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WEALTH in the UK

Distribution, Accumulation, and Policy

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The opinions expressed here and any remaining errors are, of course, those of the authors, and not of any of the organizations or individuals that have helped and supported us.

Centre for Analysis of Social Exclusion
London School of Economics
August 2012

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Introduction

John Hills

Wealth, as the late Douglas Adams once remarked of Space, is big, really big. The most comprehensive survey ever carried out on wealth in Britain—barring perhaps the Domesday Book—the Office for National Statistics' Wealth and Assets Survey put a value of £5.5 trillion on the total value of personal wealth in the wave of the survey carried out between 2008 and 2010. This was nearly four times annual national income at the time. Adding in the value of people's rights to pensions from employers and other private sources—generally of most importance to people higher up the wealth distribution—the total was even higher, £10 trillion, and if rights to state pensions were included, the number would be higher still.

Of that total, £3.4 trillion was accounted for by the value of houses and other property, net of mortgages, £1.1 trillion by net financial assets, and £1.0 trillion by what ONS counts as 'physical wealth'. The latter includes consumer durables, the contents of people's homes, and vehicles. It even includes an astonishing £1.8 billion for the value people put on their personalized vehicle number plates.[1]

To put that in more accessible terms, median net household wealth—the level where half of households have more and half have less—was £145,000 if private pension rights were not included, or £232,000 if they were. This compares with about £23,000 per year for median gross full-time earnings in 2008, or around £20,000 for median net household income.[2] In other words, median household wealth is between seven and twelve times the value of median annual household income. In the decade from 1995 one measure of

[1] An average of £1300 for 5.7 per cent of households (Black, 2011, ch. 3, tables 5 and 6).

[2] After income tax and National Insurance Contributions, and adjusted for family size to give the amount that would give an equivalent spending power to a couple without children. Figures from Hills *et al.* (2010, ch. 2).

median net household wealth rose in real terms by an amount equivalent to more than three years' worth of individual annual pre-tax earnings.[3]

Who has that wealth, how it is distributed between them, and who is affected by changes in its value can therefore have even larger implications than similar features of the distributions of income and of earnings. Yet, in thinking about social and taxation policies and about the distribution of economic resources across the population, far more attention is paid to the flow of income to individuals and households than to their stock of assets (or debts).

In part that is because day-to-day economic life is dominated by income. Much wealth does not generate an immediate flow of cash, and the increases in its value may not be immediately apparent. In the middle of a house price boom, people who own a house sometimes remark that their home 'earned more' than they did last year, but actually spending that capital gain is as not straightforward as spending cash that arrives in a bank account. Equally, the increase in the effective value of someone's promised pension rights as we revise upwards prospective life expectancies is often not readily appreciated.

Despite the complexity of the issues involved, the distribution of wealth has profound impacts on society. 'Equality of opportunity' is an aim said to be central by both the New Labour government that lost office in 2010 and the Conservative-Liberal Democrat coalition that replaced it. But access to wealth can determine whether parents can afford to buy a house in the catchment area of the most popular state primary and secondary schools. A small amount of savings early in someone's career can allow them to take unpaid work for experience, take risks, or pump-prime an enterprise. Parents trading down their own property can help children get on or move up the housing ladder, and to live in parts of the country where there are most work opportunities. The prospects for the quality and security of life in retirement are hugely different between those who have accumulated savings and pension rights and those who have not. While it is not necessarily a main causal factor—as opposed to reflecting the accumulation of other advantages—wealth in the first wave of the English Longitudinal Survey of Ageing turned out to be a better single predictor of whether those aged over 50 survived the next six years than factors such as occupational social class or education.[4] A quarter of the men with the lowest fifth of household wealth had died within the six-year period, compared to a tenth of those with the highest fifth of wealth. And each year around one adult in forty benefits from an inheritance with an

[3] From £37,000 to £110,000 at 2005 prices (see table 2.6). Figures include net financial and housing wealth only.

[4] Nazroo, Zaninotto, and Gjonca (2008, p. 267).

average (although very unequally shared) value greater than a year's worth of pre-tax annual earnings.[5]

Our aim in this book is therefore to provide an integrated study of the distribution of wealth in Britain. We present a detailed discussion of trends in the distribution of wealth in the UK and compare the current position with that in other countries. We use longitudinal data to examine trajectories in wealth accumulation over the decade to 2005 and patterns of inheritance over the same period. We look at the evidence on the impact of both parental wealth levels and of asset-holding in early adulthood on later outcomes. We then examine the ways in which policies towards wealth-holding developed historically, and the resultant policy mix across tax, means-testing, and policies to encourage saving, and finally how these policies might change in the future.

Chapter 2 sets the scene by describing the results of several exercises that have investigated the distribution of wealth in the UK (or parts of it) and how it has changed over time. We use material from official sources such as the long-run HM Revenue and Customs series based on the reported value of people's estates and the new Office for National Statistics Wealth and Assets Survey, as well as our own analysis of data from the British Household Panel Survey (BHPS). The chapter presents a picture of wealth distribution in Britain today, looking not just at differences between the wealthiest and the least wealthy, but also analysing those between and within social groups defined by age, housing tenure, and occupational social class. We argue that we need to think not only about what has happened to *relative* wealth differences—such as the percentage shares of the total going to the top 1 per cent or 10 per cent—but also at what has happened to *absolute* differences—how have gaps changed between those near the top, in the middle, or at the bottom in terms of what they represent in terms of other measures of economic resources, such as annual incomes. Those absolute gaps have widened considerably.

The picture we present in Chapter 2 is one where wealth inequalities in Britain are much greater than those we are used to when looking at income differences. For instance, surveys suggest that those near the top (at the 90th percentile) of the earnings and income distributions have weekly earnings (before tax) or household incomes (after tax) that are around four times higher than those of people near the bottom (at the 10th percentile).[6] For household wealth (as reported to the 2008–10 Wealth and Assets Survey) the corresponding ratio is seventy-seven to one. Summary measures of inequality such as the Gini coefficient are far higher for wealth than they are for income.

[5] See Chapter 5.
[6] Hills *et al*. (2010, ch. 2).

However, in international terms this level of inequality does not appear to be so unusual. We investigate this in Chapter 3, using newly available data from the international Luxembourg Wealth Study. The chapter examines the difficulties in making this kind of comparison between countries and looks in particular at the way in which differences in coverage of the very wealthiest can affect the comparisons. It uses modelling of the ‘upper tail’ of the distribution to correct the pictures shown by national surveys and to clarify the international comparisons, using data from Sweden, the USA, and Canada as well as for the UK. We conclude from this that variations in coverage of the very top of the wealth distribution are not in fact the explanation of, for instance, the perhaps surprising observation that levels of wealth inequality are actually higher in Sweden than they are in the UK (although the importance and role of personal wealth differs considerably between the two countries).

In Chapter 4 we also use data from the BHPS to investigate trends in the distribution of household wealth accumulation between 1995 and 2005. The panel nature of the survey allows us to track how particular households built up their wealth over the period and to examine to what extent the final distribution was the product of life-cycle effects, where people first build up their wealth in their working lives through saving or buying a house with a mortgage they pay off and then run down their wealth through their retirement.

We find a widening absolute gap over the period between wealthier households and those with no or negative wealth. However, in relative terms, the BHPS suggests that wealth grew fastest for households in the middle of the distribution, and inequality measured by the Gini coefficient decreased. This mainly reflected housing wealth becoming a greater share of net worth, more equally distributed, and the highest percentage increases in housing wealth taking place in the middle of the distribution. Given the remarkable rise in house prices over the period, the chapter analyses the distributional impacts of the house price boom. We simulate the distribution of net housing wealth in 2005 under the hypothetical scenario that real house prices had remained the same as in 1995. We find that for the panel of households used, the reduction in wealth inequality is almost entirely accounted for by changes in house prices. The chapter also examines how the patterns of accumulation depending on people’s age, initial wealth, educational qualifications, housing tenure, and partnership change over the period, and the ways in which certain kinds of household—generally those who were already advantaged—were in a position to benefit most from the house price boom.

A prominent factor in wealth accumulation is inheritance and lifetime transfers from parents, which we examine in Chapter 5. This also uses data from the BHPS not just to track who had benefited from inheritance between 1995 and 2005, but also how that pattern related to the wealth they started with and the amounts they ended with. This reveals a fascinating pattern. Inheritances are even more unequally distributed than wealth-holdings—half of the total went to just 10 per cent of the one in five adults who inherited over the period. Twelve per cent went to the top 1 per cent of inheritors, each receiving a total of more than half a million pounds. Both people's chances of inheriting and the amounts they are likely to receive are greater, the larger their initial wealth. And yet, such is the inequality of wealth that the impact of inheritance is not unambiguously to make wealth more unequal, but perhaps more to maintain wealth inequalities, rather than change them hugely in either direction over this period. At the same time, reported lifetime transfers from parents are smaller than inheritances but also follow a complex pattern. On a snapshot basis those who are already well-qualified and have higher incomes are *less* likely to receive them, but the transfers are most likely to be made by the most advantaged parents, so the overall effect is also to reinforce intergenerational links in resources.

One of the questions which arises from this kind of analysis is the extent to which the wealth of people's parents and their own asset-holding when young adults have effects on the trajectories their lives subsequently follow, over and above those we would expect to see given the other advantages that the children of wealthier parents tend to have. If there is such an independent 'asset effect', how much of it operates through opportunities to maximize educational advantage, and how much through other routes? In Chapter 6 we present new findings on these questions, drawing on the results of two surveys. To look at intergenerational relationships between parental wealth when children were growing up and their early adult outcomes by the time they were aged 25, we again use the BHPS. To look at the impact of early wealth-holding by young adults (at age 23) on what happens to them later on, we use results from the National Child Development Study (NCDS), which has followed a cohort of people since they were born in 1958, including looking at their circumstances when they reached 33 and 42. To try to avoid the results being skewed, both surveys allow us to control for a wide range of other factors that we would also expect to be associated with both wealth-holding and favourable outcomes. The results suggest strong relationships between parental wealth—particularly housing wealth—and children's educational outcomes, and through these on to earnings and employment. Early asset-holding—perhaps the product of the inheritance or lifetime transfer patterns investigated in the previous chapter—is also associated with better later employment prospects and higher earnings, as well as with better later general health and psychological well-being (although patterns vary between men and women).

Although it is hard definitely to prove a causal link because of possible associations with other unobserved factors, results of this kind suggest that wealth may have a more important role in people's life trajectories and in the transmission of economic advantage and disadvantage between generations than often allowed for. In the last part of the book we therefore look at the ways in which public policies interact with wealth-holding, either through the role of wealth as a resource that can be taxed or used to disqualify people from social support, or through policies intended to equalize wealth-holdings to some degree.

In Chapter 7 we look at how opposing political traditions have regarded wealth and its appropriate treatment since the sixteenth century, and the implications of these for views of taxation of wealth and inheritance in particular, and of schemes that would ensure that all adults started with some level of assets. We look in detail at the point in recent history when it appeared that Britain might add an explicit tax on wealth-holding to its system, following the manifesto commitment of the incoming Labour government in 1974 to an annual wealth tax. The reasons why in the end such a tax was *not* introduced are instructive to anyone who supports reforms of this kind to the tax system in terms of both popular attitudes and administrative practicalities.

Contrasting aims for policy towards wealth, as well as both administrative and attitudinal constraints on policy, mean that the ways in which tax and social policies treat wealth-holding are both very complex and inconsistent. We examine the current position in detail in Chapter 8. We look at the way the tax system treats saving (including building up pension rights); ownership of financial assets, housing, and other kinds of wealth; transfers of wealth; and different kinds of investment return. We put this alongside the ways in which social policies are affected by assets, such as entitlement to social security benefits, support for care in old age, encouragement of asset-holding, such as the Right to Buy and Child Trust Funds, and student support. In some circumstances ownership of assets is encouraged, but in others it is strongly discouraged—often for the same people at different points in their lives, and sometimes for the same people at the same time. Wealth accumulation and saving can be strongly assisted by the state—often including those who are already most economically advantaged—but can also lead to loss of other rights—including for those who are much less advantaged.

In the final chapter we draw out some of the implications of the picture we paint in the rest of the book for the current—and possible future—policy debate. Wealth is large, very unequally distributed, and its possession not only represents economic advantage, but also reinforces other forms of economic advantage, not just in people's own lives but also across generations. But public policy towards it could be described as at best incoherent. We look at the central issues suggested by our analysis and at what might follow as reforms aimed at achieving more economic efficiency or starting from different political perspectives. Past experience suggests that coherent reforms are hard to achieve. The evidence presented in this volume shows, however, that the current policy mix as it stands fails to meet objectives that many would see as reasonable or important. We aim to help those who want to understand the context within which policies in this crucial area operate, and how they will or could evolve.

2

Trends in the Distribution of Wealth in Britain

John Hills and Francesca Bastagli

This chapter describes what the distribution of wealth in the UK looks like today, and how it has changed over time. It draws on information from a variety of different sources, none entirely comprehensive, and using varying definitions of what forms of wealth are covered, and whether the distribution is between individual adults or between households. Some of the issues involved in this kind of measurement are summarized in Section 2.1. Section 2.2 then presents a picture of the current distribution of wealth between households (within Great Britain, excluding Northern Ireland, rather than the UK) from what is in many ways the most complete data source, the ONS Wealth and Assets Survey. This is, however, a new survey, so to understand trends over time we need to look at other sources. First, Section 2.3 examines how total personal wealth has grown since the 1940s. Section 2.4 then presents information on the longest time series available, that produced by HM Revenue and Customs (HMRC), on the distribution of wealth between individual adults, based on data for the size of estates when people die. It includes comparable estimates going back to the 1920s. Data on the distribution of wealth between households cannot be compared over a long time period, but in Section 2.5 we show results from our own analysis of data on housing and financial wealth from the British Household Panel Survey (BHPS), comparing these with the more recent data from the Wealth and Assets Survey and elsewhere. Section 2.6 discusses the effects of adding pension wealth to estimates drawn from the different sources. Section 2.7 summarizes some of the main findings of the chapter.

2.1 Measuring the distribution of wealth

Before examining some of the available information on wealth, it is important to distinguish between several different aspects of how it is defined, as the available sources vary in ways that mean that they are measuring different things.

- First, what is included in the *definition of wealth* can vary. Some sources look only at financial assets, others include housing as well, and coverage of other personal possessions (such as cars, consumer durables, or other household goods) varies. It makes a considerable difference whether the value of people's pension rights is included, and if so, whether these include state pension rights or only private pension rights.
- Second, *valuation methods* may vary. An important issue is whether assets and rights are valued in terms of their current use or in terms of their realization value (which may be much lower).[1] An important issue here is the valuation of life insurance policies. Where estimates are based on the valuation of estates when people die, this will be high, as that is the moment that they pay out. But for a cross-section of the population at any moment, their value will be lower, as it reflects only possible pay-outs at a later date.
- Third, some series refer to the distribution of wealth between *individuals* and others to that between *households*. Individual-based series face the difficulty of how to allocate joint assets—some do this on a per capita basis, others assume that a jointly-owned and lived-in house is as valuable to each co-owner.[2] While one individual may be the legal owner of an asset, other household members—especially spouses—may benefit considerably from it, even if their own wealth is very low.
- Linked to this, household-based series face the issue that households come in different shapes and sizes: the same amount of wealth may put a single person in a more privileged position than a family of six with the same assets. But it is not at all clear what would be the appropriate way of allowing for this, especially as there are undoubtedly large economies of scale in the use of housing, the most important

[1] See Atkinson and Harrison (1978, ch. 5), for discussion of the effects of these different approaches.

[2] The HMRC long-term series uses the former approach; the estimates based on ELSA in Banks and Tetlow (2009) are an example of the latter.