern of policy makers. But it would be a mistake to do so at the expense of another category – those who are earning significantly more than the minimum wage, and whose lives before the recession looked healthy, but who are in fact struggling badly to manage their living costs now and their financial security in the long term. This is a group of people for whom neither cuts to tax nor increased state involvement seem likely to entirely address their problems. As we explain through the course of this report, they need another, different set of interventions from the working poor and those at the very bottom of the income scale.

The real squeezed are median earners – those who earn between £31,000 and £42,300 a year. Over the course of the recession their real incomes have dropped steeply – by as much as £2,000 a year – and policy changes aimed at cutting the deficit have cut them loose from state support. They depend more on their wages than ever before and have little in the way of savings to fall back on.

With a stuttering labour market, higher inflation and interest rates, what can be done to give the 4 million middle-earning households in Britain more financial security? One avenue seems firmly restricted. The Coalition Government has embarked on the most ambitious austerity programme in UK history in order to repair public finances and reduce the public deficit, which was £1,185.3 billion at the end of March 2013, equivalent to 75.2 per cent of gross domestic product (GDP).[3] The state has rarely been generous to this income cohort, whose members are often ineligible for tax credits (targeted at low income workers), but it is now even less able than in most previous periods to support median earners through welfare or other direct transfers of income. Tax credits are becoming less generous, while Child Benefit, the last universal benefit for working-age people, is now means tested. Yet while support is less forthcoming, the squeezed middle must continue to pay down the debts built up when credit was easier to access. In short, both the state and middle earning households are seeking to deleverage, leaving the state less able to support households and rendering households more dependent on their own resources, which are also more constrained.

But it is not simply the result of the recession that prevents the state providing extra support to middle earners. Even when there was more cash in the coffers, the real middle earners were never the focus of state resources as they never showed external signs of struggling financially. Instead, therefore, solutions to the precarious financial position of middle earners will most likely come from a mix of state and financial sector support, yet as this report explains, middle earners are not currently disposed to engage with such systems.

Presenting peer research and original work, this report explores some of the recent social, economic and policy changes as well as the financial behaviour and attitudes of middle earners. Chapter 1 gives a broad outline of who we refer to as 'middle earners', including their financial position. Chapter 2 analyses the ambitions, expectations and apprehensions of middle earners in order to understand how the recession and longer-term trends have impacted them. Chapter 3 explores the challenges middle earners face in the longer term – considering the life-cycle costs they will be exposed to. Chapter 4 explores the squeezed middle's attitudes towards savings and insurance, in order to assess how well (or ill) prepared people in this group are in relation to their future life-cycle costs. Our findings give serious cause for concern about the financial health of this group, but also suggest avenues to explore for policy makers who seek to work with the grain of this independent, hard-working group, and improve their financial situation in sustainable ways, over the long term.

This is increasingly necessary. Those in the real squeezed middle are losing faith in the British social contract because they are being ill served by it – a live debate is now unfolding among members of the Conservative party, keen to understand the rise of UKIP; backbenchers are increasingly concerned that 'ordinary voters' no longer believe the Conservative leadership speaks for them. Policy makers must engage with the real squeezed middle, identify practical solutions for them, and help them build their way to financial security.

1 Identifying the real squeezed middle

Defining the 'squeezed middle' has provoked charged debate. There is stark disagreement about who belongs to this group and in what way they are being squeezed.

In interview, Labour leader Ed Miliband pushed the agenda of the 'squeezed middle' but failed when pressed to identify where they reside on the income spectrum. In reply to criticisms, Liam Byrne, the Shadow Work and Pensions Secretary, defined the squeezed middle as people on an income between £16,000 and £50,000 per year.[4] The Chancellor of the Exchequer, George Osborne, replied:

> *Let's pass over his [Ed Miliband's] failure in every interview to define it – his last effort included around 90 per cent of taxpayers… the real squeeze is not on the middle, but on Labour's muddle.*[5]

But this reply demonstrates that the Conservatives have failed not only to engage properly with an important concept and constituency, but also sidelined a group in society that is in substantial need. This approach is also in danger of cementing the impression that the Conservative party is unable, or unwilling, to meet the aspirations and needs of middle earners – that it is somehow only able to engage with the very wealthy.

The Resolution Foundation provided an alternative analysis, defining the 'squeezed middle' as 'low-to-middle earners' in the 2nd to 5th income decile.[6] This has provided valuable insight and succeeded in raising the profile of this group. However, this definition falls short in one key way: it is not truly representative of 'middle' earners, conflating them with low earners, often eligible for tax credits, and struggling to get by even though they are in work. Those at the lowest end of this income spectrum are likely to fall into the 'working poor' group.

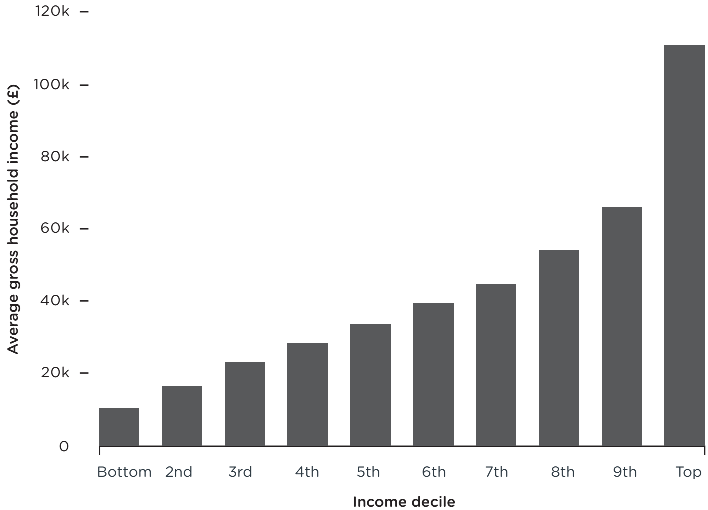
Defining the 'squeezed middle' in this way therefore overlooks many of the unique concerns of actual middle (median) earners. This association of the 'squeezed middle' being the 'lower middle' is now commonplace across the public policy world, including in the work of the Trades Union Council (TUC).[7] Certainly the individuals and families looked at by those organisations in their research are important and in need of support. They fall at the bottom end of the income scale and the impact of inflation and rising costs of living has been harmful to their financial health. In-work poverty is a growing and important social phenomenon.

But that does not mean that other groups – more appropriately termed the 'middle' when defined by their earnings – are not also struggling, but policy solutions for them differ from those aimed at alleviating in-work poverty. Those in this group are not as immersed in the benefits system – for example, they are less likely to benefit from tax credits, which top up the incomes of those at the bottom, and also are less likely to suffer from unsustainably low wages – rather, the costs of living and financial preparation for them are bigger issues. Therefore, discussions about the living wage, 'pre-distribution' and welfare reform hold little benefit for the 'real squeezed middle'.

As yet, no one has explored the difficulties faced by this overlooked group or the types of solutions needed to overcome these difficulties. This report begins the investigation to fill that gap, focusing on those households that actually fall in the middle of the income distribution.

Specifically, we look at households whose heads are of working age – therefore excluding retired households – and have a gross household income falling between the 40th and 60th percentile on the income distribution curve; the '3rd quintile'. In 2009/10 this equated to a gross annual income (before tax and including direct benefits) of between £31,000 and £42,300 per year, according to Office for National Statistics (ONS) data. The median gross household income was approximately £36,500 per year. Figure 1 breaks this down further, showing the income distribution curve in deciles. Those in the 40th to 50th percentile

Figure 1 **Average gross household income in UK by decile, 2009/10**



Source: Demos analysis of ONS data, 2009/10

of income are in the '5th decile' and their average gross household income for the year was £33,646. Those in the 50th to 60th percentile of income fell in the '6th decile' and their average gross household income for the year was £39,506.

All participants in the focus groups we hosted during this project – who were chosen because of their median household income – placed themselves in this 'middle', and felt, as the phrase tries to capture, that those at the top and the bottom of the income scale were better protected from the recession:

There's people either side who've kept carrying on in the way they have been.

When asked who it is that the term 'squeezed middle' applies to, participants in the focus groups acknowledged that the phrase was an attempt to appeal to a very large group of people:

The bulk of the workforce, ordinary folk. It's not your rich footballers and it's not your actors and people on benefits and stuff like that, it's Monday to Friday, 9 to 5.

They also understood the political motive for using the phrase, which is to try to give as many voters as possible a sense that the attention of the politician using the phrase is directing their attention towards them. However, they resisted the suggestion that its broadness rendered the phrase meaningless, and felt it did speak to their experiences of having lived through the recession:

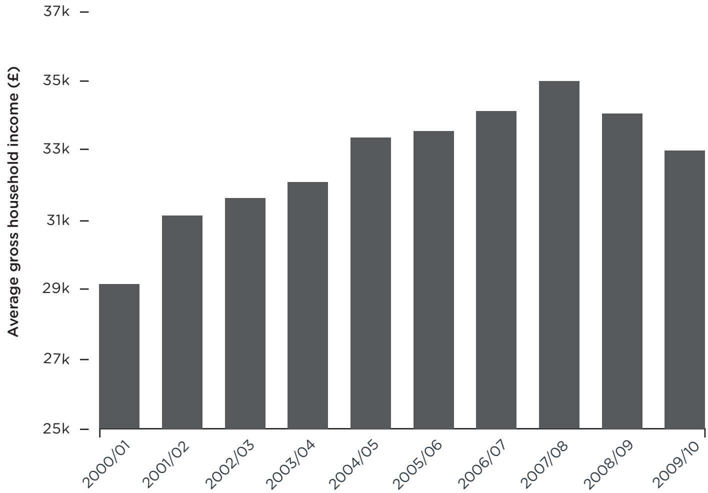
To me, the squeezed middle class or the squeezed middle ground or whatever are those average guys who are just getting hammered left, right and centre, because you're not getting any help with anything, yet you're being hit with everything.

The squeeze

The '3rd quintile' – middle earners – has been financially squeezed in recent years. As figure 2 shows, the real wages and salaries of those on median gross household income dropped by around £2,000 between 2007/8 and 2009/10 at 2005 prices. This same squeeze was not felt to such an extent by those with higher incomes whose salaries, on the whole, continued to rise.[8] This has caused a split between middle earners and higher earners, restricting the access of middle income households to many goods and services they previously shared with their higher income counterparts.

We must also bear in mind that the financial problems for middle earners were stacking up before the financial downturn. The historically low interest rates of the past ten years, below 6 per cent since its peak in 2000 and at 0.5 per cent in 2013, made life easier for them than it otherwise would have been.[10] This facilitated the achievement of certain macro-economic goals,

Figure 2 **Change in average gross household income in UK of middle earners, 2000/01–2009/10**



Source: Demos analysis of ONS and OECD data[9]

through increasing access to credit, but many middle earners were lulled into a false sense of security regarding unmanageable increases in debt.[11] Low interest rates also disincentivised saving, so middle earners were harder hit when 'times got tough' – with few reserves to draw on. Now, in a period of higher inflation – with the Consumer Price Index at 2.4 per cent as of May 2013 – they also see the real value of any savings they do have being eroded.[12] As Bank of England Chairman, Sir Mervyn King, has said: 'We face the rather unappealing combination of a subdued recovery with inflation remaining above target for a while.'[13]

With a stuttering labour market, higher inflation and interest rates, what can be done to give the 4 million middle earning households in Britain more financial security? One avenue seems firmly restricted. The Government has embarked on the most ambitious austerity programmes in UK history in order to repair public finances and reduce the public deficit, which was £1,185.3bn at the end of March 2013, equivalent to 75.2% of gross domestic product (GDP).[14] The state has rarely been generous to this income cohort, whose members are often ineligible for tax credits (targeted at low income workers), but it is now even less able than in most previous periods to support median earners through welfare or other direct transfers of income. Tax credits are being made less generous, while Child Benefit, the last universal benefit for working-age people, is now means tested. While support is less forthcoming, the squeezed middle must continue to pay down the debts built up when credit was easier to access and interest rates lower. In short, both the state and middle earning households are seeking to deleverage, leaving the state less able to support households and rendering households more dependent on their own resources, which are also more constrained.

Table 1 shows that households on median incomes face a set of problems distinct from those of higher earners, whose greater wealth protects them from the squeeze, and lower earners, who are guaranteed a larger proportion of their income by the state. Middle earners are more *income dependent*, relying on their salaries alone to support their lifestyles, and are thus vulnerable to any disruption to their incomes. Middle earners, in effect, have achieved *income sovereignty* in that they are no longer dependent on the state for support, yet their dependency on their income alone (as opposed to other assets or investments) puts this sovereignty and self-autonomy at risk. As outlined above, in the current economic climate, the state is unable to aid middle earners through benefits. Indeed, current government welfare reform policies have residualised welfare in such a way as to further remove many in this group from traditional state support.

Table 1 deconstructs the income of the different groups, showing the main sources and outflows of their income for an average household in that income group. It orders income deciles according to 'equivalised disposable income'. Disposable income is money left over after tax, excluding housing costs. In

Table 1 **Annual income of those in the 1st to 10th deciles, by source**

	1st–4th decile (£)	Squeezed middle (£)	7th–10th decile (£)
Original income			
Wages and salaries	11,329	28,774	54,851
Imputed income from benefits in kind	50	248	938
Self-employment income	1,236	2,440	7,513
Occupational pensions, annuities	425	980	2,074
Investment income	140	282	1,636
Other income	291	349	298
Total	13,470	33,072	67,310
Direct benefits in cash			
Contributory			
Retirement pension	446	929	711
Jobseeker's Allowance (contribution based)	100	19	4
Incapacity benefit[a]	468	175	49
Widows' benefits	18	22	14
Statutory maternity pay/allowance	39	154	183
Non-contributory			
Income support and pension credit[b]	767	230	37
Child Benefit	788	603	397
Housing benefit	1,233	350	57
Jobseeker's Allowance (income based)	189	48	8
Carer's allowance	103	71	17
Attendance allowance	17	10	9
Disability Living Allowance	442	424	127
War pensions or war widows' pensions			21
Severe Disablement Allowance	16	38	9
Industrial Injury Disablement Benefit	17	39	14
Student support	160	29	125
Government training schemes	11	23	9
Tax credits[c]	1,185	305	54
Other non-contributory benefits	59	60	48
Total cash benefits	6,039	3,505	1,849
Gross income	19,509	36,576	69,159

Table 1 **Annual income of those in the 1st to 10th deciles, by source – *continued***

	1st–4th decile (£)	Squeezed middle (£)	7th–10th decile (£)
Direct taxes and employees' NIC			
Income tax	1,471	4,288	11,379
less: tax credits[d]	297	324	98
Employees' NI contributions	725	2,092	3,864
Council tax and Northern Ireland rates[e]	1,018	1,155	1,354
less: council tax benefit and rates rebates	253	90	16
Total	2,663	7,121	16,484
Disposable income	16,846	29,456	52,675
Equivalised disposable income	14,371	25,093	47,806
Indirect taxes on final goods and services			
VAT	1,350	2,011	2,876
Duty on tobacco	450	438	252
Duty on beer and cider	99	172	182
Duty on wines and spirits	110	191	295
Duty on hydrocarbon oils	389	583	728
Vehicle excise duty	113	173	217
Television licences	139	135	139
Stamp duty on house purchase	44	86	184
Customs duties	27	33	44
Betting taxes	21	33	65
Insurance premium tax	30	48	69
Air passenger duty	26	41	95
Camelot National Lottery Fund	47	68	60
Other	19	18	23
Intermediate taxes			
Commercial and industrial rates	246	305	407
Employers' NI contributions	417	518	691
Duty on hydrocarbon oils	141	175	232
Vehicle Excise Duty	13	16	21
Other	216	268	358
Total indirect taxes	3,894	5,307	6,936
Post-tax income	12,953	24,149	45,739

Table 1 **Annual income of those in the 1st to 10th deciles, by source – *continued***

	1st–4th decile (£)	Squeezed middle (£)	7th–10th decile (£)
Benefits in kind			
Education	4,706	3,418	2,169
National Health Service	3,483	3,489	3,190
Housing subsidy	42	14	5
Rail travel subsidy	11	15	40
Bus travel subsidy	65	68	76
School meals and Healthy Start vouchers[f]	111	18	4
Total	8,416	7,020	5,482
Final income	21,369	31,169	51,221

Notes:
[a] Using the modified OECD scale
[b] Including Employment Support Allowance
[c] Child Tax Credit and Working Tax Credit
[d] Including tax relief at source on life assurance premiums
[e] Council Tax and Northern Ireland rates after deducting discounts
[f] The Healthy Start vouchers component includes school milk data for 2009

Source: Demos analysis of ONS data, 2009/10

table 1 this has been equivalised according to the OECD measure to take account of the different household structures – such as number of children – in each income group. The equivalised disposable income of households on below-average salaries is £14,371; for those on median income it is £25,093; and for higher earners it is £47,806.

Table 1 demonstrates that low earners have two main sources of support: income from work and state support. The wages of those in the bottom two-fifths of the income distribution make up just 58 per cent of their gross household earnings. In contrast, middle earning households rely heavily on just one source of income: their wages. It makes up 79 per cent of their earnings, the same as the highest earners. Middle earners are, in effect, 'income dependent'.

Table 2 **Distribution of household wealth excluding pension wealth, by income per week, 2006/08**

Weekly earnings	Mean	1st quartile	Median	3rd quartile
< £100	£199,400	£15,300	£120,200	£278,500
£100 to < £200	£180,100	£15,600	£85,500	£223,800
£200 to < £300	£156,100	£18,500	£88,500	£200,700
£300 to < £400	£170,600	£33,000	£108,700	£223,000
£400 to < £500	£186,100	£47,200	£131,300	£241,900
£500 to < £600	£212,800	£65,800	£156,200	£272,000
£600 to < £700*	£233,900	£73,700	£175,000	£302,400
£700 to < £800*	£257,900	£110,100	£196,800	£330,400
£800 to < £900	£292,600	£123,700	£226,200	£369,700
£900 to < £1,000	£352,500	£138,700	£268,700	£417,500
£1,000+	£548,000	£204,200	£361,500	£609,900

* Middle earners

Source: ONS, *Wealth and Assets Survey*

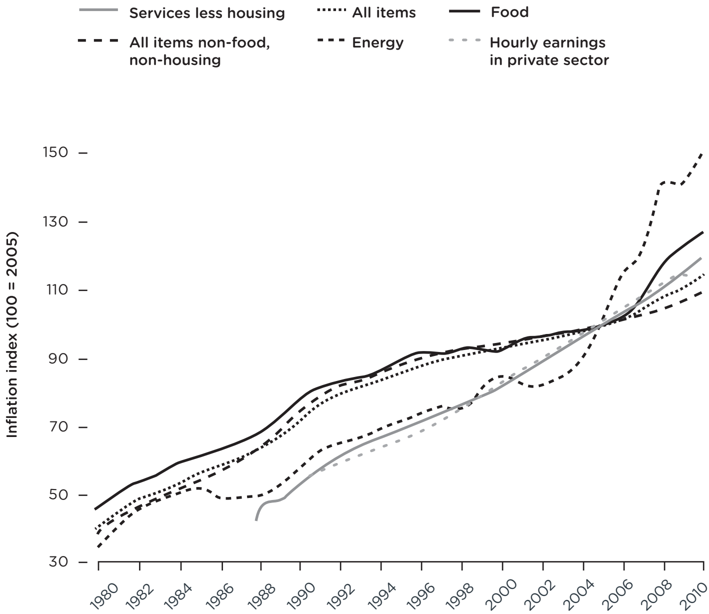
Of course, income is only half the picture. Wealth inequality in the UK, as in much of the western world, is more significant than income inequality. Table 2 shows the relationship between income and wealth – with higher earners having greater wealth.

Taken together, these data show that those in the squeezed middle are income dependent, with significantly less wealth to draw on and fewer sources of other income, such as investment income and annuities, compared with higher earners.

As a result of their vulnerability, unemployment can have a catastrophic impact on the standard of living of middle earners – it cuts off their predominant source of income. This negative impact is compounded by the relatively low level of unemployment benefits in our welfare system; whereas a low earner who becomes unemployed can receive around three-quarters of their previous salary in benefit, middle earners only receive 40 percent of their previous income.

A very significant recent phenomenon for middle earners, which has compounded this situation, is higher inflation. As

Figure 3 **The inflation index in UK for different goods based on Consumer Price Index, 1980–2010**



Source: Demos analysis of OECD statistics

figure 3 shows, all households in the UK have had to grapple with rising costs of living, which since 2008 have accelerated faster than earnings, resulting in a decrease in real wages. But because of the nature of the current crisis, where lending remains restricted and aggregate demand limited, this rising inflation has not been met within rising interest rates. This has disincentivised saving and penalised those middle earners who do save.

This rising inflation has contributed to the 'real cut' in gross household income experienced since 2008/09 among middle earners. But this inflation has also had the effect of undercutting the value of wealth – particularly given the recent downturn in property prices. While middle earners have lower wealth than their higher earning counterparts, they remain at risk of devalued housing and, at worst, negative equity. The falling value of housing equity restricts consumers' access to credit and otherwise diminishes the amount of income households have available to maintain their lifestyles, making them vulnerable to income disruption and resulting in loss of income sovereignty.[15] Yet what is important is that the falling value of housing equity shakes the widely held belief, encouraged by successive governments, that people should invest their money and savings in assets, particularly homes, in order to have secure reserves to draw on in case of emergency. A report in 2010 by the Joseph Rowntree Foundation stated: 'Residential property is also increasingly seen as an investment, rather than a consumption good and now contributes to a household's financial planning.'[16]

In sum, those in the real squeezed middle – the subject of this report – are middle earners: those whose incomes fall in the middle of the income distribution curve, whose heads of household are of working age, and whose gross household income is between £31,000 and £42,300 per year. They have suffered a significant drop in their real income since the recession. Unlike higher earners, who have more varied income streams and greater wealth, and lower earners, who are more reliant on benefits, middle earners are income dependent. They stored up financial problems before the downturn thanks to easy access to credit and disincentives to save. As a result, they are particularly vulnerable to three important aspects of the current economic situation: losses of income, inflation and rising interest rates.

Solutions to 'unsqueezing' this group are not straightforward – policy makers have tried to reconnect with a large proportion of the electorate by talking of 'strivers', yet often this translates into policies aimed at helping those on low–middle incomes or the working poor, rather than the actual middle. In the absence of any existing policy solutions, and with welfare transfers off the table, it seems sensible to consult the squeezed middle themselves as to what they feel may be the best solutions to their 'squeeze'. It is only through active engagement with their attitudes and desires that the Government can hope to bridge the gaps in the squeezed middle's financial wellbeing through meaningful, long-term and successful policy.

2 Views from the middle lane

In order to better understand how those in the real squeezed middle perceived their situation and how they might be assisted out of it, Demos and IpsosMori polled a sample of 2,000 households who fit into the income brackets we use to define the 'real squeezed middle'. Our survey aimed to understand the extent to which the financial stresses highlighted by our quantitative analysis presented above were recognised by these households, to gauge their understanding of the long and short-term trends that lay behind their direct financial experience, and to assess their attitudes to potential approaches to ameliorating those stresses.[17]

Our findings hold significant lessons for policy makers of all political stripes. Three important characteristics define the real squeezed middle by their attitudes to their personal financial health and the macro-economic situation, which to some extent dictates their relative wealth. These characteristics are generalisations – there are members of this demographic who hold different attitudes and views. But the real squeezed middle – largely wage-dependent households earning around the median wage – broadly share certain approaches to affluence and aspiration, which it is important to understand and engage with if we are to shape solutions that are likely to resonate with this group and prove effective.

Irrational optimists

The real squeezed middle are, to some extent, 'irrational optimists' about both their personal and the national finances. We do not use this term disparagingly – it is not intended to patronise this group. But there is a marked and worrying degree of faith in the likelihood of household and macro-financial health improvement that does not reflect the growing consensus on economic trends or the long-term nature of this group's financial difficulties. This optimism may reduce the impetus for these households to take steps to insulate themselves and prepare for future eventualities. For example, 60 per cent of households in this category believe that the economy at large will either remain steady or will improve over a five-year span, with the same proportion predicting that their standard of living will improve in the same period. What is more, only 28 per cent believe that there will be further cuts to public spending and public services in the next Parliament – despite agreement between all three major political parties that this is likely to be the case, with both Coalition parties asserting that it is certain.

The Chancellor used his spring budget in 2013 to reconfirm his commitment to identifying further cuts to departmental spending in all non-ring-fenced departments. Previous announcements have set the figure at around £10 billion a year in further cuts to Department for Work and Pensions (DWP) – as a focus on reducing the cost of annual managed expenditure (AME), the budget from which welfare spending is taken.[18] This suggests that the era of sweeping cuts to welfare is far from over.

Our focus groups with individuals from the real squeezed middle illustrated this sense of optimism about both the state and their household finances:

I think things will get better – certainly for me and my family. I don't see why they shouldn't. Things have been tough for this year, we've all had to make sacrifices, but once the debt is paid off things will get back to normal.

And the real squeezed middle's sense of what 'normal' is for families like theirs should worry policy makers:

Well, for the last 15 years or so – as long as I've been working really – my wages have pretty much gone up, we've had more money one year to the next, new cars when we needed them. I'm not saying we're rich – I wish – but we're alright. The last couple of years haven't been so good but that's the banks. When that gets sorted we should be OK.

Proud strivers

The real squeezed middle self-identifies as a 'striving class'. Our focus group leaders asked participants to define the squeezed middle in a number of ways – from wealth to income to ethos. Many described people in the squeezed middle as being defined by their work ethic and determination to succeed:

People like us work hard – we struggle but we apply ourselves. That's why I always tell my kids they need to get an education above all else because to families like mine that's the values… you have to work if you want to get ahead in life.

And the real squeezed middle is not particularly embittered by the fact that they are hard working. In fact, they take great pride in this fact about themselves – identifying it as a particular badge of identity and values. Many saw this element of their lives as separating them from both the 'poor' and the 'rich' – readily identifying the existence of so-called free-riders at the bottom and (importantly) the top of society:

The squeezed middle are ordinary folk. It's not your rich footballers and it's not your actors and people on benefits and stuff like that, it's Monday to Friday, 9 to 5.

Autonomy prizers

Interlinked with a pride in hard work, those in the real squeezed middle have a sense of the virtue and importance of autonomy. Many in our focus groups felt that, as well as their work ethic, it was their relative independence from state aid that marked the squeezed middle apart from the low-waged. Interestingly, however, there was little demand in either our focus groups or our polling for additional welfare targeted at their households – despite a recognition of the relative lack of direct support available. Only 25 per cent of individuals in the real squeezed middle want more services and subsidies for families like theirs.

The reason for this is clear from the narrative that emerged strongly from our focus groups – these are families who, on the whole, take pride in their independence and are wary (in principle) of becoming dependent on state aid:

These people on a middle income, they've got a good work ethic, and I think that gets shattered along with their self-esteem and self-confidence. The people on the poverty line who have never had a job don't know what this is, they don't know what self-esteem is... It's a way of life for these people.

This characteristic of the real squeezed middle contains an important lesson for policy makers looking to shape interventions to assist them. A simple expansion of welfare to include those who are in this category, and who see themselves as the 'middle ground', is not likely to prove politically popular – serving to undermine, as it would, their sense of themselves. Not only would such an extension prove economically burdensome, it could be in danger of sapping morale and offending sensitivities.

These three themes tell us a great deal about how those in the real squeezed middle view themselves. They are optimistic, see themselves as hard working and are proud of their independence. In many ways, those in the real squeezed middle are defined by their economic conservatism – their sense that their application, skills and personal investment will be rewarded. However, the underlying reality of their precarious and potentially stagnant economic position does not necessarily reflect this perception – as outlined above, a decade of available credit has allowed many in this category to experience economic 'reward' based on lending rather than actual wage increases. What is more, many in this category hold low levels of assets – and what wealth they do possess is likely to be held within a home rather than in savings – so as credit has become withdrawn they have become ever more reliant on those largely stagnant wages. As a combination of labour-market reform and slow growth looks likely to keep middle wages relatively stable, while inflation rises and credit continues to be more restricted, there is a real danger that the squeezed middle's optimistic sense of self-improvement will fall into disappointment and resentment.

Further trends brought out by our polling and focus group work with the real squeezed middle are discussed below. These trends support the quantitative findings presented in chapter 1 regarding analysis of the economic position of the real squeezed middle, explain some of the reasons for the three main characteristics of this group highlighted above, and highlight the threats to the real squeezed middle in the future.

Savings

Those in the real squeezed middle understand the need to save, and to acquire a liquid asset to use in times of financial stress:

Of course it's important to save money. I know that. I've always tried to save money.

Many focus group participants suggested that for a number of reasons the recession had prompted them to aspire to save money regularly when this had not been a priority in the past:

When my husband lost his job I realised that we hadn't really got anything put aside to look after us. We were lucky, he managed to get another… more work quite quickly so we didn't lose the house or anything. But it made me think how we should be putting a bit aside, y'know?

It's funny because we'd always survived fine really. Not had to struggle. But I think quite a lot of that was based on loans – which have been easy to get, probably a bit too easy to get – and that meant we could always smooth everything over. But that's more difficult now because it's not so easy.

However, despite an apparent recognition of the importance of saving, the real squeezed middle has not succeeded in turning their aspiration to build up assets into a reality. Only 22 per cent of the real squeezed middle polled in our study always save the amount that they want to save each month. This means that 78 per cent of these households are either failing to meet their savings targets or have no savings aspirations whatsoever. Our polling found that 15 per cent rarely save the amount that they want to save each month while 10 per cent of the real squeezed middle never manage to.

Within the real squeezed middle there are differences in the extent to which individuals and households manage to meet their savings aspirations. These disparities are important to policy makers for two reasons: they show that failure to save is not necessarily borne purely out of financial inability to do so (these differences are not driven by differing incomes), and there are particularly groups within the real squeezed middle that it would be more fruitful to target in the short term.

Women are shown to be marginally better at keeping to their savings targets than men: 25 per cent always save the amount they want to save compared with 20 per cent of men, and only 12 per cent of women rarely save the amount they want to save compared with 18 per cent of men. At the same time, older individuals are more likely to manage to keep to their savings targets regularly – 32 per cent of over 55s meet their targets compared with only 10 per cent of those aged between 35 and 44. This perhaps reflects two factors: the varied level of dependants (younger individuals are more likely to have young, dependent children), and the increased immediacy of retirement. As one focus group participant told us (reflecting the views of many older participants):

I started to really save when I hit about 50. My husband too. It was when we started to look ahead and think about what life is going to be like when we can't work anymore. We want a nice life. Our pensions aren't going to give us that on their own.

Intriguingly, the ability to meet savings targets is not dictated entirely by the income of individuals and households. We asked about the meeting of savings targets because we wanted to understand the behaviour of individuals and households – their ability and determination to meet aspirations around savings – rather than bare sums. This allows us to compare the relative likelihood of savings success across different factors – strikingly, the level of social class and of personal income within the squeezed middle income band have a somewhat counter-intuitive impact on an individual's meeting of their savings targets.

While respondents from social band AB are marginally more likely 'always' to keep to their monthly savings targets – 27 per cent compared with 16 per cent in social band DE – those in this band who do manage to keep to their target every month tend to be worse at occasionally meeting them. However, those from social band DE are more likely to keep to their targets sometimes – 41 per cent compared with 36 per cent.

What is more, lower-income individuals within the real squeezed middle are considerably more likely to be meeting their savings targets regularly than those higher up the scale: 72 per cent of those on an individual income of £6,500 to £11,499 within a middle earning household either always or sometimes save the amount they want to each month, compared with 37 per cent of those earning up to £17,499 and 53 per cent of those earning over £25,000.

An emerging and worrying trend – identified through our focus groups – is that while awareness of the importance of savings is growing among the real squeezed middle, short-term factors have caused those who have previously saved to reduce the amount they save. Very few participants believed that they would last longer than a month on their savings should they lose their jobs. Some, with no or little savings, said they would be immediately reliant on benefits should they fall out of the workforce. Many with savings believed that because of the low interest rates combined with increasing living costs it was reasonable to use their assets to cover shortfalls each month:

I use mine to cover bills when things are tight. Then I try and top them up when I'm doing a bit better. I'm running at a loss, as it were, but I'm doing my best.

Many participants reported that they have stopped saving money as the recession has started to bite. One person reported cashing in an ISA in order to pay a credit card bill, while another described cutting back on saving in order to balance the monthly household budget – seeing saving as a luxury that they could no longer afford:

I've only got my wage coming in and I can't save anything... I don't have it to spend or to save.

Some participants explained that – having made sacrifices in other areas of their lives – they considered it unreasonable also to put money aside through saving. As one participant said:

I'm working harder than I ever have before. I've got bills to pay that are bigger than ever before. My gas, electric, rent, insurance, everything. I can't dump everything I enjoy and have no life at all. To be honest, after all that, I dumped my savings first, before dumping going out.

Focus group participants overwhelmingly managed to reconcile their acceptance that savings are important with their current non-saving behaviour, through optimism about future prospects. Those who were failing to meet monthly savings targets (half of focus group participants) offered a number of explanations about how they saw the future – connected by a common assumption that disposable income (and ability to save) would improve in the near to mid-term future:

Of course I'll save more – and make up for the savings that I've spent – once everything's back to normal.

I'm hoping I'll have a bit more to put away soon. But everyone's in the same boat, aren't they? It's not like it's just me. I mean, who can afford to save money nowadays?

The cost of everything has gone up. So I've stopped saving. But when costs go down again I'll start saving again. It's simple, really.

It is clear that, alongside direct financial considerations, attitudinal differences have a profound impact on an individual's relative likelihood of meeting their savings targets. Women, older people and those on lower individual wages are considerably more likely to save the amount they aspire to either monthly or regularly at some other interval. Those intending to make interventions that seek to improve saving rates among the real squeezed middle need to learn lessons about the circumstances in which saving rates among particular demographics tend to improve – such as proximity to (and understanding of) retirement, likelihood of being a primary carer and low pay.

Cost of living

The real squeezed middle has experienced a much reported rise in living costs. Outlined above are the trends underpinning these – from rising utilities to the impact of inflation on food prices – and respondents and participants in our polling and focus groups described these rising costs and the impact that they have had.

We asked respondents to our polling to outline the three costs that had risen most for their household over the past five years. They identified the soaring cost of petrol – and interlinked expense of transport and commuting – as the most significant rise (65 per cent of respondents raised it), followed by utilities (61 per cent) and food (58 per cent).

Of the options available to respondents, the least chosen were personal insurance (3 per cent), leisure and entertainment (6 per cent) and income tax (8 per cent).

There are particularities contained within the broad sweep of responses. Food prices were perceived to have been the most significantly growing factor by a disproportionate number of individuals on a lower income, with 72 per cent of those earning £6,500–11,499 citing it as a rising cost compared with 17 per cent of those earning between £17,500 and £24,999 and 58 per cent of those earning over £25,000.

Additionally, for those on lower individual incomes, council tax was a much more significant factor than for others. Those on lower individual incomes reported rising council tax disproportionately, 25 per cent of those earning up to £11,499 raised it, compared with 13 per cent of those earning over £25,000. However, rising utility and transport costs were reported more often by those earning higher individual incomes:

48 per cent and 39 per cent, compared with 63 per cent and 69 per cent.

We asked respondents to identify the specific costs that have had an impact on their particular household. Interestingly, the results for this question are more nuanced. Again, the cost of utilities and petrol or transport were among the top three most cited types of spending that has the biggest impact on living standards – however, when asked what costs had most impacted on their personal finances respondents rated mortgage repayments at 17 per cent and food prices at 16 per cent.

Young people felt that mortgage and rent expenditure had a greater impact on their living standards than did older respondents (36 per cent for those aged up to 24 compared with 6 per cent for over 55s), whereas older people tended to be more concerned about prices of utilities (35 per cent of over 55s compared with 16 per cent of those aged up to 24).

The cost of utilities was of a greater concern in Scotland and the North than London and the South (61 per cent compared with 36 per cent), whereas mortgage and rent expenditure was more of a concern to those in London and the South than those in Scotland and the North (49 per cent London or South to 29 per cent Scotland or North).

The reasons for the disparity between what respondents perceive as the greatest overall rises in costs and what has had the most significant impact on their lives is perhaps explained in part by the relative necessity of items. One focus group participant told us:

You can cut down on food. Buy the value stuff, cook more yourself than have takeaways. But you can't do that with the mortgage. Especially now they won't let you go on to an interest-only. And it's harder to do it with the heating or whatever.

The focus on 'necessity' may also have a bearing on some costs that failed to register highly as impactful. Insurance was judged by 3 per cent of respondents to be among the top three rising costs, yet only 1 per cent of respondents believed rising insurance costs have had an impact on their living standards. One focus group participant explained:

I've shopped around on my insurance and I've cut back on any I don't need. So we've dropped the husband's life insurance and raised the excess on the car. Of course it'll make it more difficult if anything happens, more expensive, but it saves us money day-to-day.

A similar pattern to that driving down savings rates is being found in other areas of the real squeezed middle's lives. 'Necessities' – those costs that are unavoidable and which failure to pay for may be met with some form of penalty – are being prioritised while families identify cut-backs in more optional expenses. So it is that despite the importance of financial security and protection, those products that are most likely to equip households and families with assets and insulation are being deprioritised, alongside savings.

In the same way that those in the real squeezed middle expect their saving behaviour to improve in the near future, so too they predict that the cost of living will come down over time, perhaps making financial protection affordable once more. Nearly two-thirds (60 per cent) of polling respondents believe that long-term economic change will have either no impact or a positive impact on their personal living standards, while only 8 per cent believe that the economy will have a very negative impact on them. Many focus group participants argued that the negative impact of economic factors on their living standards will become less severe in the short to medium term:

The thing that's made everything more expensive is inflation, yeah? And that's caused by the debt. Once that's paid off the cost of things will go down.

Life-cycle costs

We asked respondents in our poll to identify the life-cycle costs that will have the most profound impact on their families. The prospects for these costs – covering the likely significant spending moments over squeezed middle life cycles – are outlined in detail below. But before approaching what the reality of these costs, and their relative significance, are likely to be it is important to understand what those in the real squeezed middle expect to spend significant sums on over the course of their lives.

Those in the real squeezed middle believe that the most significant costs they will face over their life cycle are higher education for their children (37 per cent), assisting their children onto the property ladder (31 per cent) and their own retirement (30 per cent). They expect to spend least on long-term social care (19 per cent) and health costs (5 per cent).

It is interesting and significant that those in the real squeezed middle are highly concerned about the costs of supporting children into young adulthood – through university fees or potential support for buying a home – and express relatively little concern about the potential costs of ill health, unemployment and social care for themselves. It is likely, as described in detail below, that covering a substantial proportion of the cost of long-term social care will be inevitable for those individuals and families within this bracket of society – yet it scores relatively poorly as a concern. On the other hand, while the funding mechanisms for university have changed in order to pass on a greater proportion of the cost to the individual, no family is compelled to finance the most expensive single item (tuition fees, which are paid via a low-interest loans system) and most young people from squeezed middle backgrounds are eligible for support towards living costs. Yet it is financing higher education that stands out for squeezed middle families as the likely most significant spending moment in the life cycle.

This perception of likely cost was borne out by our focus group research. As tuition fees have increased to a maximum of £9,000 and an average of £8,507,[19] the recession had influenced the participants' attitudes to sending their children to university; many focus group participants argued that a university education – whether or not they had benefited from one themselves – is now a prerequisite for the kind of 'squeezed middle' jobs that parents foresee their children occupying.

However, participants had heightened fears about the costs of higher education – and many parents appeared to take responsibility for bearing the brunt of these costs. This has had the profound effect of persuading some squeezed middle families to look on university as desirable but ultimately unaffordable:

I was thinking to myself, I've got twins, that's £18,000 a year. There's no way you're going to university.

On the question of pensions, long-term social care and ill health and unemployment the focus groups reflected the polling but also gave insights into why some of the 'projected costs' of these important and expensive life-cycle moments may have been underestimated. There is a certain amount of cynicism and confusion among the squeezed middle with regard to the costs of ageing, and as this is mixed with a level of unjustified optimism about the likelihood of state intervention, some are dangerously under-protecting themselves.

Many focus group participants stated that they had either ceased saving for retirement or had minimised their payments into pension schemes, in some cases entirely for reasons of affordability:

I'm taking a break from my pension contributions. It's the same as with luxuries like going on holiday – I just can't afford it at the moment.

But others had a degree of defeatism about pensions and saving for old age, which had affected their behaviour and helped them justify their decision to withdraw from long-term savings schemes and neglecting pension contributions:

I don't think I'm going to be better off financially, it's an absolute waste of time.

I heard somewhere that on a private pension if you haven't got more than £100,000 in the pot when you retire you might as well have not bothered.

I pay into a pension, but I don't know if I've wasted my money there. Fifty quid a month into a pension that isn't going to make any difference at all. I'm thinking, is it worth it? I need to get financial advice.

Similarly, there is a level of disengagement on the issue of long-term social care, which is particularly worrying as we progress to a more explicitly self-funded model:

I haven't thought about it at all to be honest. I have no idea how much it would cost if me or my wife needed care – I suppose we'd just have to sell the house which would be a shame because I always thought we'd leave that to the kids.

I would think that my pension would pay for any care that I need. If I'm in an old folks' home, surely I wouldn't need my pension so it could just go to pay for that, right?

We asked people in our focus groups to explain what they believe they will receive from the state in old age. Many expressed frustration with the likely level of state pension they will be entitled to and there was considerable resentment at the perception that despite their life-long economic independence and non-reliance on state benefits their pension was likely to be insufficient:

I think it's like £100 a week or something. I don't know how I'll survive on that. You get more on benefits which is the wrong way round. I've never asked anyone for anything, I look after myself, but then I look at things like the pension – which obviously I'll probably need – and I just think what's the point? It's people like us paying for all this and then the one bit we need is crap.

However, despite widespread frustration and lack of confidence in their likely financial security in old age, many in the squeezed middle express a sense that retirement and long-term social care will, somehow, 'look after themselves':

I don't know how we'll cope to be honest. But we will. We always have before.

I try not to think about it. There's no point worrying about it. Everyone gets old – I've seen my parents manage on their pensions and I've helped them to sort out care and stuff – they've managed. It all seems much more scary looking forward than it is in reality.

3 Prospects for the squeezed middle

In chapter 1 we describe how those in the squeezed middle, through a combination of income dependency, reduced access to credit and limited assets, are particularly vulnerable to the current economic climate and are unlikely to be helped by the welfare state. In chapter 2 we explored the squeezed middle's view of their present situation. In this chapter we take a longer-term view, and consider the challenges faced by middle earners over their life course.

During several key parts of the life cycle – including needing childcare, sending children to higher education, and then requiring old age care – middle earners bear a disproportionate financial burden.

For old age care, they are too wealthy to receive state-funded support, but will find the average £30,000 cost of care in later life a substantial financial burden to meet. The forthcoming cap of £72,000[20] may well help those with 'catastrophic' care costs, but for average care users and middle earners, care costs will be an entirely private outlay, perhaps resulting in the need to sell the family home. Under the recent reforms, if their children want to go to university, squeezed middle parents may feel obliged to contribute to their children's educational costs – up to a maximum of £9,000 a year in tuition fees alone. Their children will not have access to the same proportion of bursaries as their lower earning counterparts. Finally, because of the lack of reciprocity in our welfare system – whereby out-of-work benefits are completely de-coupled from pre-unemployment income – middle earners risk losing 65 per cent of their income if they become unemployed and have to rely on out-of-work benefits.[21] With increased job turnover and broader macro-economic instability, there is an ever increasing likelihood of this happening.

This increasing burden placed on middle earning households to pay their own way, coupled with a withdrawal of state support in their current situation (through tax credits and Child Benefit) and if they fall on hard times (with less and less generous out-of-work benefits), has contributed to the steady erosion in the middle earners' feelings of ownership of public services and representation by the state. Middle earners are key contributors to the state coffers, paying around a quarter of their earned income in income tax and national insurance.[22] It is therefore unsurprising that a 2011 study of middle earners found 40 per cent agreed with the statement that 'Government doesn't do anything for people like me'.[23]

Yet despite this recognition that the state is unlikely to support them in difficult times, middle earners are not sufficiently protecting themselves against key life-cycle risks. This chapter explores the key financial outflows of middle earners during the life cycle and the likely impact of loss of income on their ability to maintain their standard of living. We focus on five key areas in particular: education, childcare, income and job security, ageing and care for older people.

We draw on OECD data, the British Social Attitudes (BSA) survey and other data sources to identify the aspirations, behaviour and values of middle earners, in comparison with higher and lower earners at respective stages in the life cycle. The BSA survey is an annual cross-sectional survey of British households. It maps the behaviour and attitudes of British citizens over time on a range of indicators including education, the state, health and morality. We look at the most recent BSA survey, for 2012,[24] and 2009 where necessary (regarding questions related to education which were not included in the subsequent wave).

Education

Despite the high value middle earners place on education for their children, they are increasingly unable to meet the rising costs of education and their aspirations are changing accordingly.

Middle earners have long recognised the importance of education as a pathway into employment and security and they have strong aspirations for their children to enter higher education. A 2008 report for the former Department for Children, Schools and Families found,

Parents from higher socio-economic groups in terms of income, education, and occupation placed a relatively greater emphasis on education and the concept of 'parental push'. Around a third of middle income households said 'Children should be pushed if they are to reach their full potential' as opposed to 'Children should be allowed to develop at their own pace without feeling pressurised'.[25]

Almost 60 per cent of middle earners in the 2009 BSA (the latest BSA asking education-related questions) said that, 'in order to get ahead', 'having a good education' was either essential or very important. Interestingly, middle earners were also the most likely to say that they had left their work in order to 'return to education': 6 per cent of those who had left their job cited this, compared with zero higher earners, 2 per cent of 2nd quintile earners and 4 per cent of 1st quintile low earners.

Participation in higher education is substantially greater among middle earners than low earners, but far below the rates among higher earners. In the BSA, 18 per cent of middle earners under 65 said that they 'had a degree', compared with 11 per cent of those in the 2nd quintile and 7 per cent among the lowest quintile. However, this was substantially less than those in the 4th quintile, 31 per cent of whom had a degree, and 52 per cent among the highest earners.

Education, particularly higher education, can be a gateway to greater earning power. Lord Browne claimed that a person with a degree can expect to earn £100,000 more on average across their working life than someone with only A levels.[26] As table 3 shows, there are substantial monetary returns related to having a university-level education.

Table 3 illustrates that having a university-level education corresponds with an annual income over 50 per cent higher than for those who have A level or equivalent qualifications. Yet

Table 3 **Index of average income by education level for different age groups and gender**

	Below upper secondary education			Post-secondary non-tertiary education			All tertiary education		
	Age 25–64	Age 25–34	Age 55–64	Age 25–64	Age 25–34	Age 55–64	Age 25–64	Age 25–34	Age 55–64
All people	71	72	69	100	100	100	154	149	150
Males	68	70	72	100	100	100	145	136	146
Females	73	73	70	100	100	100	177	182	159

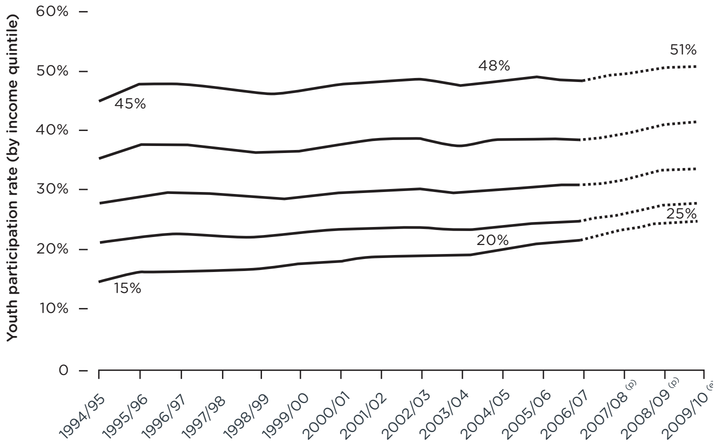
Index: 100 = income of those with post-secondary non-tertiary education as highest qualification, A level or equivalent

Source: OECD, Education at a Glance, 2010, based on 2008 data

despite their aspirations and the clear benefits associated with higher education, because of changes over the past 15 years middle earners are not benefiting as much as their higher and lower earning counterparts. Figure 4 shows five lines representing income quintiles based on the proportion of people in the household in receipt of income-related benefits. It shows that the highest level of growth in the number of young people entering higher education over the last 15 years occurred in the most disadvantaged households (the bottom line), and there was also relatively high growth in higher education participation among better off households (top line). It is in the middle line – the middle earners – where growth in higher education participation is slowest.

Further, with recent reforms to higher education funding, the 'real returns' on higher education for middle earners were cut, and applications to higher education institutions decreased by between 2.5 per cent and 1 per cent among the squeezed middle (compared with decreases of 0.2 per cent among the poorest fifth of households). This has been put down to the fact that universities have been given the ability to set fees up to a level of £9,000 per year, compared with the previous cap of

Figure 4 **Trends in young participation for areas grouped by the proportion of children in lower-income households, 1994/95–2009/10**



Source: HEFCE[27]

£3,000 per year. Average fees are now around £8,500, rendering children's attendance at university a significant financial commitment for middle earning families. The CEO of the Universities and Colleges Admissions Service (UCAS) commented on these figures, saying: 'Widely expressed concerns about recent changes in higher education funding arrangements having a disproportionate effect on more disadvantaged groups are not borne out by this data.'[28]

If a middle earner's child succeeds in becoming a middle or higher earner themselves, they will bear a higher rate of interest on their student loan than lower earners. For graduates earning between £21,000 and around £41,000, a real rate of interest will start to be charged leading to means-tested repayments plus an interest rate of the Retail Price Index plus 3 per cent.[29] Given these changes, middle income families report that they are reconsidering the viability of university education in response to the Government's plans: over half (51 per cent) believe that reforms will have an impact on their children's access to university, and 31 per cent believe it is not worth the investment.[30]

However, the burden of higher fees may not be the main issue – these are only paid off when the child has sufficient income (and in this they are more generous than the previous system). A potentially bigger problem is the lack of savings parents have to help their child cover immediate living costs. Middle earners are less likely to be eligible for the range of bursaries offered by universities to boost participation among students from low-earning families. Those earning less than £25,000 receive full bursaries for their children, while those in the squeezed middle would get partial bursaries as best.[31]

Table 4 shows the average annual living costs that students face.

According to a 2010 NatWest report on student expenditure, over half of students receive some form of financial support from their parents to meet such costs. Yet the amount of support parents have been giving has been squeezed. One in four students reported receiving less from their parents, and only one in ten more. This is particularly problematic, they report, as average student rent had risen on average by £312 over that year.[33] The maximum state support of £524 per year in partial bursaries that middle earning households are eligible for therefore does little to cover the outstanding immediate living costs of over £10,000 a year.

A 2011 HSBC study exploring the impact on higher fees found 10 per cent of parents reported that they would no longer contribute to their child's university education, while half of parents reported not yet having begun to start saving for their child's university education.[34] Only 10 per cent reported having begun to save more in response to the changes, and 16 per cent said they would save more to be able to afford their children's university education. While research by ING Direct found 13 per cent of parents were reassessing whether university was the right course for their children,[35] HSBC's data suggest more would try

Table 4 **Average annual student living costs, 2012/13**

	Inside London (£)	Outside London (£)
Rent	5,069	4,004
Food	1,788	1,788
Household goods	289	289
Insurance	65	40
Personal items	1,896	1,896
Travel	1,393	1,393
Leisure	1,197	1,197
Total living costs	11,697	10,607

Source: NUS study[32]

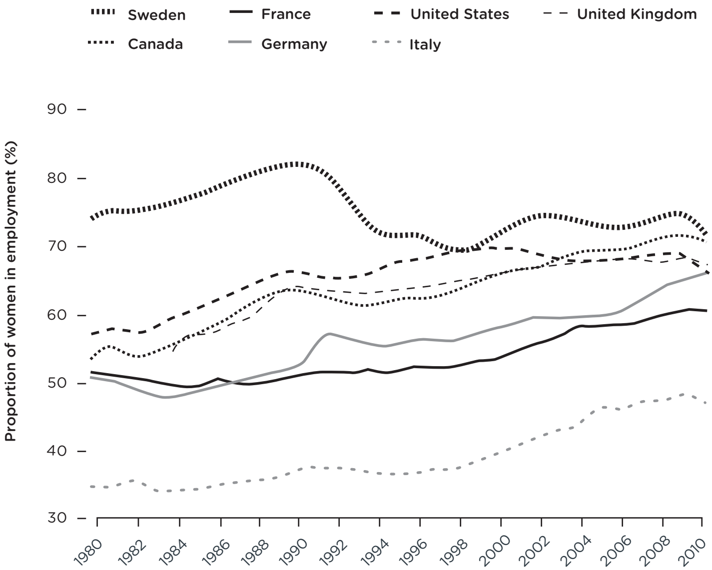
to cope with the costs: 20 per cent said that they would work overtime to be able to help; 26 per cent would consider asking their child to live at home during their university years; and 8 per cent would even downsize their home.[36]

Supporting the new labour force with childcare

The cost of childcare is rising disproportionately for middle income families, though because of their income dependency, they are particularly likely to require it.

The labour market has been transformed over the past 30 years. This has involved a rise of female participation in the workforce, particularly middle class women, as Universities Minister David Willetts discussed in 2011.[37] In the UK the proportion of women in work has risen from 59 per cent in 1980 to 70 per cent today. Now, the numbers of men and women at work are almost equal, with men performing 12.8 million jobs and women 12.7 million, though almost half of these are part time. In the first quarter of 2010, 66.5 per cent of mothers were in work.[38] The rate of employment is even higher among women from middle earning backgrounds. Figure 5 shows the number of women in employment as a proportion of the female population in the UK and other countries between 1980 and 2008.

Figure 5 **Women in employment as a proportion of the female population in the UK and six other countries, 1980–2008**



Source: OECD data[39]

This expansion has been able to bring new skilled labour into the workplace, improving productivity and economic growth. But it has also required a balancing act for many middle earning families between work and childcare. Greater flexible working has helped to ease the burden somewhat: today 56 per cent of employees work flexibly and 91 per cent of workplaces offer a form of flexible working arrangement.[40] Yet this hasn't been able to alleviate the burden for everyone, particularly because the cost of childcare is spiralling. In England the cost of a place in a nursery has risen by an inflation-busting rate of 5.8 per cent in the past year.[41]

Demos' report *Reinventing the Workplace* found that 15 per cent of women said they 'worked flexibly' because of the 'cost of childcare'.[42] In order not to forgo the economic benefits of greater female participation and not to create a barrier for families to work and improve their income, more support is needed to help cover the costs of childcare. The spiralling cost squeezes the potential earnings of middle earning households – forcing them to choose between career and family. It runs counter to the Prime Minister's ambition to make Britain 'the most family-friendly country in Europe'.[43]

The Daycare Trust ran a survey in 2012 to assess the burden of childcare on families. The average cost of 25 hours per week of childcare is in excess of £100 in England. Parents in London face the highest reported costs, up to £11,050 a year for 25 hours a week, or £22,100 for 50 hours.[44] Average English yearly expenditure on childcare is £4,576 in England, £4,368 in Scotland and £4,056 in Wales for 25 hours of nursery care per week for a child under 2. This is a substantial squeeze on household income for middle earners. Average English childcare costs equate to 18 per cent of equivalised household disposable income for the squeezed middle.[45]

The Coalition Government has sought to help tackle these spiralling costs, with the March 2013 budget laying out a plan to offer government funding for childcare – to the maximum value of £1,200 a year – to all two-earner families earning up to £300,000 a year.[46] However, while support for childcare is spread up the income scale, those in the squeezed middle lose out by tax credits being reduced by up to £1,560 a year and focused on lower earners, while the overall value of the voucher is reduced from £1,500.[47] The £1,200 available is a drop in the ocean compared with the overall cost to parents – representing one-quarter of average childcare costs per child per year.[48] It is highly unlikely that any government in the near future will be able to afford a dramatic boost to this grant – and supply-side reform, while improving the number of available places – has been criticised for having an adverse impact on quality and a minimal impact on cost.[49] What is needed in the long term is reduction in cost coupled with long-term support to individuals and families to prepare them for the cost of childcare in advance.

Demos also analysed the costs associated with parental leave. At present, the cost in lost earnings of parental leave for middle income parents is up to £20,000 per year. It can cover less than 15 per cent of an averaged waged parent's income if the fathers take their full allocation of leave. These costs can be immediately crippling to families, while not taking parental leave can hamper the longer-term development of the child.[50] Tables 5–7 illustrate this squeeze, showing the costs associated with different leave options, and contrasts it with the Icelandic system where four-fifths of income is guaranteed during parental leave.

In response to this squeeze Demos has previously proposed the creation of a 'carer's account' to help parents cover the costs associated with parental leave in the first year of a child's life. This is a critical year in the development of the child's cognitive and behavioural capabilities.[51] The carer's account would be an opt-out tax-free account into which the individual could save during their working life, with matched contributions by employers, to help cover up to two-thirds of their salary in case of parental leave. If the savings are not used they would go into

Table 5 **Situation 1: Mother takes parental leave for 52 weeks and returns to work; father takes two weeks of paternity leave**

Mother	6 weeks at 90% of wage	£2,370.6
	33 weeks at statutory maternity pay (SMP) rate (£124.88 pw)	£4,121.04
	13 weeks unpaid	£0
	Total maternity pay for 52 weeks	£6,491.64
	Total wages for 52 weeks' employment	£22,828
	Parental pay replacement rate	28%
	Lost earnings	£16,336.36
Father	2 weeks at ordinary paternity pay (OPP) rate	£249.76
	Total paternity leave pay	£249.76
	Total wages for 2 weeks	£1,076
	Parental pay replacement rate	23%
	Lost earnings	£826.24

Table 6 **Situation 2: Mother takes parental leave for 26 weeks and returns to work; father takes two weeks' paternity leave and additional paternity leave from week 27 to 52 then returns to work**

Mother	6 weeks pay at 90% of wage	£2,370.6
	20 weeks at SMP rate (£124.88 pw)	£2,497.6
	Total maternity pay for 26 weeks	£4,868.2
	Total wages for 26 weeks' employment	£11,414
	Parental pay replacement rate	43%
	Lost earnings	£6,545.8
Father	2 weeks at OPP rate (£124.88 pw)	£249.76
	13 weeks at OPP rate	£1,623.44
	13 weeks unpaid	£0
	Total paternity pay for 28 weeks	£1,873.2
	Total wages for 28 weeks' employment	£15,064
	Parental pay replacement rate	12%
	Lost earnings	£13,190.8

Table 7 **Situation 3: Icelandic model for the UK – mother takes non-transferable three months, father takes non-transferable three months, mother takes three months' shared leave**

Mother	13 weeks at 80% of wage	£4,565.6
	13 weeks at 80% of wage	£4,565.6
	Total maternity pay	£9,131.2
	Wages for 26 weeks	£11,414
	Parental pay replacement rate	80%
	Lost earnings	£2,282.8
Father	13 weeks at 80% of wage	£5,595.2
	Wages for 13 weeks	£6,994
	Parental pay replacement rate	80%
	Lost earnings	£1,398.8

Source: Demos analysis of ONS data, May 2011

the individual's pension.[52] Such an account could help support middle earners and their families maintain their standard of living while enabling their children to develop to the best of their potential.

Career

Middle earners, more dependent on their incomes than lower and higher earners in order to maintain their lifestyles, are particularly vulnerable to the current climate of job insecurity.

Middle earners face a significant drop in income if they become unemployed, with state benefits too low to cover their costs of living and possibly debt repayments. Higher earners face a dramatic drop too; however, both categories are likely to be privately insured against unemployment (see below) and have other assets and investments to draw on. Lower earners, on the other hand, will find state benefits less of an income drop. For example, a single person without children earning £17,000 pa pays under 20 per cent of their wages in income tax and national insurance contributions. If they were to become unemployed the state would replace 70 per cent of their after-tax income with out-of-work benefits. If that person were instead on an income of £37,000 they would pay a quarter of their income in tax and national insurance contributions, but the state would replace just 35 per cent of the individual's income.[53] This lack of reciprocity, where contributors are no better off than non-contributors, is seen as a driver for reduced public support for the welfare system (halving over the last 18 years).[54] Whereas in 2001, 88 per cent of us said that we believe government should be mainly responsible for ensuring unemployed people have enough to live on, currently only 59 per cent of us agree.[55] Furthermore, in the last 20 years, the proportion of us who say we want to see higher spending on benefits has fallen from around six in ten to an all-time low of just 28 per cent.[56]

Focus groups hosted during the course of this project found that while middle earners knew that state support for unemployment was limited, they were surprised by just how small it was for people in their position. These findings align with those of a recent poll by the TUC, which showed that the public over-estimates the amount claimants on out-of-work benefits can claim by 30 per cent.[57] Participants in our focus groups strongly challenged the lack of reciprocity in our welfare system:

To find out we are so low – does make me more scared. It would not benefit me as someone who has contributed significantly.[58]

Table 8 **The index of financial protection for OECD countries, 2009/10**

Country	Replacement ratio (%)	State benefits pa (£)	Total accident health (adjusted) and pecuniary loss premium value (£)	State protection index	Private protection index	Total protection index	Rank
Norway	66	23,318	4,591	95	71	83	1
Sweden	48	14,553	12,330	59	100	80	2
Netherlands	74	24,490	8,954	100	40	70	3
Canada	63	17,336	28,795	71	62	66	4
USA	51	16,738	202,335	68	52	60	5
Germany	60	17,852	39,355	73	38	55	6
France	67	18,050	19,877	74	28	51	7
UK	38	14,991	20,637	61	26	44	8
Spain	60	16,333	6,023	67	10	39	9
Italy	59	14,887	2,663	61	4	33	10
Australia	31	10,106	2,129	41	7	24	11
Poland	45	6,206	2,797	25	6	16	12

Source: Demos analysis of OECD statistics, 2009/10

If you're used to living on [the] minimum wage, you don't spend more than you get. So you need less to keep you afloat when you lose your job, less than someone who's got a mortgage to pay and lives in a more expensive area. It's about what you need, what you're used to.[59]

The lack of support is not just a felt experience by middle earners, but an objective failure compared with our peer nations. Demos drew on OECD data to compare private and state-provided financial protection that middle earners had against unemployment in 11 peer nations (table 8). The UK performed poorly, coming eighth of 12, and had poor state and private provision. For middle earners in the UK, state unemployment benefits covered just 38 per cent of their income, second lowest only to Australia, and worse than even Poland and the US. Second, British citizens' private protection against unemployment was minimal. The number of people in the labour force with unemployment-related insurance was just a quarter of that of the best nation, Sweden.

One area where this lack of protection is particularly damaging is in the case of disability. Around 4 per cent of the population is struck with disability during their lifetimes. Yet the disability itself is not the only difficulty disabled people face; the spill-over effects are most clear when looking at income. For someone in work in the squeezed middle, disability results in a cut in excess of 50 per cent of their income and a potential lifetime of dependency on the state for financial support, without savings or assets to fall back on.

Demos has argued in the past that one way of improving the out-of-work incomes for middle earners, who themselves are sceptical about their ability to survive on state levels of unemployment benefits, is through the promotion of 'income protection insurance'. Currently, 11 per cent of employees have such policies, but they are concentrated among highest earners. Middle earners would also benefit substantially from such products, but the low take-up is a result of several factors, including cost, lack of awareness of risk by consumers, and confusion with 'mistrusted' insurance products like Payment Protection Insurance.[60]

Alternatively, James Purnell, the former Secretary of State for Work and Pensions, has put forward the idea of 'salary insurance'. He suggested that when people become unemployed they should be eligible for a non-means-tested loan from the state, capped at £200 per week, at a zero rate of interest. The amount would then be repayable when the person returned to employment.[61]

Old age

Although the squeezed middle are likely to consider it the individual's responsibility to save for old age, low savings rates will leave them particularly vulnerable in retirement, while many regard financial products that might help them with ambivalence.

Britain is ageing. Over the past 25 years the number of people aged over 65 has increased by 1.7 million. As a share of the population, this is a rise from 15 per cent in 1985 to 17 per cent in 2010, projected to rise to 23 per cent by 2035.[62] The number of centenarians is also rocketing – by 2066 it is estimated that there will be half a million.[63] But middle earners, more than others, are not saving enough to be able to maintain their welfare across their lengthening lifetimes.

Research by Chatham House projected that middle earners could expect to see their income in retirement drop by more than half from their pre-retirement income. These households – without significant savings or other assets – will be left with few sources of income beyond the basic state pension. Not only is their retirement income low, but they will also be the quintile most affected by worsening retirement incomes over the period to 2050, as a result of being more affected by projected trends such as the impact of low bond yields, low house price growth and an accelerated shift out of defined benefit pension scheme membership.[64]

Interestingly, middle earners tend to believe that the responsibility for retirement belongs to the individual. A survey in 2009 by the DWP of attitudes to pensions showed that 60 per cent of people in this income bracket considered it the individual's responsibility to provide for their income in retirement (compared with 56 per cent on average across the whole sample), while 35 per cent considered it the government's responsibility (compared with 38 per cent on average across the whole sample); 4 per cent of middle earners considered it mainly an employer's responsibility. This might suggest that middle earners want to save more than they do, but they also expect the state to take a role in encouraging individual responsibility: of this income group, 85 per cent agreed or strongly agreed that it was the responsibility of the Government to encourage people to save for their retirement.[65]

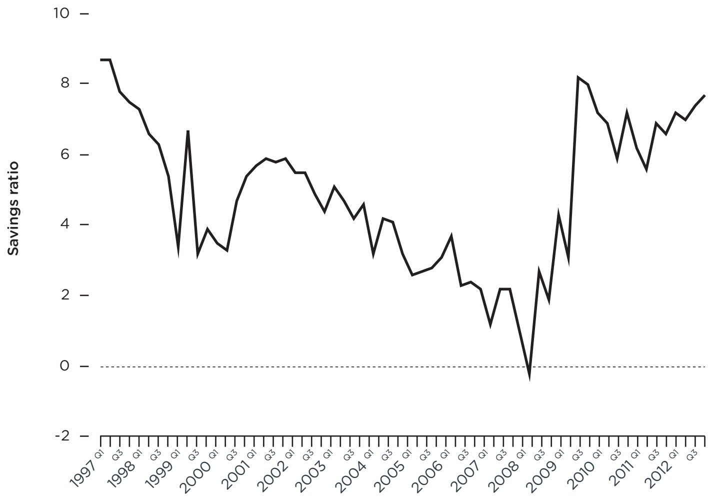
However, household savings remain historically low, which the Workplace Retirement Income Commission (WRIC) considers will affect saving for retirement detrimentally.[66]

Indeed, in 2012 private sector pension savings fell to an all-time low, with just 1.9 million contributing to their pension compared with 5.9 million in 2000.[67]

The household saving rate (the proportion of disposable income households saved or used to repay loans debt each week) was 4.6 per cent in the first quarter of 2011, and has fallen, after a high of 7.5 per cent in 2009.[68] By contrast, the average rate in the 1990s was 9.2 per cent and 8.7 per cent in the 1980s. It is important to note that household saving as a proportion of income did increase marginally in the third quarter of 2012 – up 0.3 per cent year-on-year – but this increase equates to roughly £79 in savings for an individual earning £35,000 pre-tax per year.[69] The latest figures show that the savings ratio remains at below 8 per cent of disposable income – still significantly below pre-1997 levels and lower, even, than in 2009. Figure 6 shows the household savings ratio in the UK between 1997 and 2012.

We have already identified numerous reasons why household saving may have declined in recent years, but the WRIC indicates another barrier to greater pension savings: attitudes towards financial products. Trust in the financial services industry – and by extension financial products – has been shaken as a result of the 2008 crisis. The WRIC report found that the proportion of the public who believe that banks and building societies will 'act competently' has declined by 8 per cent and 'with care' by 18 per cent since 2006. Less than half of respondents to the DWP's attitudes to pensions survey in 2009 considered pensions the most secure way to save for retirement, compared with 63 per cent in 2006. Indeed, in 2009, 21 per cent of the working-age public who had ever had a private pension reported a negative experience relating to it, such as being sold an unsuitable pension, or losing all or most of an employer's pension after changing jobs. There is a strong relationship between the incidence of negative pension experiences and the likelihood of one choosing another form of saving for retirement: 42 per cent of those who had had a negative experience chose to save in another way, compared with 29 per cent of those who had not.[71]

Figure 6 **Household savings ratio in the UK, 1997–2012**



Source: ONS[70]

The WRIC report concluded that ignorance about pension options was to blame for low savings rates, above distrust of pension schemes, as a means of providing for retirement.[72] The DWP suggests that the most significant factor explaining negative attitudes towards pensions among the public was the complexity of pensions, while a significant minority agreed that pensions were 'boring'.

While these trends emerge from looking at broad studies of public attitudes to financial services, as we will see in chapter 4, middle earners are particularly likely to doubt the value of existing forms of protection against future financial costs, despite their belief in individual responsibility for saving.

The public generally considers itself ill-informed about pensions provision, with lack of confidence linked to age and gender. The DWP reports that in 2009 just 6 per cent of the public considered themselves to have good knowledge of pension issues, while 29 per cent considered that they had little or no knowledge. Even the highly educated felt this way: 67 per cent of those with a degree found pensions 'so complicated that they did not know how best to save', and 77 per cent of those with no qualifications felt the same. Men and older respondents were more likely to believe themselves to have good knowledge of pensions than women or the young.[73]

Here again, the squeezed middle are at a disadvantage – higher earners are much more likely to have financial advisers to help them navigate the complex world of saving and investment, annuities and other long-term vehicles. Lower earners, reliant on benefits and basic pensions or pension credit in old age, do not have the same need for savings advice and are often supported by the voluntary sector for their financial information needs. But the squeezed middle – not wealthy enough for an adviser but in need of advice all the same to maximise their modest pensions – are left exposed.[74]

Social care

The current system of means-tested support for old age care denies help to middle earners who have saved, and there is currently a very limited selection of financial products to help middle earners with care costs.

The other aspect of an ageing population is increasing demand for old age care. According to the Department of Health's Dilnot Commission on funding of care and support, the cost of care in old age care has risen to an average of £30,000 in total, and a fifth of users have a bill in excess of £100,000.[75] This has been a particular burden for middle earners, given that the means test was set at a very modest £23,250. As table 2 showed, only a tiny proportion of middle earners fall below this line, so most have to pay for all or some of their care. They sit on the cliff edge of the means test – too 'wealthy' to be eligible for support (as a result of being home owners), but not wealthy enough (because they lack savings) to make care costs easily affordable.

The Dilnot report captures this problem concisely:

The system as established is perceived by those who use it as unfair, for example when they have to sell their home or use up most of their assets. It penalises savers, offering almost no help to those with savings over the means-tested limit, but who require home care, for example. It is also ill-understood (the authors note that many people assume that their care in later life will be free). Even if individuals understand the current system, there is little they can do to prepare, given the doubt over how much their care might cost. There are currently no pre-funded insurance products for care, partly because of this uncertainty, and partly because of the risk of potentially huge care costs that insurers would incur.[76]

In response to this inequity, which falls disproportionately on middle earners, Dilnot recommended a mix of state and private sector support. He suggested that individuals pay up to £35,000 towards the cost of their care, but from there the state steps in to cover any further payment. The hope is that this will prevent the need for care users to sell their homes. He also pushed for a rise in the level of means testing of wealth from £23,250 to £100,000, which he states would result in a system whereby

no one would see their assets depleted due to the cost of funding their care by more than approximately 30%, due to the capped cost of £35,000 and the extended means test. (Under the current system, an individual with savings of £150,000 could lose up to 90%.)[77]

As table 2 shows, around a quarter of middle earners have less than £100,000 in wealth. But there are two key problems. First, we can expect substantially less than 15 per cent of middle earners to have savings of £35,000. Second, having savings at this level excludes people from receiving state support in case of unemployment. Essentially, our system either penalises people for saving for old age care or eventually penalises people for not saving for old age care.

The Coalition Government has now announced its plans for funding long-term care. Under these proposals, the logic of the Dilnot review will be applied but with very different numbers involved. By 2016, residential care will be provided free or at a subsidised rate for individuals with assets lower than £118,000 (including the value of their home). Considering the average value of a home in the UK is now £238,293, we can see that very few people in our middle-earner category are likely to find themselves immune from meeting costs.[78]

For those with assets higher than £118,000, a 'ceiling' will apply of £72,000. This means the maximum a person will pay towards their care is £72,000, after which time the state will step in and pay. This plan creates some level of protection for the 16 per cent of older people needing care each year faced with 'catastrophic costs'.

There are, however, some limitations to this model. First, the means test for domiciliary care will remain at £23,500 (excluding one's home), so for those not needing to move into a residential home, eligibility for free care remains relatively ungenerous (although the same £72,000 ceiling applies). Second, the £72,000 cap does not include 'hotel' costs – the accommodation element of residential fees – which people will have to pay for themselves. Therefore, many people will have to find ways to afford much more than £72,000 before free care becomes available. Middle earners' savings will still be unlikely to stretch to a possible £72,000 – and many will, anyway, have to use the value of their home in order to meet additional hotel costs or pre-residential domiciliary care costs.

Until now, the potentially unlimited costs of care have made products such as 'immediate needs annuities', which insure against spiralling long-term care costs, very expensive (with premiums of around £80,000) and primarily appeal to the very wealthiest. Dilnot has subsequently suggested that a fixed cap will change this, and give the financial services industry the certainty about its potential liabilities required for it to market insurance products to cover the cost of care: 'By giving certainty about the amount which an individual will be required to pay, the authors expect new insurance products to emerge in response.'[79]

However, some experts have doubted the cap's ability to help build a self-protecting model for long-term care – James Lloyd, of the Strategic Society Centre, for example says, 'The implementation of the [cap cost model] and the design of the model and the implications for users means there will be no market at all.'[80]

Even if the market for such products were to emerge, it would likely face a degree of ambivalence among middle earners. In chapter 4 we will explore the phenomenon of middle earner apathy towards insurance products and savings, but our polling is particularly telling: only 10 per cent of those aged 35 to 44 and earning between £33,000 and £44,000 annually have made preparations to cover the costs of social care needs later in life. Some of these people are little more than a decade away from needing to meet these costs, and have yet to prepare. Equally, they assert determination to meet these and other costs independently. These are understandable and praiseworthy aspirations, but in a group with relatively modest assets and an increasing amount of risk levied on them they display a set of priorities that have not adjusted to the realities of their situation or policy moves in this area.

With this in mind, it is clear that a two-pronged approach to tackling the long-term care crisis – and its devastating impact on middle earning families – is required.

First, we would need to create a mixed policy framework to reduce the financial shocks of requiring care; and second we would need to build up long-term resilience in the UK population in order to better finance care in the future. The first of these needs will necessarily include new approaches to equity release – a set of products that allow the squeezed middle to pay for domiciliary and hotel costs from their primary (often only) asset – their home – without losing it in their lifetime. As the Joseph Rowntree Foundation has argued:

Existing private options to release home equity to pay for long-term care or other items can be expensive, and are not well taken up by lower-income groups. An alternative is to create a scheme that combines public and private resources to help cover domiciliary care charges for those finding them hard to afford. This would be voluntary, with the purpose of enabling but not obliging people to deploy some of their home equity to help meet existing private costs of care at home, whether to pay existing local authority *charges or to make it possible to afford a wider range of care services than offered by the local authority. This would make it possible for users to get care free at the point of use, and to repay charges, plus modest interest (at base rate), when the person eventually sells their home.*[81]

But such an approach would need, also, to find ways of demonstrating affinity for the values of the squeezed middle – many of whom told us in focus groups that a key political and emotional flashpoint for them was the thought of being unable (after a lifetime of work) to leave even a small amount to their children from the equity they've accumulated.

The second strand of an overarching approach must concern itself with promoting long-care products more aggressively and to individuals much younger than those currently involved in these conversations. The Joint Committee on the Draft Care and Support Bill in its interim report calls for 'a national campaign to raise awareness of what the national care and support offer is, how people can plan and prepare for their own care needs, and what rights they have to care and support'.[82]

Government must find ways of raising awareness of this crucial and often devastating life-cycle cost among the squeezed middle – as home owners with low savings, they are in the worst position of being both ineligible for state support (because of their home) but unable to pay for their own care with ease (as they lack sufficient savings). Their scepticism regarding financial products which might protect them from paying these costs only exacerbates the issue – something we explore further in the following chapter.

4 The squeezed middle and financial products

This chapter explores the attitudes and behaviour of middle earners around finances and insurance. This will help us understand why middle earners are failing to protect themselves against key risks in the life cycle and how we may promote greater responsibility. It will be shown that part of the problem lies with the short-termist behaviour of middle earners, part a result of the macro-economic choice of government and its lack of planning, and part due to lack of a substantive private sector infrastructure to support them. This analysis will focus on three key areas: savings, debt levels and attitudes towards insurance.

Savings and debt

Household savings are historically low and inflation is discouraging further steps to plan for long-term costs. Nor are middle earners benefiting from low interest rates.

British households were unprepared for the financial crisis. In 2008, the average UK home had one of the lowest savings rates in over a generation and, as we explain above, despite a recent up-tick, savings rates remain historically low.

Limited savings is a particular problem for middle earners, as can be seen in table 9. Over 40 per cent of middle earning households have savings and investments equivalent to less than a month's household income. This puts them at great risk if there is any change in their financial position, particularly because of their income dependency. What is also interesting is the divergence of savings positions within the group: a substantial number have in excess of six months' worth, and a large number have less than a month's worth, of income in savings. Around 18 per cent of middle earners have over £16,000 in savings and investments. This also puts them at risk: those with savings in excess of £16,000 are ineligible for several income-based means-tested benefits in the event of job loss or illness, and also, because of low interest rates and rising inflation, the real value of their savings and investments are depreciating.

Further, table 10 shows that middle earners depend on few savings and investment devices. Nearly all middle earners have current accounts, and a majority have another bank or building society account. Yet less than half have an ISA and share ownership is limited. This demonstrates the lack of forward-looking financial behaviour among middle earners.

As outlined at the beginning of this report, the squeezed middle were not big savers before the downturn and relied on readily available credit to maintain their standards of living. The financial crisis disrupted access to credit, with the Bank of England reporting a 5 per cent rise in the proportion of people concerned about the availability of credit.[85] The most common transmission mechanisms for credit accessed by British households are mortgages, particularly among middle earners, but loan approvals for those on middle and low incomes have fallen significantly. Lending criteria tightened at the middle and bottom end of the market, and mortgage approvals only rose in the £750,000 price bracket. Deposits required by lenders in 2011 remain at levels near those required during the peak of the credit crunch.[86]

The reduction in the Bank of England Base Rate from 5 per cent to 0.5 per cent at the end of 2008 has to some extent encouraged borrowing and disincentivised saving.[87] In important ways it has benefited households: those with tracker mortgages have experienced significant falls in their monthly repayments over the last five years. Between 2008 and 2011 the average mortgage rate paid by existing borrowers fell from 5.80 per cent to 3.49 per cent. However, low-to-middle earners are substantially more likely to have a fixed-rate mortgage than higher earners, and so have not received the full benefit of reduced interest rates.[88] Further, lack of long-term planning remains: the public considers itself highly vulnerable to volatile mortgage interest rates. Households report that the impact of a rise of only a few per cent would cause 21 per cent to cut their

Table 9 **Households by amount of savings and investments, and total weekly household income (percentage of households)**

Amount of savings and investments	Total weekly household income: Less than £100 (%)	£600 but less than £700 (%)	£700 but less than £800 (%)	High earners: £1,000+ (%)
No savings	45	26	22	12
Less than £1,499	16	22	22	15
£1,500–2,999	5	8	10	7
£3,000–7,999	11	15	17	18
£8,000–9,999	4	4	4	4
£10,000–15,999	6	8	9	10
£16,000–19,999	2	3	3	4
£20,000 or more	10	15	14	29

Source: *Family Resources Survey*, 2009–10[83]

Table 10 **Households by type of savings and investments, and total weekly household income**

Types of savings and investments	Total weekly household income: £600 but less than £700 (%)	£700 but less than £800 (%)
Current account	96	96
NSI savings account	4	4
Basic bank account	7	6
Post Office card account	4	4
ISA	43	48
Other bank or building society account	51	55
Stocks and shares or member of a share club	17	18
Unit trusts	4	3
Endowment policy not linked	2	1
Premium bonds	21	23
National Savings bonds	3	4
Company share scheme or profit sharing	2	5
Credit unions	1	2
Any other type of asset	1	1

Source: *Family Resources Survey*, 2009–10[84] spending on luxuries severely, and 17 per cent to cut their spending on basics severely; 7 per cent would not be able to pay their mortgage; 11 per cent would work more hours; 9 per cent would extend the term of their mortgage; and 40 per cent would have to 'tighten their belt'. Only 20 per cent suggested it would have no impact.[89]

The fall in mortgage interest rates and interest repayments should make debt more affordable to households. Yet in 2011 the proportion of households who were spending more than 20 per cent of their gross income on mortgage repayments had fallen only slightly over the previous two years, a trend most likely due to declining incomes, the high proportion of fixed-rate mortgages, and the wish to pay off more of one's mortgage in principle.

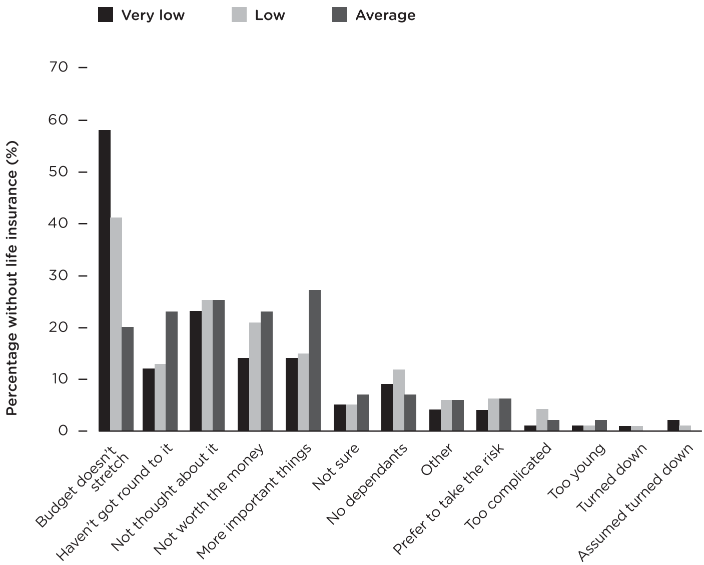
It is also becoming increasingly expensive to run a home. While mortgage payments have fallen in recent years, Halifax reports that mortgage repayments are the only cost of homeownership to have fallen between March 2008 and March 2011.[90] After a decline in the costs associated with owning a home after 2008, between March 2010 and March 2011, the cost rose by 1.4 per cent. The rising cost of electricity and gas charges (by £68) was the biggest contributing factor to the rising cost of home expenses. Utility bills have risen by 19 per cent (£237) since 2008.[91]

Insurance

Middle earners are more apathetic than higher and lower earners about insurance products that could help them mitigate the dangers of income-reliance.

The opinions expressed in our focus groups pointed to widespread disinterest with financial services and financial products, with many suggesting they could not afford to buy such products and dismissing the need to until their incomes inevitably increased (displaying aforementioned irrational optimism). This is borne out by other research, including a survey by the Association of British Insurers, which asked people on medium incomes their reasons for not having life insurance. Unlike those on very low incomes, who said that their budget

Figure 7 **Reasons for not having life insurance, by income group, UK, 2006**



Source: ABI[92]

could not cover the premiums, the most common response among those on 'average incomes' was that they had 'more important things' to spend their money on – suggesting they made a value judgement about the importance of insurance relative to other expenditure.[93]

According to figure 7, apathy is also one of the key barriers to average income households purchasing insurance – with not thinking about it or not getting round to it key factors for the squeezed middle.

Table 11 **Views on whether government or private companies are best at getting the long-term unemployed into work, by quintile, 2011**

	Definitely government (%)	Probably government (%)	Probably private companies (%)	Definitely private companies (%)
1st quintile – less than £15,000 pa	39.2	35.7	18.5	6.5
2nd quintile	39.5	37.6	17.6	5.3
3rd quintile – middle earners	39.9	42.7	12.6	4.8
4th quintile	35.6	42.5	16.8	5.1
5th quintile – over £56,000 pa	35.9	42.2	19.2	2.7

Source: Demos analysis of BSA survey, 2011

Importantly, those on middle incomes are also the most sceptical about the ability of private providers to help the long-term unemployed find work. When asked by the BSA 'Who do you think is best at getting the long-term unemployed into work – the Government or private companies?' (table 11), middle earners were the most likely to say the Government, suggesting they may be least likely to take out private protection against unemployment (despite being the most likely to benefit from it, as we explained above).

5 Concluding thoughts – building reasonable hope

This report has outlined the financial challenges faced by the squeezed middle – both immediate and related to difficulties over the life cycle – the perceptions of their situation and attitudes to resolving it. It is not a particularly encouraging picture. The group remain overly optimistic about their precarious situation, which is highly income dependent. With low savings and few other assets besides their homes, a legacy of credit reliance, which has now dried up but must still be repaid, and under-use of insurance, this group is extremely vulnerable in today's unstable labour market and stuttering economy.

Unsurprisingly, the squeezed middle as we define them – those who literally fall into the middle quintiles of earners in the UK – are not the obvious targets of Government attention. For the most part, they 'get by'. They are autonomous and self-sufficient – and proud of that fact – and to the outside world their lives do not smack of poverty or deprivation. But these people, the much vaunted 'strivers' of the UK economy, are in trouble. Contrary to their own assumptions, and the narrative of convenience for many politicians, it is not the recession that has caused the difficulties faced by many squeezed middle individuals and families, rather the culmination of longer-term trends. The financial collapse – and particularly the sudden withdrawal of cheap and available credit – has jolted squeezed middle families. But that is a symptom rather than a cause. The fact that so many of these families were so reliant on borrowing to keep their heads above water should, in and of itself, be seen as problematic.

Those in the squeezed middle have been victims of long-term trends in behaviour, attitudes and wages – trends that have rendered them financially vulnerable. Many of the macro-economic trends that have caused this look set to continue for the foreseeable future. With this in mind, this report has explored two issues: the nature of the predicament that middle earners face now – the 'immediate squeeze', and the longer-term life-cycle challenges they will face – from childcare, to sending children to university, and preparing for later life.

Helping the squeezed middle will be extremely challenging. First, this group is not a priority of policy makers, whose focus on 'strivers' and 'squeezed middle' results in policies aimed at the working poor or below-average earners, where problems and required solutions look very different. Second, those in this group are not open to direct state intervention, prizing as they do autonomy from the state. Third, they also are not motivated to help themselves, through saving or buying insurance products to mitigate the risks they face – such as unemployment or ill health in later life. This is driven by a dangerous, irrational optimism found among those in the squeezed middle regarding the transitory nature of their present problems and their ability to cope should things go from bad to worse. Their optimism is belied by the projections for the labour market and economic growth, their ill-preparedness for future life-cycle costs, and trends related to pensions and policy changes, which will see them consistently lose out relative to their poorer and richer counterparts.

It is clear that no single policy intervention will help the real squeezed middle. It is not a matter of bringing in the living wage, boosting tax credits, or even encouraging greater financial literacy. Instead, this group must be helped to move from an 'irrational optimism' about their situation to a more 'reasonable hope'. Attitudes towards savings, pensions and financial security – which are, in principle, positive among the squeezed middle – have to be translated into reality. That will not be done by creating the impression that government will be able to spend for them – the squeezed middle do not want government to solve their problems, even if it could afford to do so in this period of austerity. At the same time, simply cutting the taxes paid by the squeezed middle may ease immediate pressures but will not help to build the long-term financial resilience that those in the squeezed middle need for sustainable improvements in their situation. Our research shows how savings, pensions and other protections are often the first to fall off the squeezed middle's priorities and the last to make it back on to the list.

While we have not provided any specific recommendations here, the findings in this report suggest that any policies to help the real squeezed middle will be most effective if they work with the grain of their instincts towards optimism and autonomy. For example, using targeted rebates to encourage middle earners to build their life-cycle protections and resilience would reward autonomy, help individual independence and mitigate risks to the Exchequer – a win-win situation. Innovative approaches to building the insurance and equity release markets in ways that encourage the use of income and assets while reinforcing and rewarding the positive values of the squeezed middle would also be fruitful avenues to explore.

But we also need government to be direct and honest with middle earners about their individual and collective financial vulnerabilities. Using the revolution in data to communicate more effectively with individuals, families and demographic groups about the impact of their personal decisions and of government policy on their long-term financial robustness is a promising way forward that ought to be explored. Such an approach will require coordination between government and the private sector, but it is neither impossible nor particularly costly. If government can't solve the long-term problems faced by the squeezed middle, it can at least give them a reality check.

In short, we should be working with the grain of what makes the squeezed middle striving, aspirational and hard working, but at the same time, we should be trying to nudge these individuals into choices that will protect their long-term financial futures and help them to overcome the corrosive impact of long-term trends. Even if a new age of cheap credit were to dawn tomorrow, it would be unwise simply to sit back and allow individuals and families to pretend that borrowing will solve their worries. We need to help this wage-dependent group to build the assets that will insulate them from shocks and offer them prosperity as they transition out of the workplace.

Despite their problems, the real squeezed middle are defined, attitudinally, by a set of values that are deeply admirable and hugely helpful to politicians. They are proud of their self-reliance and work ethic, and determined not to rely too heavily on the state. While 95 per cent of respondents believe that they are taxed either about right or too much, 66 per cent agree that the level of state provision to families like theirs is either about right or too generous. This is not a group in search of a hand-out solution to their troubles.

The truth is that the squeezed middle need to save more, insure more and protect themselves better – they understand this but they need help to achieve it. Government has a real role to play in driving this crucial change.

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This project was supported by:

PRUDENTIAL

Since the economic downturn, the vast majority of Britons have been facing a cost of living crisis. This report looks at how the UK's middle earners – earning between £31,000 and £42,300 a year – have fared in the years since the crisis of 2008. It lays out the particular challenges and threats faced by this group: including their dependency on wages, pre-2008 dependency on credit, low levels of saving, and a pervasive optimism regarding their situations, which discourages them from protecting themselves against future hardship.

Contrary to their own assumptions, it was not the financial crisis which created the difficulties faced by this squeezed middle – it has instead exacerbated pre-existing financial vulnerabilities. These long-term trends will continue to dog the squeezed middle throughout their life cycles – hitting them with costs and financial pressures for which they seem under prepared. *Irrational Optimists* shows that although these issues are present in their thoughts, preparing for them is not an immediate concern.

Despite their problems, this group are defined by self-reliance and a strong work ethic, and are determined not to rely too heavily on the state. The findings presented in this report suggest the squeezed middle must be helped to move from an 'irrational optimism' about their situation to a more 'reasonable hope', through policies that work with the grain of their instincts. Policy makers must also nudge this group to become more aware of the risks they face – tax cuts or similar help will not help to build the more long-term, sustainable financial resilience that is required.

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ISBN 978-1-909037-50-2 £10