LEARNING AND WORK INSTITUTE

BRIEFING NOTE

The cost of living crisis and its impact on low-income Londoners

Summary

- Driven by soaring energy prices, inflation is at a 40-year high and is predicted to reach 13% by the end of 2022. The cost of living crisis comes on the back of over a decade of lost pay growth, making the impacts of high inflation worse.
- The total increase in energy bills facing UK households in 2022-23, net of the £400 Energy Bills Support Scheme, equates to almost £53 billion compared to bills in 2021-22. If the price cap rises as predicted in 2023, UK households face an additional bill of £126 billion in 2023-24 compared to 2021-22.
- Inflation is hitting low-income households hardest as they spend a larger proportion of their household budgets on the items, namely gas and electricity, that have seen the largest price increases. The average rate of inflation of 13%, projected by the Bank of England for the end of 2022, may be as high as 18.9% among the poorest households compared to 11.5% among the richest.
- Rises in the energy price cap in 2022-23 are likely to more than double the share households across the income distribution spend on energy. For the poorest 10% of households this could mean spending 19% of their budgets on energy.
- The impacts on low-income households are compounded by there being less scope to cut back on non-essentials (as they spend less on them). They are also likely to have limited or no savings to fall back on. Real pay may have fallen furthest among the lowest paid employees in recent months, as data suggests their pay packets have grown more slowly than employees on higher wages.
- Regional rates of inflation are lower in London reflecting different patterns of expenditure. Yet with the highest levels of poverty driven by high levels of inequality and living costs, many households in London will be among the worst hit by inflation. With energy prices forecast to rise further, the poorest 20% of households in London face inflation rates that are 1.8 times higher than the richest 10% of households.
- Households in London face an additional bill of £7 billion in 2022-23 compared to 2021-22 from rising energy costs, increasing to £16 billion in 2023-24.
- Low income households in London are particularly vulnerable to high inflation as they have high rates of expenditure on essential items (66% compared to 47% for the richest 10% of households) and less room to adjust outgoings. Non-discretionary spend is likely to increase with rising energy bills, with the lowest income households in London spending more than 80% of their budgets on essentials. Real wages for the lowest paid in London have also been falling since the financial crisis, falling by 3% for the 10% lowest paid in London compared to a 12% increase at UK level for the 10% lowest paid. This is likely linked to the National Minimum Wage/ Living Wage, which has greater 'bite' or impact outside of London where average nominal wages are lower.
- The Government should implement a national package of support to offset the increase in household and small business energy prices, targeting greatest help at low-income households. This should involve a mix of capping energy prices, cutting taxes and additional direct payments. We also need to tackle the problem at source, investing in energy independence, microgeneration, and energy efficiency and providing people with more information to maximise benefit take-up and promote energy efficiency.

Inflation and the impact on low-income households

Introduction

Inflation has risen rapidly over the last year, rising from the Bank of England's target rate of 2.0% to 10.1% in the twelve months up to July 2022. This has largely been caused by rising energy prices, which are expected to continue to push inflation to the highest levels in a generation by the end of 2022.

Rising inflation erodes household incomes and people's capability to maintain the same standard of living – and the current crisis is having a disproportionate impact on low income households. While London is one of the most prosperous cities in the UK, high levels of poverty and inequality leaves many in the capital vulnerable in the face of record increases in living costs.

This briefing note examines the scale of the crisis facing London and the UK, and the disproportionate impact on low income households. It also explores a wider set of factors that affects people's ability to cope with record price increases. It concludes with a series of recommendations for central and local government to address the challenges arising from the cost of living.

Instability in the energy markets and rising inflation

Worker shortages, supply-chain disruption, higher fuel costs, the end of lockdown restrictions, the reopening of economies across the globe, and Russia's invasion of Ukraine have driven rising prices and ended decades of relatively low inflation in the UK.

This has contributed to the UK experiencing its highest rate of inflation in 40 years, and just the fourth time that Consumer Price Index (CPI) inflation has surpassed the 10% threshold in the last 70 years (as shown by Figure 1).[12] Inflation is expected to rise further – with the BoE projecting it will hit just over 13% before starting to slowdown next year.[3]

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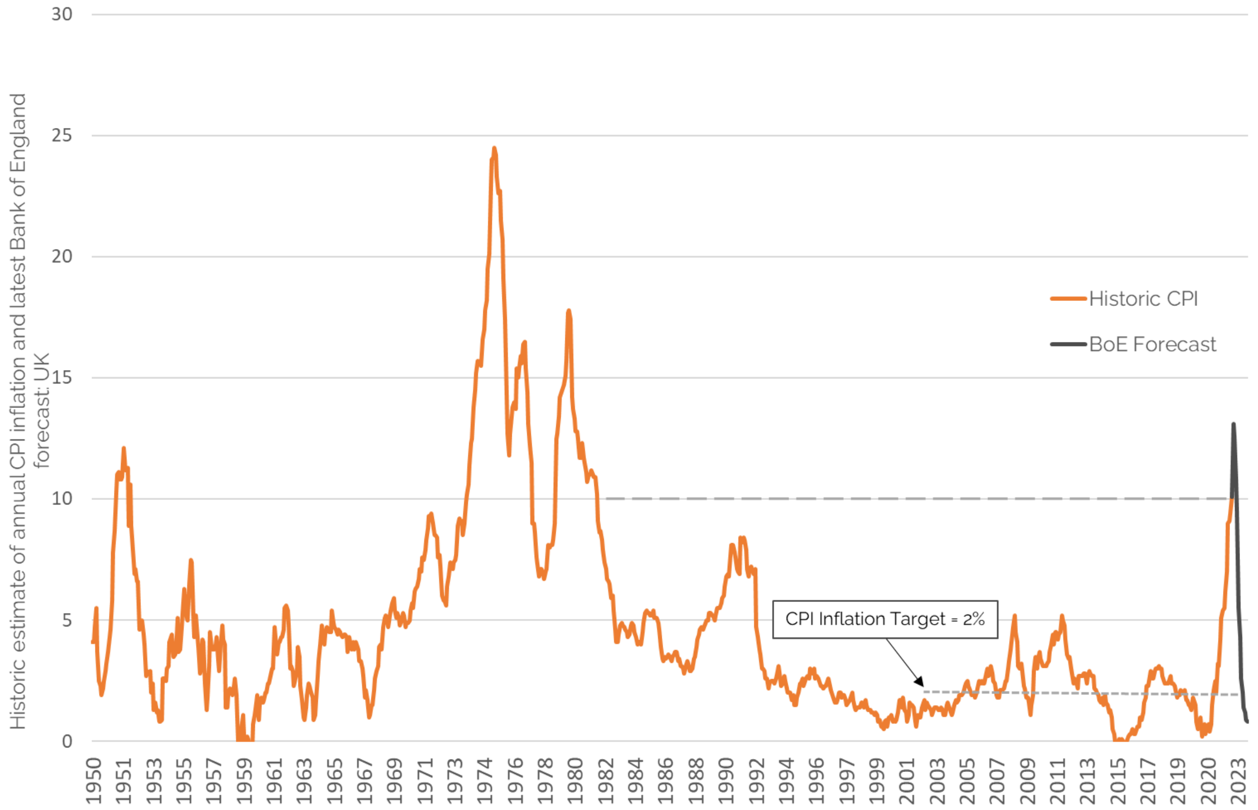
[1] The Consumer Price Index (CPI) measures the overall change in prices based on a basket of goods and services, as measured by the Office for National Statistics (ONS). CPI is different to the Consumer Price Index including owner occupiers' housing costs (CPIH) measure, which extends CPI to include owner occupiers' housing costs.

[2] Consumer price inflation, UK: July 2022, ONS, 2022.

[3] Monetary Policy Report – August 2022, Monetary Policy Committee, Bank of England, 2022.

Figure 1: Inflation is at its highest level in 40 years

Measure of annual CPI inflation and latest Bank of England forecast (1950-2023)



Source: Consumer Prices Inflation, ONS and Bank of England forecasts, 2022

Similarly, the Consumer Price Index including owner occupiers' housing costs (CPIH) - which includes extra housing components not included in the CPI – has risen, reaching 8.8% in the 12 months to July 2022.[4] This is the highest recorded annual inflation rate, since CPIH records began in 2006.

Energy prices have been a key driver of rising living costs, with wholesale gas prices quadrupling in the 12 months up to February 2022. This record rise led to increases in household energy bills, with the energy price cap rising from £1,277 to £1,971 between October 2021 and April 2022, and domestic gas and electricity prices rising by 95.7% and 54% respectively in the 12 months up to July 2022. [5] [6]

This has pushed higher inflation, with energy prices contributing 1.87 percentage points to the CPIH measure of inflation in the 12 months to July 2022 – meaning increases in electricity, gas and other fuels directly drove over one quarter of price rises (including owner occupiers' housing costs) over this period (as shown by Figure 2).[7] Other key drivers of inflation in the 12 months to July 2022 include transport (1.66

[4] Consumer Price Index including owner occupiers' housing costs (CPIH) measures the overall change in prices based on a basket of goods, services and costs associated with owning, maintaining and living in your own home.

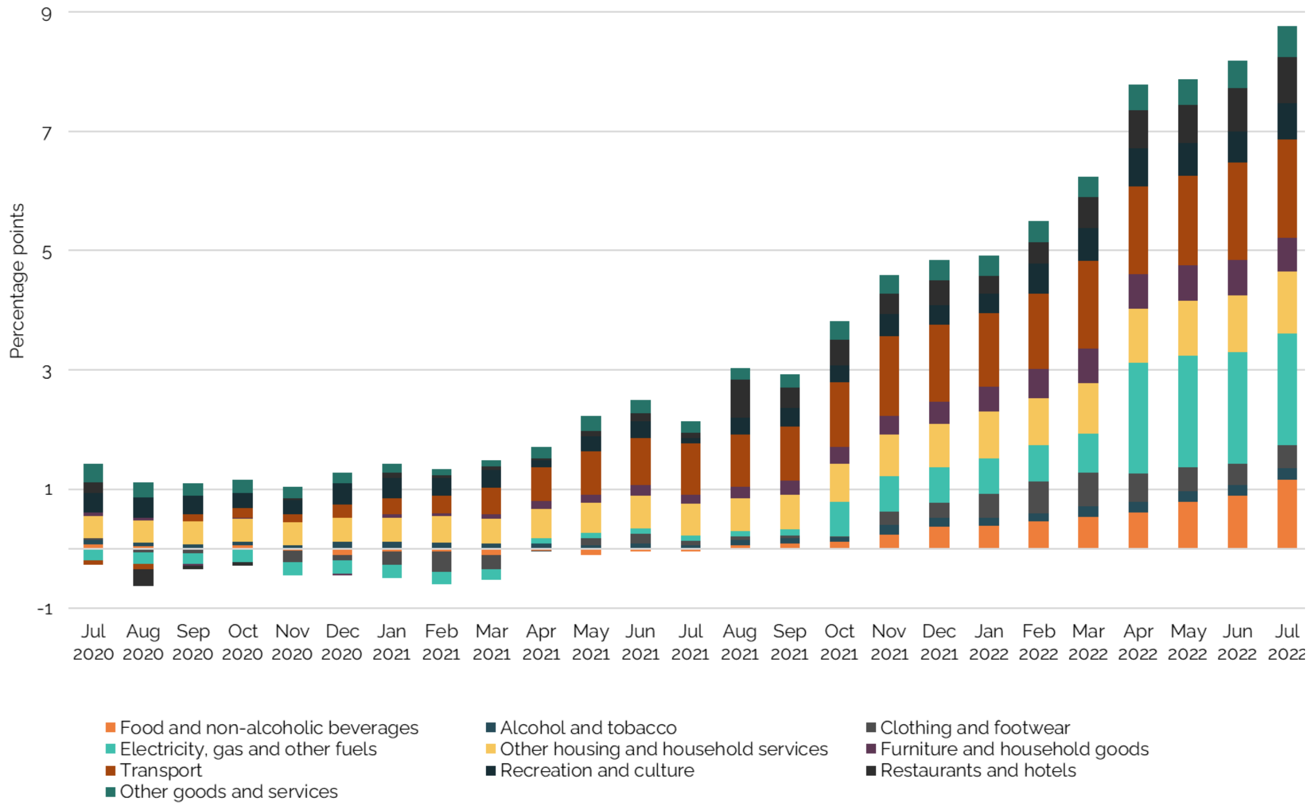
[5] Price cap to increase by £693 from April, Ofgem, 2022

[6] The energy price cap is set by the Office of Gas and Electricity Markets (Ofgem) and puts a maximum per unit price on energy, based on the wholesale cost of energy and costs of supply. The price cap figure is based on a household with typical consumption on a dual electricity and gas bill paying by direct debit.

[7] The Consumer Price Index including owner occupiers' housing costs (CPIH) measures the overall change in prices based on a basket of goods, services and costs associated with owning, maintaining and living in your own home, as measured by the Office for National Statistics (ONS). CPIH is different to the Consumer Price Index (CPI) measure, which omits owner occupiers' housing costs. This makes CPIH the most comprehensive measure of inflation.

percentage points); food and non-alcoholic beverages (1.15 percentage points); and other housing and household services (1.05 percentage points). [8]

Figure 2: Energy prices account for more than one quarter of annual CPIH inflation
Contributions to the CPIH 12-month inflation rate, UK, July 2020 to July 2022



Source: ONS, 2022

Ongoing instability in energy markets means the cost of energy is continuing to rise, with the wholesale related costs of energy rising by 131% between February 2022 and August 2022. This has led to a rise in the energy price cap between October 2022 and December 2022, with Ofgem confirming this will increase to the equivalent of £3,459 per annum[9] – meaning the average household will have seen energy prices rise by nearly 180% over the 12 months up to October 2022. The BoE forecasts that this will directly contribute 6.5 percentage points to CPI inflation in Oct-Dec 2022.[10]

Instability in the energy markets shows little sign of abating. Cornwall Insights predicts this will lead to greater increases in the energy price cap, with forecasts showing that the typical household faces costs of the equivalent of £5,387 per annum for the period January 2023 to March 2023, and the equivalent of £6,616 per annum for the period April 2023 to June 2023. This is then expected to fall slightly, hovering around £5,890 for the rest of 2023.[11] This has contributed to higher forecasts for inflation for the next year amongst independent forecasters, with Citigroup predicting CPI will reach 18% in Q1 2023 and Goldman Sachs estimating inflation could hit 22% in 2023 if energy prices do not recede.

[8] Consumer price inflation, UK: July 2022, ONS, 2022
[9] Ofgem updates price cap level and tightens up rules on suppliers, Ofgem, 2022
[10] Monetary Policy Report – August 2022, Monetary Policy Committee, Bank of England, 2022
[11] Cornwall Insight comments on the announcement of the October price cap, Cornwall Insight, 2022

Consequences of high inflation

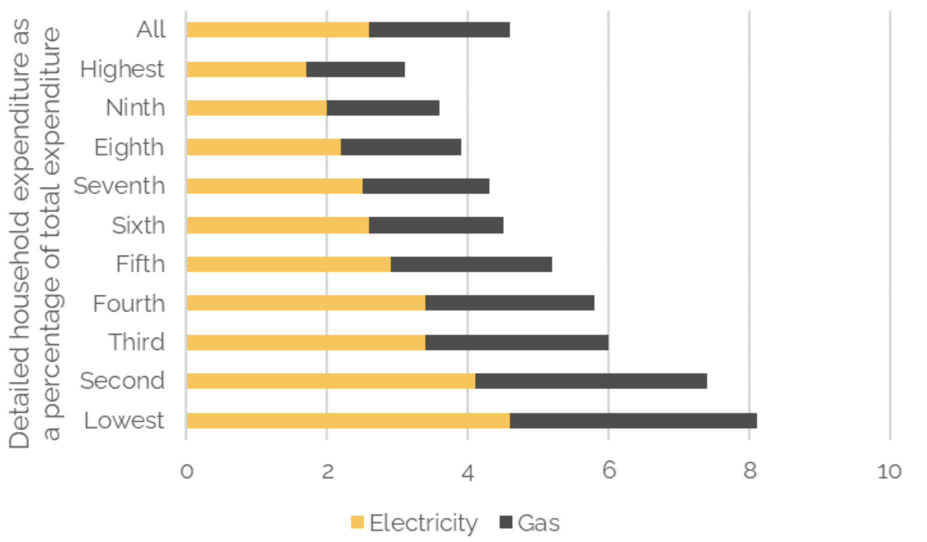
Spiralling energy costs risk an unprecedented crisis, as ever higher costs add to mounting inflation for households and firms. High inflation reduces households' purchasing power and makes it harder for them to stay within budget. The latest survey data shows that 9 in 10 adults have seen an increase in their cost of living and just under one half of adults who pay energy bills found it difficult to afford them.[12] For firms, it makes planning and investment decisions harder. It can ultimately lead to a cycle of ongoing inflationary pressure as businesses increase prices to reflect higher costs and maintain profit margins, leading to greater levels of inflation becoming embedded in the wider economy. Persistent recruitment challenges could cause further inflationary pressure, if employers increase wages to aid recruitment and subsequently increase prices further (though there is little general sign of this currently, with real wages falling sharply).[13][14]

Recent rises in inflation have had a disproportionate impact on low-income households.

Inflation is not felt evenly, with households affected differently according to their expenditure patterns and price increases for the goods and services they consume.

Low-income households tend to spend a larger proportion of their income on essential items, such as energy and food. For example, the latest data indicates that households with the lowest incomes spending more than twice as much of their household budgets on electricity and gas than the richest (Figure 3). This means low-income households face higher inflation rates and larger real terms cuts to living standards, as energy prices in particular have seen sharp increases.

Figure 3: Low-income households spend a far higher proportion of total expenditure on energy
Proportion of household expenditure spent on gas and electricity, by UK income decile, 2020-21



Source: L&W analysis of Living Costs and Food Survey (LCFS), ONS, 2022

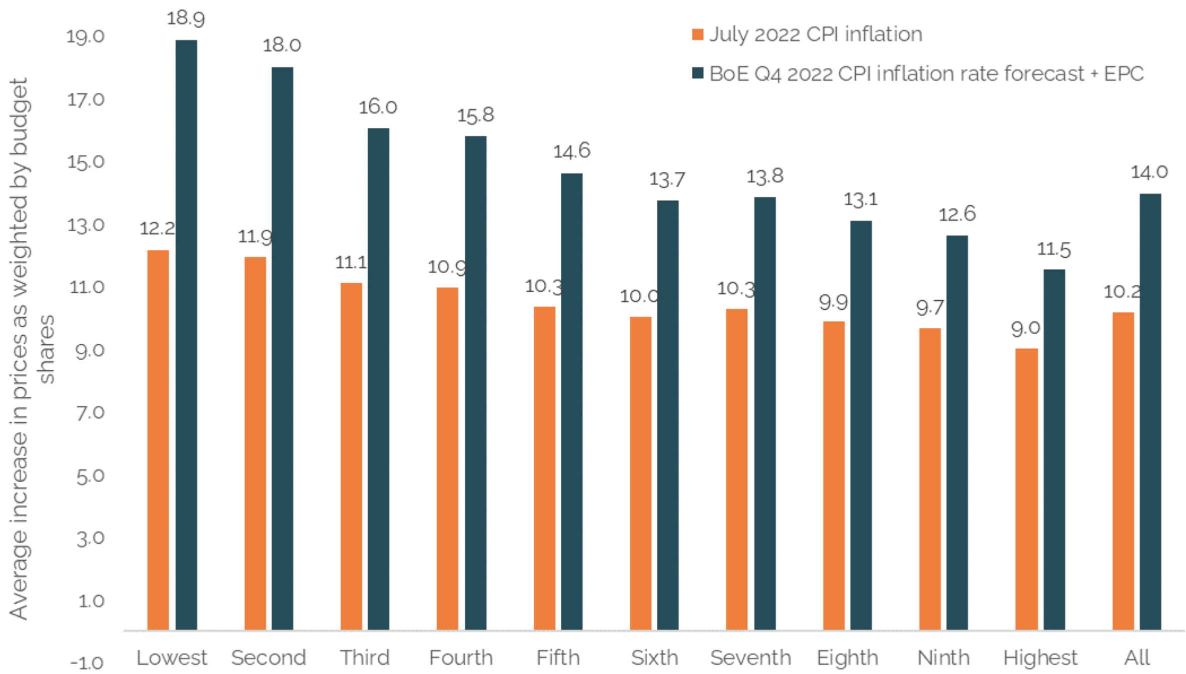
Figure 4 shows that the level of inflation faced by households in the 12 months up to July 2022 is inversely linked to household income. Inflation rates faced by the poorest 10% of households are 3.2 percentage

[12] Opinions and Lifestyle Survey, Official for National Statistics, 2022
[13] Labour Market Update – August 2022, Learning and Work Institute, 2022
[14] Labour market overview, UK: August 2022, Official for National Statistics, 2022

points higher than the richest 10% of households – and 2 percentage points higher than the average. Based on current predictions for the end of 2022, based on the BoE inflation rate forecast and Ofgem's Energy Price Cap (EPC), the lowest income households face an inflation rate of 18.9% - over 7 percentage points higher than the richest 10% of households.

Figure 4: Lower income households face higher rates of inflation

Average increase in prices as weighted by budget shares, by UK income decile, July 2022 and BoE Q4 2022 forecast



Source: L&W analysis of Living Costs and Food Survey (LCFS), ONS, Consumer Prices Inflation, ONS, BoE inflation forecasts and Resolution Foundation estimates for average energy bills for 2022/23.

Increases in the cost of essentials for which there are little or no relative substitutes available, or substantial ability to reduce consumption in the short-term at least – for example, household energy – can compound the impact of rising prices. This can leave households having no choice other than to reduce their wider spending, utilise savings, incur debt, or forego the purchase of essential items.

The disproportionate impact of rising inflation on low-income households is compounded by the fact that there is less scope to cut back on non-essentials (as they spend less on them) and higher likelihood of having limited or no savings to fall back on. The poorest 10% households are four times as likely to have no savings as the richest 10%.[15] This means that those least able to absorb increased prices are facing the greatest level of price rises, posing considerable risks to the living standards of low-income households.

The government launched an extensive package of support earlier in May 2022, with up to £1,350 for the most vulnerable households this year – yet prices are set to rise far higher than originally predicted, with households facing huge gaps in their finances.

The Government initially responded to these risks by introducing a cost of living support package. Up to September 7th 2022, this has included:

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[15] Broome, M and Leslie, J (2022) *Arrears Fears: The distribution of UK household wealth and the impact on families*, Resolution Foundation

- £400 off energy bills for all households
- £650 payments for households receiving means-tested benefits with additional payments of £300 for pensioners and £150 for people receiving disability payments
- a £150 council tax rebate for households in council tax band A-D
- a 5p cut to fuel duty
- an increase in the threshold at which NICs begins to be charged on earnings

This package of support delivers support to all households. The latest additions recognise the disproportionate impact of the rising cost of living on low-income households, with targeted support for the poorest households. This includes supplementary payments for low earners, pensioners, claimant unemployed, and those unable to work due to sickness and disability.

Yet, with the energy price cap now scheduled to rise to £3,459 in October 2022 and £5,287 in January 2023 for the average household, even households receiving the highest level of support will face significant shortfalls. Estimates suggest the average household will face a total fuel bill of £3,749 for 2022-23 – over £2,200 higher than they would have paid if fuel prices remained around the 2021 levels.[16] There was also an implicit assumption in the one-off support package that energy prices would start to fall in 2023, but forecasts now expect the price cap will remain significantly higher than £5,000 until at least 2024.

The total increase in energy bills facing UK households in 2022-23, net of the £400 Energy Bills Support Scheme, equates to almost £53 billion compared to bills in 2021-22.[17] If the price cap rises as predicted in 2023-24, UK households face an additional bill of £126 billion compared to 2021-22.[18] The increase in energy bills faced by businesses will be on top of this.

The share of household spending on energy bills is set to more than double across the income distribution in 2022-23 compared to 2020-21 (Figure 5). Energy bills are forecast to account for 10% of spending for the average household compared to 4.6% in 2020-21, net of the £400 Energy Bills Support Scheme and assuming households do not change their consumption patterns. For the poorest 10% of households, the share of households' budgets spent on energy will potentially reach 19%.

There will also be substantial variation within different income groups. Energy bills could vary by more than £2,000 within income deciles, as energy consumption varies by family size, heating systems and the energy efficiency of homes.[19] Those on pre-payment meters, who do not have bills smoothed over the year, will face particularly high bills in winter, with January bills taking up half of these families' budgets.[20] Single parent families are also likely to be hard hit, facing bills that equate to two thirds of their income in 2022-23.[21]

[16] Resolution Foundation (2022) Soaring price cap means energy bills are set to treble this winter to around £500 a month – and over £700 in January alone

[17] Calculated using RF's estimates average energy bills for 2022-23.

[18] Calculated using Cornwall Insights' predictions for the Energy Price Cap in 2023.

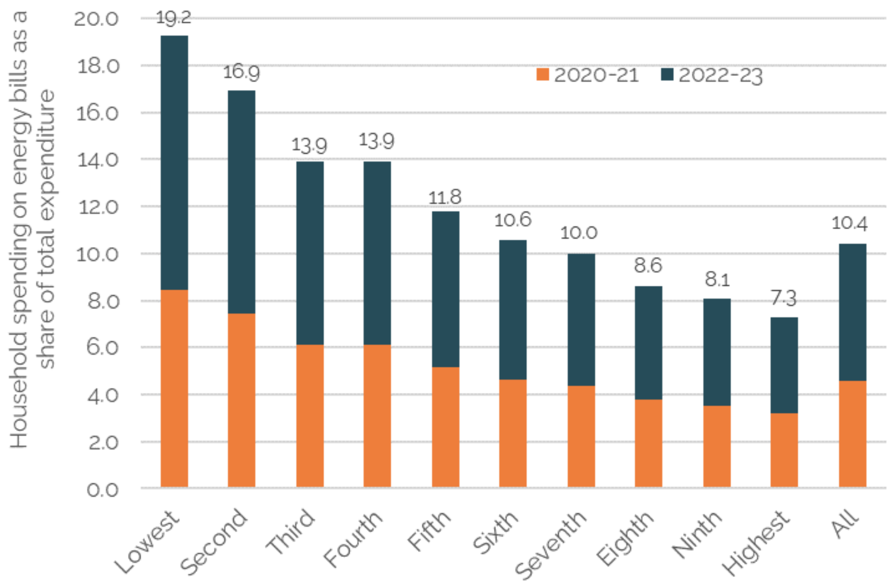
[19] ibid

[20] ibid

[21] JRF (2022) Stratospheric energy bills will completely wipe out incomes for low income households – new JRF analysis [press release]

Figure 5: The share of household spending on energy bills is forecast to more than double in 2022-23

Proportion of household expenditure spent on gas and electricity, by UK income decile, 2020-21 and 2022-23



Source: L&W analysis of Living Costs and Food Survey (LCFS), ONS, Consumer Prices Inflation, ONS, BoE inflation forecasts, and Resolution Foundation estimates for average energy bills for 2022/23. Total expenditure is held constant between 2020-21 and 2022-23.

With costs increasing across the entire economy (as shown by Figure 2), households will also have to contend with rising costs of wider goods and services as firms embed price rises to counteract higher input costs. This risks huge gaps in household finances, with an unprecedented cost of living crisis threatening people's capability to afford essentials.

The cost of living crisis comes on the back of over a decade of lost pay growth – and falling living standards.

Following the 2008 financial crisis, pay has failed to keep pace with inflation, leading to a marked decline in real earnings and the largest fall in living standards in over two centuries. Real wages in June 2022 were less than 1% higher than they were in 2008 and total real pay (including bonuses) is 3% lower. This compares to wage growth of around 17% in the decade prior to the financial crisis.

Increases in average earnings between 2020 and 2021 have been largely driven by the compositional effects of low-paid workers losing their jobs – driving up overall average earnings.[22] Real wages have then fallen sharply in recent months as inflation has risen.

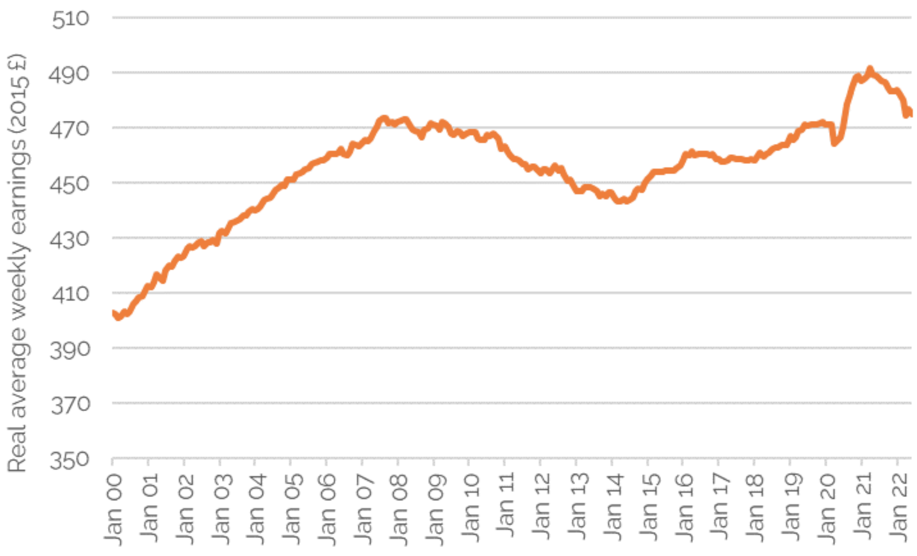
Real wages are expected to continue falling over the next year, with the BoE forecasting that real post-tax household income will fall by around 4% over 2023.[23]

[22] Low-paid workers were more likely to lose their job than higher-paid workers during the period where pandemic restrictions were in operation. This resulted in fewer low-paid workers in the workforce, meaning average earnings for those remaining increased

[23] Monetary Policy Report – August 2022, Monetary Policy Committee, Bank of England, 2022.

Figure 6: Real wages in 2022 are close to 2008 levels

Real average weekly earnings (2015 prices)



Source: Average weekly earnings, ONS, 2022

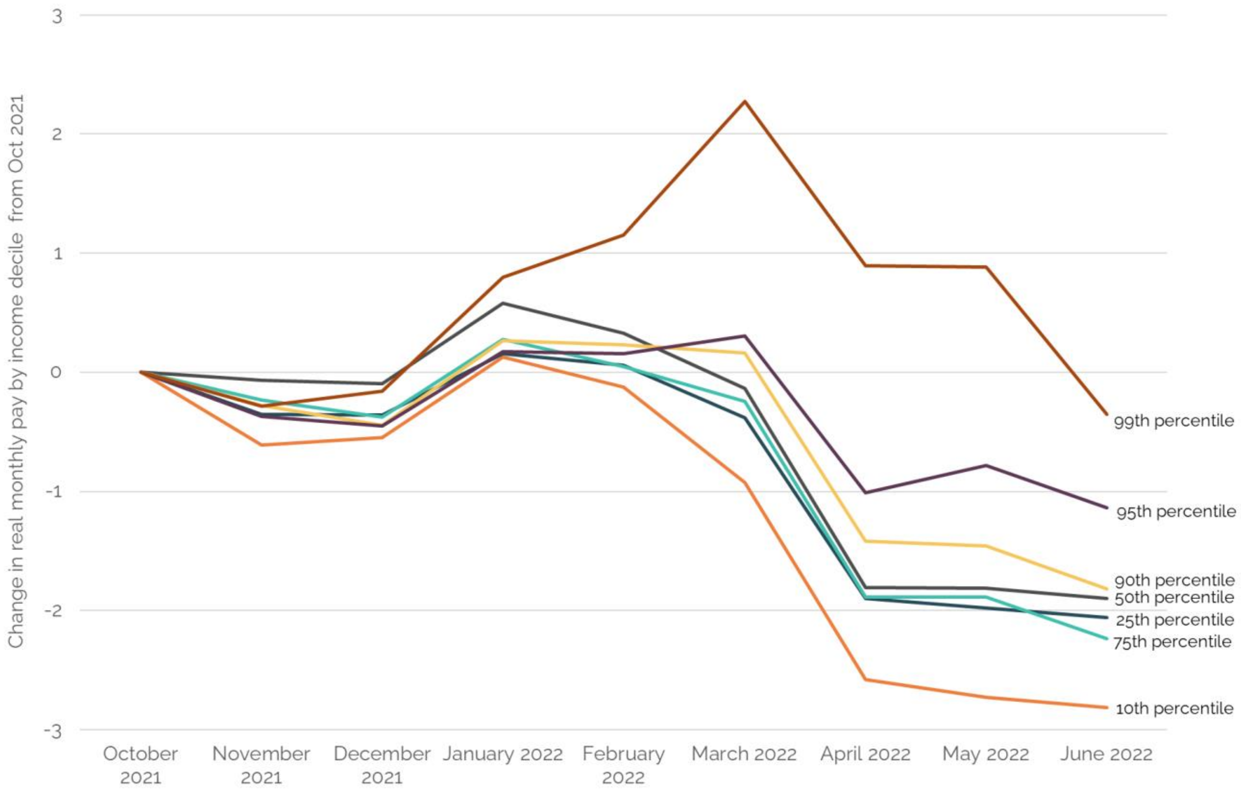
The National Living Wage has helped to boost real pay for low earners in recent years, but rising inflation means real pay has fallen furthest among the lowest paid employees in recent months.

Real monthly earnings (adjusted by overall CPI) have fallen fastest among the 10% lowest earning employees since October 2021 when the furlough scheme ended (Figure 7) according to HMRC data.[24][25] Based on a three-month moving average, payrolled employee earnings at 10th percentile fell by 2.8%, while earnings at the 99th percentile (the top 1% of earners) decreased by 0.4%. Real wages are likely to have fallen even further for low wage workers as they are likely to face higher increases in living costs (i.e. adjusting wages by the weighted CPI figures shown in Figure 4, rather than overall CPI, would result in a larger fall in real wages for the lowest earners).

[24] Earnings and employment from Pay As You Earn Real Time Information, UK: August 2022, HMRC and ONS, 2022
[25] Pay As You Earn (PAYE) Real Time Information (RTI) data is extracted in the weeks following the latest reference month. This means some payments for work done in the reference month are not yet collected at the point of extraction. Any missing returns are imputed – this represents around 15% of total data used to estimate earnings for August 2022 release. 'Flash' estimates (i.e. estimates for, or close to, the latest reference month) are subject to revision as payment returns are collected, and imputed payments are replaced with actual data

Figure 7: Real pay has fallen furthest among the bottom 10% of earners since the end of the Coronavirus Job Retention Scheme

Change in real monthly pay from October 2021 by income decile



Source: Pay As You Earn Real Time Information, ONS, 2022

Cost of living and in-work poverty in London

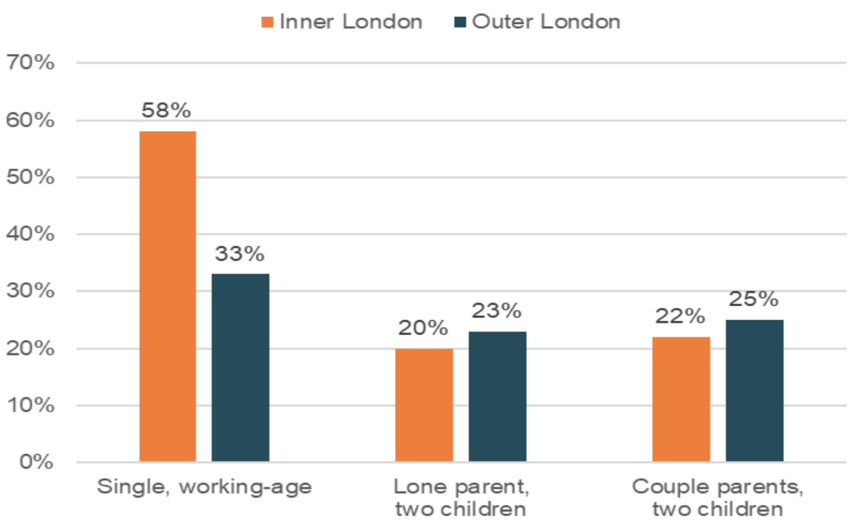
London has the highest rate of relative income poverty in the UK, with one in four people in relative income poverty after housing costs.[26] [27] A combination of low pay and high living costs means that the capital also has the highest rates of in-work poverty. This leaves many Londoners vulnerable in the face of high inflation.

High living costs mean households in London need substantially higher wages than the same households living in other urban areas of the UK to provide the same standard of living.

The higher cost of living in London is driven by a range of factors, including the limited availability of affordable housing[28]; and the costs of childcare (particularly Outer London)[29] and transport.[30].

Figure 8 shows how this impacts Londoners, with households in Inner and Outer London needing substantially higher incomes than the same households living in other urban areas of the UK to provide the same standard of living.[31] Single working-age adults living on their own in London face by far the greatest additional costs to achieve an adequate standard of living, followed by couples with two children, and then lone parents with two children.

Figure 8: Single working-age adults living on their own need 58% more for an acceptable standard of living than their counterparts living in urban areas of the UK
Additional weekly budget required to achieve an adequate standard of living in Inner and Outer London compared to other urban UK areas, by household status (2020)



Source: A Minimum Income Standard for London 2020, Loughborough University

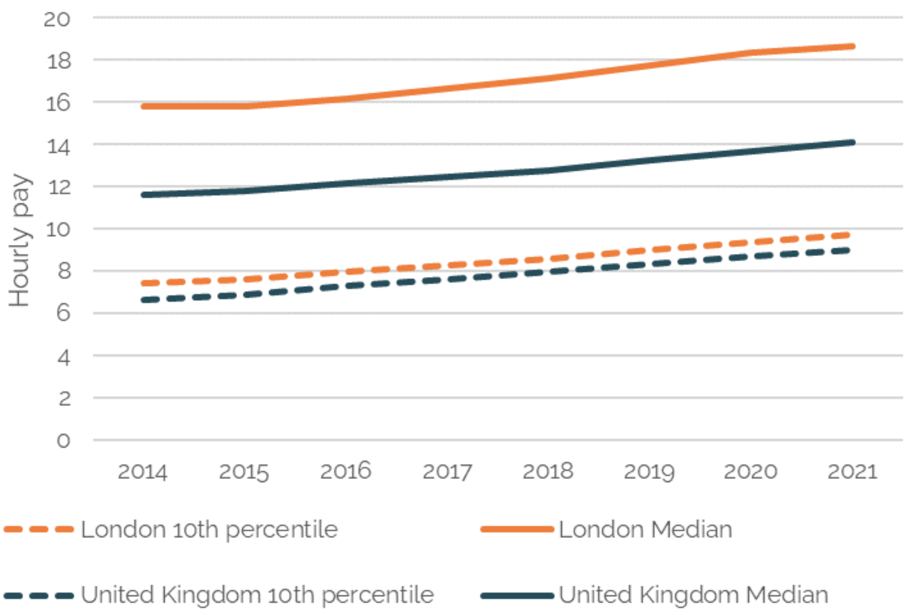
[26] Relative poverty after housing costs is where household income is below 60% of the median income in an area, region or nation, adjusted for household size and composition.
[27] UK Poverty 2022: the essential guide to understanding poverty in the UK (2022), Joseph Rowntree Foundation
[28] The cost of renting a lower quartile weekly rent for a studio flat was £222.96 in Inner London and £174.20 in Outer London, compared to £93.82 in urban UK outside London.
[29] Childcare is estimated to be 25% more expensive in London than outside.
[30] Drivers in London spend an average of £1.56 per mile to drive their cars, compared to just 74p elsewhere.
[31] This considers living costs across different types of households and is calculated based on the Minimum Income Standard (MIS) – reflecting a wide range of costs including housing and childcare.

While average wages are substantially higher in London, low earners do not earn much more than the low earners elsewhere – the wage premium does not match the higher cost of living.

Median hourly pay in London in 2021 was 32% higher than the UK average, while the difference in hourly pay at the 10th percentile was far smaller at 7.8% (Figure 9). The differential between low pay in London and elsewhere in the UK has also narrowed over the last seven years. This is likely linked to the impact of the National Minimum Wage/ Living Wage, which has greater 'bite' or impact outside of London where average nominal wages are lower. [32]

Consequently, low paid workers in London do not earn much more than low earners elsewhere but face far higher living costs, resulting in high levels of in-work poverty.

Figure 9: Low earners in London do not earn much more than low earners elsewhere in the UK
Nominal hourly wage comparison for London and UK – median and 10th percentile (2014-2021)



Source: L&W analysis of ONS data

[32] The 'bite' – the ratio of the minimum wage to mean wages – provides an indication of how many workers are likely to be affected by increases to the minimum wage.

Who are London's low paid workers?

Workers in hospitality, retail and administrative support jobs and from some ethnic minority backgrounds are substantially more likely to earn less than the London Living Wage (LLW).

Londoners working in certain sectors are most likely to be earning less than the LLW[33]:

- One in three jobs in 'retail' and 'administrative support services' pay below LLW
- 69% of jobs in 'accommodation and food service activities' pay below LLW

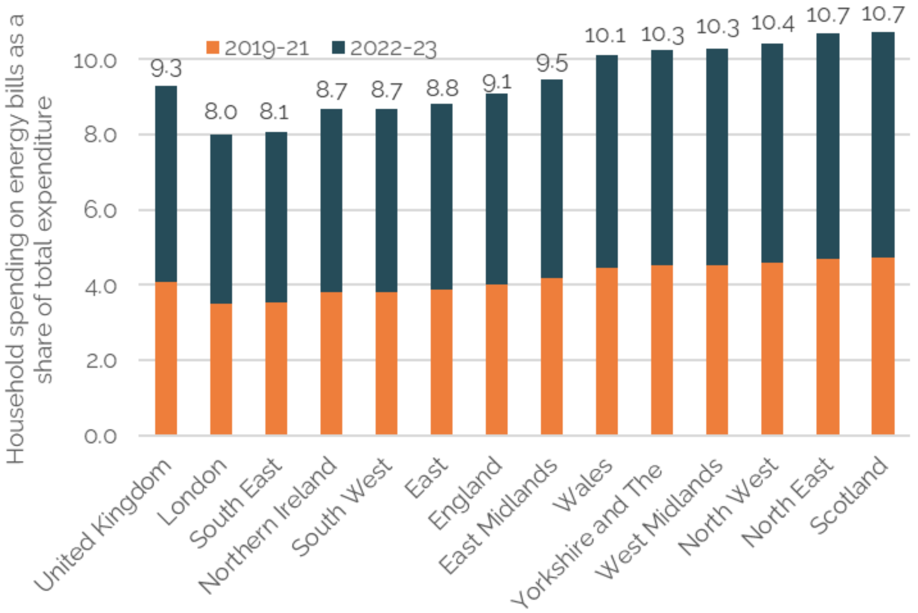
Londoners from certain black and minority ethnic backgrounds are disproportionately represented amongst low-paid Londoners[34]:

- Over one in three workers with 'Bangladeshi' or 'Pakistani' background earning less than LLW
- 27% of workers with 'Black / African / Caribbean / Black British' background earning less than LLW
- By contrast, one in six workers with 'Chinese' or 'Indian' background – and just over one in ten workers with 'White' background - earn less than LLW

How will rising inflation affect Londoners?

As previously noted, one of the main drivers of recent inflation has been energy prices – namely electricity and gas. Figure 10 shows that households in London spend the lowest proportion of total expenditure on energy of all UK regions and, while this is set to double, it is likely to remain lower than households in the North East and Scotland in particular. This suggests that those living in London may experience a lower 'rate' of inflation compared to other parts of the UK.

Figure 10: Households in London spend a lower proportion of total expenditure on energy
Proportion of household expenditure spent on gas and electricity, by region



Source: L&W analysis of Living Costs and Food Survey (LCFS), ONS, Consumer Prices Inflation, ONS, BoE inflation forecasts, and Resolution Foundation estimates for average energy bills for 2022/23. Total expenditure is held constant between 2020-21 and 2022-23.

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33 London's Poverty Profile – Trust for London, 2021

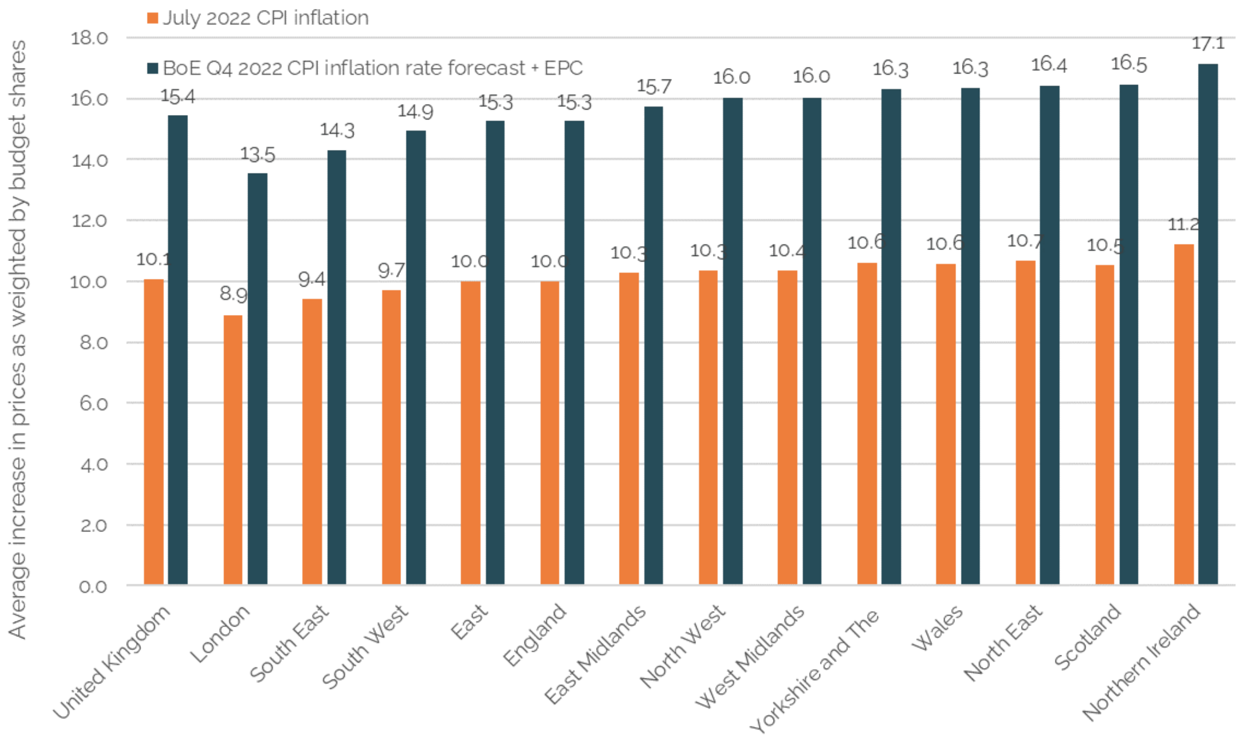
34 Joseph Rowntree Foundation (2021) UK Poverty 2020-21

Regional rates of inflation are lower in London reflecting different patterns of expenditure, although averages hide high levels of inequality within the capital.

Inflation rates are high across the country and far higher than the BoE's 2% target. The July 2022 inflation rate in London, based on expenditure patterns, was 8.9% (Figure 11). This is comparatively lower than the inflation rates experienced in other parts of the UK. Based on current predictions, inflation in London may rise to 13.5% by the end of 2022-23. While still high, this remains lower than the predictions for other regions in the UK. These differences are partly explained by the lower proportion of household expenditure spent on fast rising electricity and gas prices.

Figure 11: Rates of inflation are likely to be lower in London on average compared to other parts of the UK

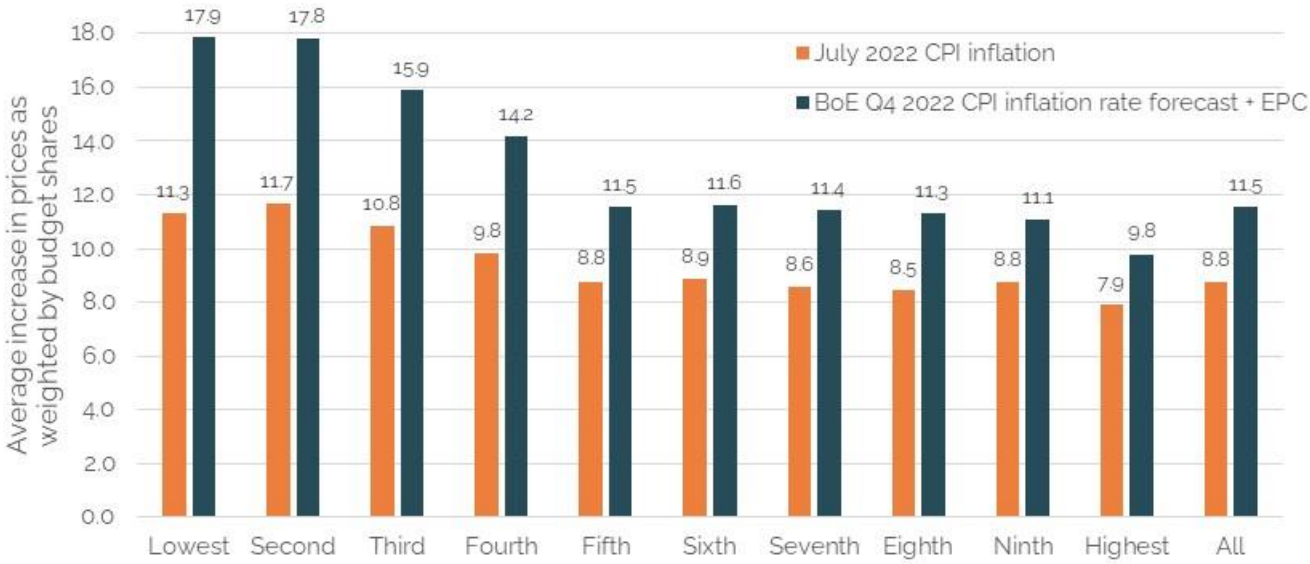
Average increase in prices as weighted by budget shares, by region, July 2022 and BoE Q4 2022 forecast



Source: Learning and Work Institute analysis of 2019-21 expenditure data from Living Costs and Food Survey (LCFS), ONS, 2022, Consumer Prices Inflation, ONS, BoE inflation forecasts, and Resolution Foundation estimates for average energy bills for 2022/23. Note the UK average differs from those in income distribution analysis as the expenditure data references different years.

Given the uneven nature of rising costs, it is also important to consider how rising prices are impacting different income groups in London. Figure 12 provides a breakdown of inflation rates by household income decile in London. This shows that the poorest households in London saw costs rise by higher than 11.3% in the 12 months up to July 2022, compared to 7.9% among the richest households. The gap between the poorest and richest households in London is likely to widen as inflation rises, rising from 3.4 percentage points to 8.1 percentage points.

Figure 12: Low-income households in London face far higher inflation rates than the richest
Average increase in prices as weighted by budget shares, by income decile in London, July 2022 and BoE Q4 2022 forecast



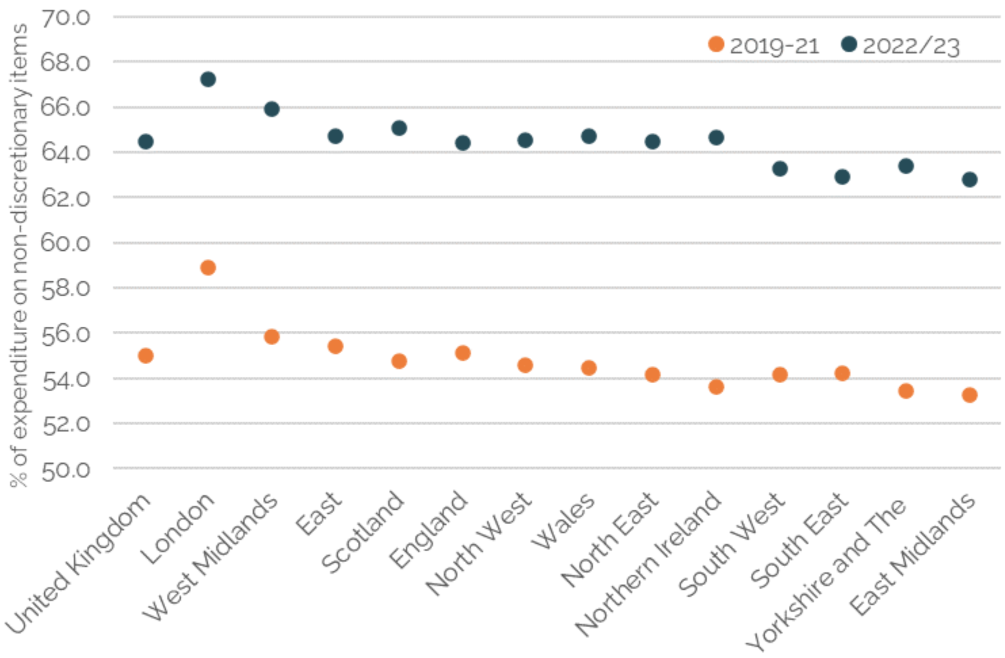
Source: Learning and Work Institute analysis of 2017-19 expenditure data from Living Costs and Food Survey (LCFS), ONS, 2022, Consumer Prices Inflation, ONS, BoE inflation forecasts, and Resolution Foundation estimates for average energy bills for 2022/23. Note the London average differs from those in regional analysis as the expenditure data references different years.

The ability of households in London to absorb increases in the costs of essentials will be constrained by existing high levels of non-discretionary spend.

The high cost of living in London means that households spend a higher proportion of their expenditure on non-discretionary items.[35] Households in London spend 59% of their expenditure on essential goods and services, including housing, compared to the UK average of 55% (Figure 13). Rising energy bills may mean average households in London spending more than 67% of their budgets on essentials. This means that there is less scope for households in London to cut back on discretionary spend to cover the rising costs of essential items.

[35] Goods or services which are purchased because they meet a basic need (food, shelter, healthcare), are required to maintain current living arrangements (car maintenance, school fees), or are a legal obligation (compulsory insurance, stamp duty).

Figure 13: Households in London spend the highest share on non-discretionary items[36]
Proportion of expenditure on non-discretionary items



Source: Learning and Work Institute analysis of 2017-19 expenditure data from Living Costs and Food Survey (LCFS), ONS, 2022, Consumer Prices Inflation, ONS, BoE inflation forecasts, and Resolution Foundation estimates for average energy bills for 2022/23. Total expenditure is held constant between 2019-21 and 2022/23.

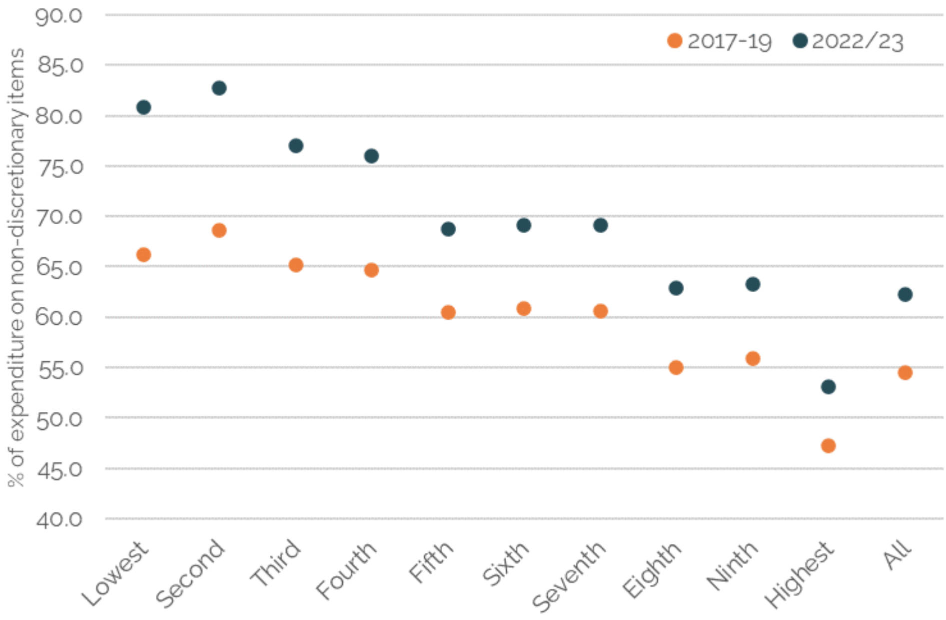
This is a particular issue for low income households in London who spend even higher proportions of their household budgets on essentials. The poorest 10% of households in London spend 66% of their budgets on essentials, compared to the 47% for the richest 10% of households (Figure 14).

Non-discretionary spend is likely to increase with rising energy bills, with the lowest income households in London spending more than 80% of their budgets on essentials. This is 28 percentage points higher than the estimates for the richest 10% of households. This is largely driven by the increase in the share of household budgets that will need to be spent on energy bills (Figure 15), which is higher for low income households. There will be variation within income groups as different types of households spend different amounts on energy and for many households these figures will be higher.[37]

[36] Discretionary and non-discretionary based on ONS categorisation. See https://www.ons.gov.uk/economy/inflationandpriceindices/articles/priceseconomicanalysisquarterly/december2021#data-sources-and-quality for further information.
[37] M Brewer, E Fry, K Handscomb & J Marshall , A chilling crisis: Policy options to deal with soaring energy prices , Resolution Foundation, August 2022

Figure 14: The lowest income households in London are set to spend over 80% of their household budgets on essential items

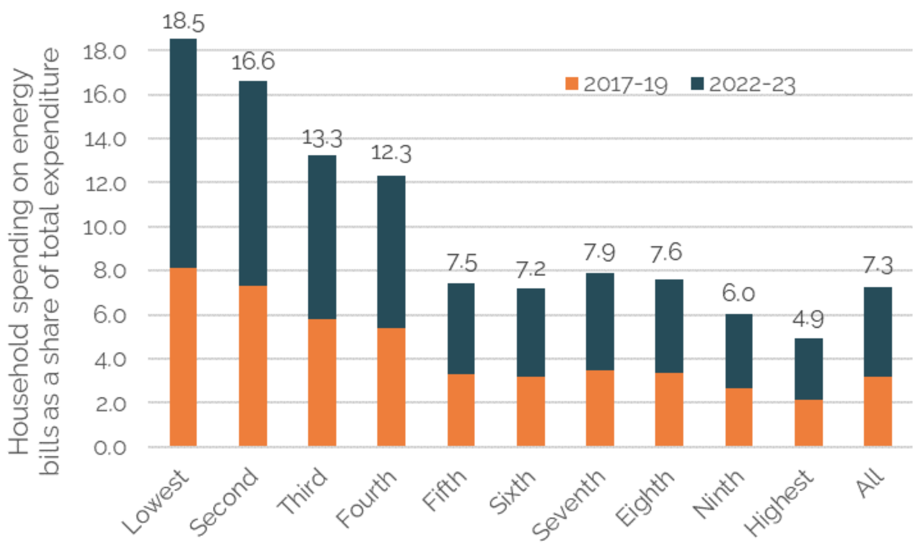
Proportion of expenditure on non-discretionary items, 2017-19 and 2022-23



Source: L&W analysis of Living Costs and Food Survey (LCFS), ONS, Consumer Prices Inflation, ONS, BoE inflation forecasts, and Resolution Foundation estimates for average energy bills for 2022/23. Total expenditure is held constant between 2017-19 and 2022-23.

Figure 15: Differences across the income distribution in share of households budgets spent on energy reflect high levels of inequality in London

Proportion of household expenditure spent on gas and electricity, by income decile in London and UK, 2017-19 and 2022-23



Source: L&W analysis of Living Costs and Food Survey (LCFS), ONS, Consumer Prices Inflation, ONS, BoE inflation forecasts, and Resolution Foundation estimates for average energy bills for 2022/23. Total expenditure is held constant between 2017-19 and 2022-23.

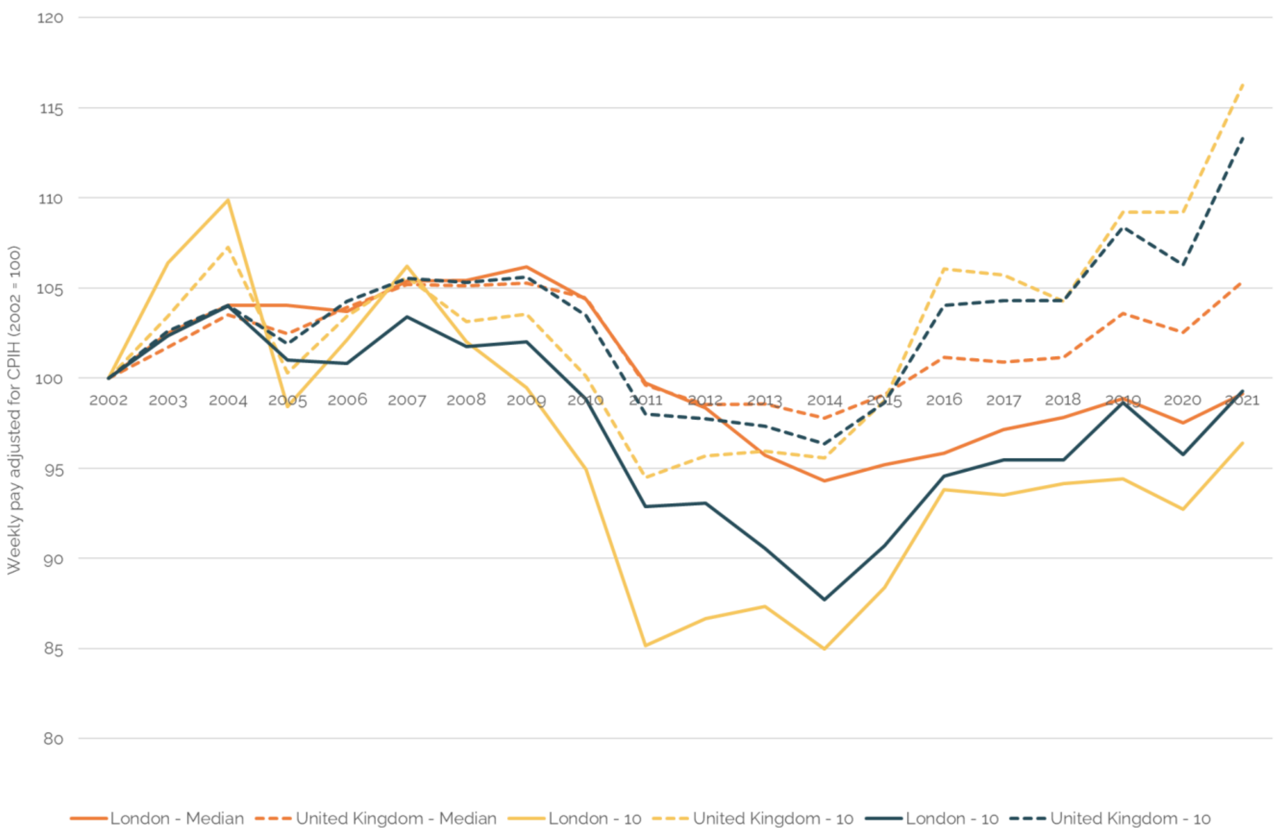
London has already seen a clear decline in real wages in recent years as inflation has outpaced wage growth, particularly at the bottom of the earnings distribution.

Adjusting for national inflation, average real weekly pay in London fell by 0.9% between 2002 and 2021. Meanwhile, average real weekly pay increased by 5.3% nationally over the same period. Real wages have fallen more markedly at the bottom of the earnings distribution in London, with real weekly pay falling by 3.6% for the 10% lowest earners between 2002 and 2021.

The financial crisis marks a point of divergence between London and the national average. In the five years before the financial crisis, average real weekly pay grew by just over 5% in London and the UK. While wages stagnated at the national level (as discussed above), average weekly pay in London fell by 6% between 2008 and 2021. The difference is even greater at the bottom of the earnings distribution. Real weekly pay among the bottom 10% fell by 5.5% in London, while nationally it grew by 12.7% between 2008 and 2021. This is likely linked to the differential impacts of the minimum wage in London compared to elsewhere in the UK.

Figure 16: Real wages have fallen in London since the financial crisis, particularly among low paid workers[38]

Weekly pay by selected percentile adjusted by CPIH (2002 = 100)



Source: ASHE – resident analysis, ONS, 2022

[38] Pay growth between 2020 and 2021 is likely to be driven, at least in part, by ‘compositional effects’. Lower-paid people were more likely to lose their jobs during the pandemic and fewer lower-paid people in the workforce increases the *average* earnings of those who remained in work.

Policy implications and recommendations

Household budgets are experiencing unprecedented pressure, with spikes in energy prices and wider price rises pushing inflation to its highest level in 40 years. This is expected to rise further and remain high over at least the next year, as rises in overall price levels continue and the energy price cap continues its extraordinary climb. This risks enormous strain for households as rising inflation erodes incomes and household capability to afford essentials.

Low income households are being hit hardest by current inflation, as they tend to spend proportionately more on energy and other essentials and as a result face higher rates of price rises. Recent falls in real wages after over a decade of stagnating real earnings and stalled living standards have reduced low paid workers' capability to maintain a safety net and manage present price increases. This means it is those least able to afford it that are facing the highest rates of inflation and the greatest hardship.

While on average households in London may not experience inflation rates that are as high as elsewhere in the country, regional averages hide high levels of inequality and disparities across income groups. The impact of the cost-of-living crisis in London, with the highest levels of poverty in the country, is compounded firstly by the fact the households spend more on essentials than other parts of the country, meaning there is less scope to reduce discretionary spend. Secondly, the current crisis comes after years of falling real wages in London, further reducing London's low-income households' ability to make ends meet. This leaves low-income Londoners highly vulnerable in the face of rising energy bills and likely to face significant shortfalls.

1. **The Government should urgently implement a national package of support to help with the increase in energy prices, targeting most support at low-income households.**

The pace of the crisis has already proven existing support is insufficient in its task to protect vulnerable households, with many facing no option other than to incur debt or forgo essentials if expected price rises go ahead. Without urgent intervention, this risks disastrous consequences for living standards, with millions of households being pushed deeper into poverty. Businesses, particularly small businesses, also need support. Not acting would mean additional Government borrowing to deal with the effects of a sharp and lengthy recession – it is better for Government to act decisively now to prevent that.

The Government needs to act swiftly to implement a package of support that reflects the scale of the crisis (with UK households facing additional bills of £53 billion and £126 billion in 2022-23 and 2023-24 respectively) and its disproportionate impact on low-income households. This should combine universal support – the scale of the price rises means every household should be provided support – with targeting additional support to provide most help to households with the lowest incomes. The Government should also stand ready to go further and extend support for longer depending on the future path of energy prices.

The support package for households and small businesses should consist of a mix of energy price caps, tax cuts, and direct payments.

Price caps: Proposed by energy companies and by the Labour Party, limiting the price cap at the current rate (£1,971) would provide more support to high-energy-use households who benefit proportionately less than low-energy-use households from the current support package of cash payments. Some have argued that a downside of this approach is that it distorts price signals which would encourage people to reduce energy consumption. However, the reality is that prices have already spiked and the further price rises likely will be unaffordable for many. Short-term action is unavoidable.

In addition, while this option provides universal support that responds to differences in energy use, it does not vary support according to income. Some, including the Resolution Foundation, have also suggested the introduction of a **social tariff**, with different rates available according to levels of household income that would help to target resources to households according to their ability to afford price rises. This could be designed to entirely offset the household energy cap rises for those on the lowest-incomes, with support tapering for those on higher incomes. The question is how quickly this could be introduced.

Tax cuts: The new Prime Minister pledged during her campaign to reverse the recent rise in National Insurance contribution rates. Measures like this, along with raising the starting points of income tax and National Insurance bands, would increase people's take-pay home. Their impacts across the income distribution mean, however, that they would not be enough on their own to help low income households with their rising energy bills and the cost of other essentials.

Direct payments: For example, extending the current support package, combining universal and targeted cash transfers. It could be designed to entirely offset the household energy cap rises for those most disadvantaged, while the use of universal payments would ensure that all households still receive support. However, the current support package of cash transfers does not account for variations in household energy usage and the additional support misses low income households not eligible for Universal Support but facing similar gaps in finances.

The Government could also bring forward the annual uprating of benefits and consider uprating benefits at two points in the year, rather than one, in periods of high inflation to ensure benefits rise in line with increases in living costs. This is perhaps more justified given Ofgem has now decided to uprate the energy price cap quarterly.

Each option has pros and cons. A mix of all three is likely. The ultimate test is whether the overall package provides sufficient help to all households given bills are likely to be £120 billion higher in 2023-24 and targets most help to those that need it most.

The Government should also consider how support can be extended to businesses, many of whom are struggling with rising energy costs. Businesses in energy intensive sectors, such as manufacturing and heavy industry, and the 'shut-down' sectors, such as hospitality, who were hit hard in the pandemic. Again there are several options, which include targeted business rate reductions and direct grants along with price caps.

2. **The Government, Greater London Authority and London Boroughs should provide greater information and advice to improve access to available support, maximise benefit take-up and reduce energy usage.**

Improvements in the accessibility and availability of information, advice, and guidance (IAG) available to residents is key to ensuring they have full knowledge of relevant support able to help people with financial difficulties, such as grants, discounts and welfare and other income-related initiatives. This includes signposting and referrals to relevant services able to help struggling households manage financial hardship.

The expansion of London-wide IAG support through the Greater London Authority (GLA) would support the development of a local, tailored IAG offer, informed by the priorities of Londoners and challenges faced. This would deliver a clear, coherent offer across a wide range of issues to residents, utilising the GLA's prominent position to deliver an integrated model with a wide range of links to relevant initiatives available through the GLA and partners. This should include specific focus on each borough, developed in partnership with sub-regions and London boroughs given their strong links with their local areas.

The GLA's Cost of Living Hub offers a suitable initiative to build upon to create a comprehensive London-wide resource. This should be marketed widely, with links to key partners and stakeholders to maximise access. The Government should also take national action to provide information to people on how they can reduce energy consumption – this is not about telling people what to do, it is about ensuring people know what their options are so they can take their own decisions.

3. **The Government, Greater London Authority and London Boroughs should urgently accelerate efforts to improve energy efficiency and promote renewable forms of energy, including through microgeneration**

For the short-term and long-term we need to limit energy use and increase energy independence. This will help to tackle fuel poverty and reduce pressure on household finances, while also supporting the transition to net zero. Part of this should be driven by urgent action to accelerate the installation of energy efficiency measures, such as insulation and low-energy systems. All levels of government should look at what they can do to accelerate this. This includes consideration of how to support action for social housing and private rented housing – where tenants cannot take all the measures they might wish to and incentives risk being misaligned (e.g. where landlords would face the costs while tenants would gain the benefits of lower energy bills).

Similarly ambitious and urgent action is required for energy production. The rises in energy prices mean the payback periods on renewables has reduced substantially. All levels of government need to look at how they can make greater use of renewable energy sources, for example, using district heating networks, and installation of solar panels and heat pumps. This should include measures for social housing, with London boroughs having responsibility for a significant proportion of social housing stock.

These measures will help protect households from movements in global energy prices and help accelerate our movement toward net zero.

The note is released by the Better Work Network, a policy and practice-based initiative which aims to support progression from low pay and improve job quality for all. The note is part of the Better Work Network's latest programme of work, focusing on key elements of job quality in London. The Better Work Network is generously funded by Trust for London and delivered in collaboration with Learning and Work Institute.