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A wealth of variety

The variation in household wealth across Britain and what it means for policy

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The Resolution Foundation joined the abrdn Financial Fairness Trust to embark on a major investigation into the role of wealth in 21st century Britain. This briefing note is the second output of a four-year project. The abrdn Financial Fairness Trust's mission is to contribute towards strategic change which improves financial wellbeing in the UK. Its focus is on tackling financial problems and improving living standards for those on low-to-middle incomes. It is an independent charitable foundation.

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Summary

Household wealth in Britain has been on a rollercoaster ride in recent decades. Having surged over the past 30 years, as falling interest rates magnified the value of pensions and stoked up house prices, total household wealth is now estimated to have peaked in 2021 at around 840 per cent of GDP. It has since fallen sharply, and may have further to go as asset prices adjust to what seems to be a seismic shift in long-term real interest rates, at least for now.

This rapid adjustment is playing out in different ways across the country, driven by variation in the level and composition of household wealth. National policy makers need to understand how and why that is the case – both because geographic variations shed light on the nature of wealth, and because these different experiences complicate efforts to improve the tax system. The need for reform is nowhere more pressing than for Council Tax – by far the biggest existing wealth tax and one that is central to both national devolution and local authority funding.

Ahead of the pandemic, there was a national divide in household wealth with substantially larger holdings in the South. In 2018-20, typical wealth per adult was £310,000 for families in the South East and more than £200,000 in the South West and East of England. This is much higher than in Scotland (£140,000) and the North East (£99,000). Perhaps surprisingly, London stands out from its surrounding regions, with the second-lowest typical family wealth per adult of any nation or region (£115,000) despite having the highest incomes by some distance, partly reflecting the capital's more unequal distribution of wealth.

Three factors explain most of the variation in wealth levels and holdings across Britain: incomes, demographics and house prices. Unsurprisingly, there is a strong correlation between wealth holdings and incomes around the country, reflecting differences in the scope for households to actively save out of earnings from paid work, dividends and interest accrued from owning assets. Households in the North East of England have the lowest level of typical wealth of any nation or region, reflecting their income ranking.

Demographics are also a key determinant of wealth. Since household wealth has a strong lifecycle pattern as people prepare for retirement, small differences in the age of the population in different regions and nations are reflected in typical wealth holdings. In particular, London's surprisingly low levels of typical wealth are partly explained by the fact that the median age of Londoners is 35, significantly below that of other regions and nations, which range from 40 to 44.

Finally, house prices are critical in determining the nature of wealth in different nations and regions. We find that at the point of retirement, households in high-price areas typically have a higher proportion of wealth held in housing. Londoners hold 42 per cent of wealth in their houses, while in Scotland, where average house prices are lower than any other part of Britain except the North East, just 20 per cent of wealth is in housing. As a result, levels of non-housing wealth are much more equal around Britain than overall wealth, suggesting that typical retirees have more comparable standards of living than disparities in total wealth would suggest.

While wealth varies across the nations and regions, it also varies hugely within them. The gap between the middle and the top of the wealth distribution has increased sharply across the country since before the financial crisis. Based on data from just before the pandemic, this measure of wealth inequality was highest in the South and East of England where a family in the ninth decile of the wealth distribution had nearly 11 times the wealth of a family in the fifth decile, on average, up from just under 9 before the financial crisis. Other regions and nations in Britain have relatively smaller gaps between the top and middle of the distribution. The Midlands has the lowest wealth inequality on this measure, with a wealth gap ratio of 8.3 and the North of England as a whole comes in at 9.4. However, in all areas, wealth gaps on the eve of the pandemic were substantially higher than they were just before the financial crisis. Another measure of wealth inequality, which can be used to assess differences in living standards across groups, is the proportion of families with very low levels of wealth. The proportion of adults with low savings has fallen over the past two decades, but regional variation remains. In the North of England, around one-in-three families (34 per cent) have less than £1,000 per adult in accessible savings, compared to around one-in-four families (27 per cent) in the South.

As the cost of living crisis took hold in 2022, surging inflation triggered the largest increase in interest rates since the late 1980s which, together with rising global long-term real interest rates, has prompted a sharp reversal in wealth levels across all parts of the UK. With real gilt yields up by around 2.5 percentage points on their pre-pandemic levels, the value of government and corporate bonds has fallen sharply. We estimate that by the second quarter of 2023, this had cut the household wealth-to-GDP ratio by 210 percentage points from its peak in 2021 to stand at around 630 per cent, wiping £2.2 trillion from household wealth in the process.

All nations and regions have been subject to a substantial fall in wealth, but as a proportion of total wealth Scotland, Wales and the North of England have seen the biggest wealth drops. This is a result of a higher proportion of their wealth being held in pensions, whose underlying assets have been hit hardest by rising interest rates. While

Scottish household wealth has fallen by 26 per cent since the start of 2022, households in the South and East of England have so far seen a reduction of just 19 per cent. Because falling asset prices reflect higher returns since 2022, these dramatic reductions in (mostly) pension wealth have largely not translated into lower incomes for pensioners.

There is substantial uncertainty over the future path of long-term interest rates and therefore the value of household wealth. Current market expectations point to them declining slightly from current levels but remaining substantially higher than the pre-pandemic norm. This would cause pension valuations to rise somewhat from current levels, boosting wealth in Scotland, Wales and the North of England. But our analysis suggests that, despite interest rates edging down from today's high levels, it would not be surprising to see house prices fall by as much as a quarter as prices come to reflect significantly higher mortgage interest rates. While the timing of these effects is uncertain, they would tend to equalise the proportionate fall in wealth across the nations and regions.

Whether falls in household wealth are good or bad news depends on individual circumstances. When driven by interest rate fluctuations, a lower wealth world is one in which it is easier for young people to save for their retirement out of labour income, while a higher wealth world is one in which some can expect to inherit large fractions of their lifetime earnings. But what recent years have underscored is that high asset price volatility exposes households to unmanageable levels of risk and distributes wealth across generations in arbitrary and unfair ways. Policy makers could lean against some of these risks, for example through measures to dampen house price volatility and rebuild mechanisms for sharing more pension risks across cohorts. Taxing pensions, inheritance and capital gains more fairly would capture some of the windfall gains that lucky households experience when interest rates fall and shift the tax burden towards the wealthier parts of Britain.

But opportunities to make the Britain's main wealth tax – Council Tax – more progressive and fairer have been missed. Here, Scotland and Wales have led the way on reform. The Welsh Government's plans to update the valuations on which Council Tax is based, and potentially reform property bands, are a big step in the right direction. In Scotland, reforms in 2017 to make Council Tax less regressive – increasing tax rates on more valuable properties by up to 22.5 per cent relative to Band D houses – represented a step towards a fairer system. Sadly, Scottish Government proposals to repeat those reforms have recently been abandoned as part of a wider decision to freeze Council Tax rates in Scotland next year. Nevertheless, reforms in both nations demonstrate that it is possible to take meaningful steps towards improving the Council Tax regime. It is time that England began a similar journey of its own.

Household wealth has surged in recent decades

Household wealth in the Britain has been on a rollercoaster ride in recent decades. Having hovered around three time national income for much of the post-war period, total household wealth in the Britain surged over the past 30 years, and is estimated to have peaked in the middle of the pandemic at around 840 per cent of GDP.[1] It has since begun to fall sharply, and may have further to go, as asset prices adjust to what seems to be a seismic shift in long-term real interest rates with the end of ultra-low rates, at least for now. But these forces do not affect all households evenly. And while there are similarities in overall wealth trends across Britain, there are also surprisingly stark differences in the level and composition of household wealth. Together, this means that the wealth shock we are now seeing is playing out differently across the country.

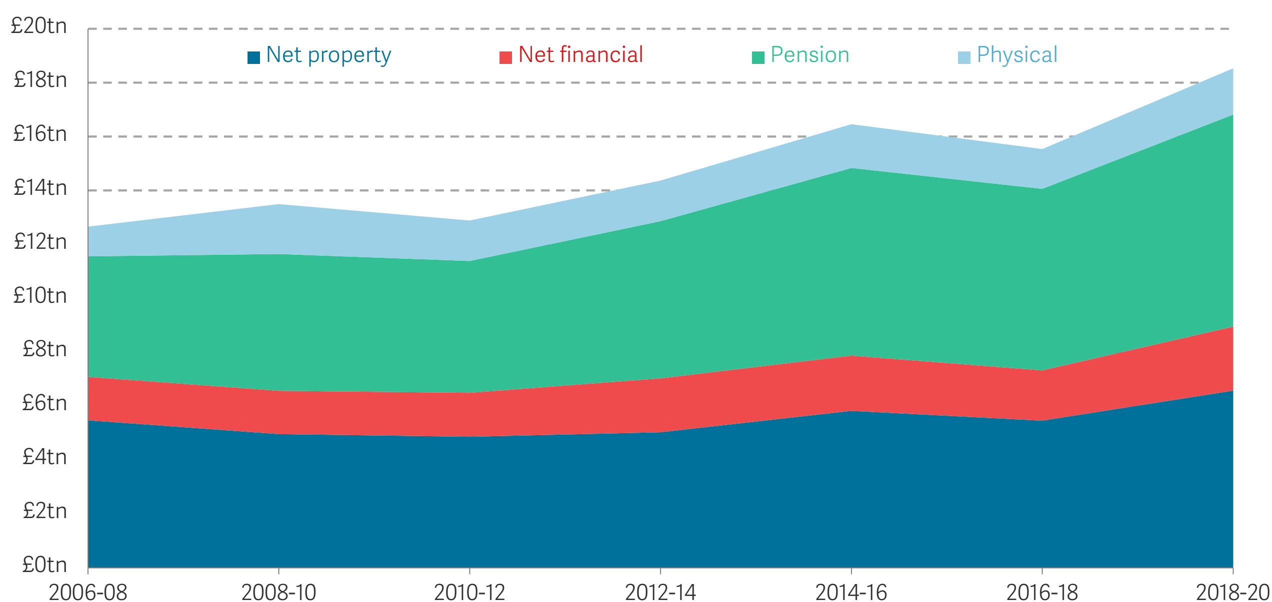
National, as well as local, policy makers need to understand how wealth is distributed across the country and what drives divergent trends between the nations and regions for at least two important reasons. First, geographic variation in wealth sheds light on the nature of wealth and its dynamics, which should inform policymaking on issues ranging from pensions and mortgage market regulation to taxation. Second, different degrees of exposure to wealth shocks complicate efforts to improve the tax system and apply taxes on wealth in fairer and more efficient ways. The need for reform is nowhere more pressing than for Council Tax – by far the biggest existing wealth tax and one that is central to both national devolution and local authority funding. So, in this briefing note we look at how household wealth is distributed across the nations and regions of Britain, what drives it, and what it means for policy.

Overwhelmingly, as Figure 1 shows, rising household wealth has been held in the form of pension savings and housing, which together account for almost £4 in every £5 of households' wealth. This meant that, for most of the second half of the 20th century, a typical household's pensions valuations and house prices tended to remain fairly constant relative to their (rising) earnings. Rising pension valuations and house prices account for the bulk of the increase in wealth. This was in large part a consequence of falling long-term interest rates, which had the effect of magnifying the valuation of pension promises and, via record low mortgage rates, stoked up house prices (albeit housing has also been subject to various booms and busts stemming from other factors over the period). In other words, the changing value of assets, rather than high levels of active saving has been the main driver of the household wealth boom.

1 M Broome, I Mulheirn & S Pittaway, Peaked interest? What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.

FIGURE 1: **Pensions and housing make up the overwhelming majority of household wealth**

Total net household wealth, by wealth type: GB, 2006-08 to 2018-20

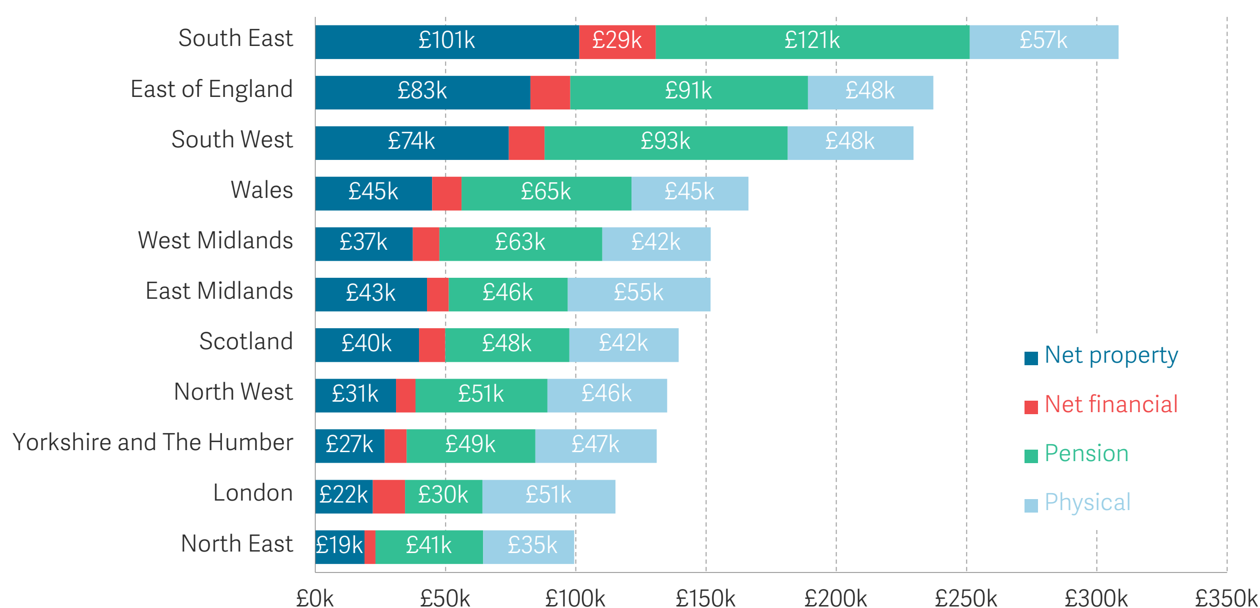


SOURCE: RF analysis of ONS, Wealth and Assets Survey.

While the effect of falling interest rates has been common across Britain, the pattern of wealth holdings varies significantly and consequently regional experiences have differed, with Figure 2 showing that on the eve of the pandemic, typical wealth was substantially higher in the South than elsewhere. Median wealth per adult was £310,000 for the typical family in the South East, and more than £200,000 in the South West and East of England. Meanwhile in Wales, Scotland, and regions in the Midlands and the North of England median wealth varied between £170,000 and £99,000. Intriguingly, typical wealth levels in London (at £115,000) were lower than in other regions in the South of England, with the capital having the second lowest level of typical wealth per adult among all UK nations and regions.

FIGURE 2: **Typical wealth holdings by nation and region vary substantially**

Median family net wealth per adult by nation and region and illustrative allocation to wealth type: GB, 2018-20



NOTES: Median total wealth is allocated to the four wealth types according to the average share held in each type among all families between the 45th and 55th percentile of the wealth distribution within a given region. Data is adjusted using CPIH into June 2023 prices.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

At the level of nations and regions, variation in wealth is driven by incomes, demographics and house prices

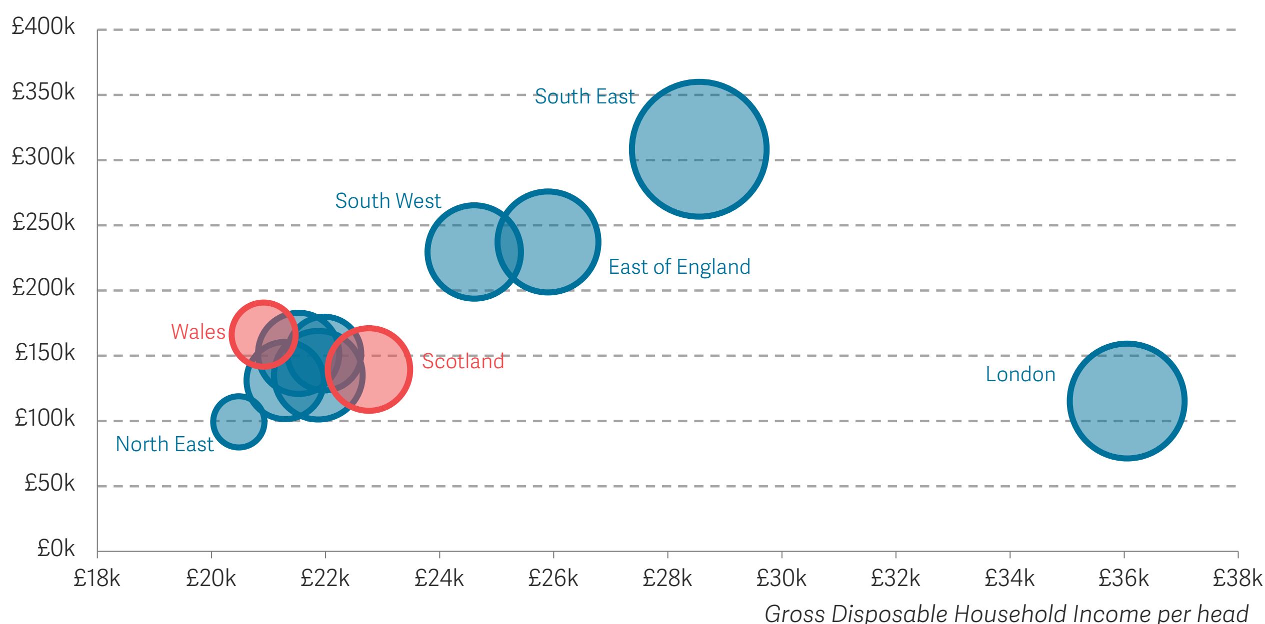
What lies behind these differences in wealth between the nations and regions of Britain? Unpacking the drivers sheds light on the nature of household wealth and what factors determine it. Regional differences are driven by three essential factors: incomes, demographics and housing.

Outside of London there is a close relationship between incomes and typical wealth

Unsurprisingly, a critical determinant of household wealth in a particular place is the income that resident households receive. Gross disposable household income (GDHI) per head captures all forms of income that flow to households, including earnings from paid work, dividends and interest accrued from owning assets, after taxes and government transfers. And as Figure 3 shows, average household wealth tends to be highly correlated with incomes across the Britain's nations and regions. Households in the North East of England, for example, have the lowest level of typical wealth of any nation or region, reflecting their income ranking.

FIGURE 3: **Typical wealth reflects income – in most nations and regions**

Median net family wealth per adult and GDHI per head, by region and nation: GB, 2018-20 and 2021



NOTES: Data is adjusted using CPIH into June 2023 prices. Bubble size represents total household wealth in each nation and region.
SOURCE: RF analysis of ONS, Wealth and Assets Survey & Regional gross disposable household income per head.

Relative to local incomes, it is notable that Wales has relatively high levels of average wealth. Most strikingly, typical wealth in London is well below the level we might expect given the much higher incomes of Londoners compared to people elsewhere in Britain. A key reason for this is that London's population is disproportionately young: the median age of Londoners is 35, significantly below that of other regions and nations which range from 40 to 44.[2] Since wealth at the individual level has a strong lifecycle pattern, typical Londoners tend not to be as wealthy as their peers in other parts of the country, despite their higher incomes, partly because they have had less time to accumulate savings. As residents of the capital age they will tend to be on a higher wealth trajectory than people in lower-income areas.

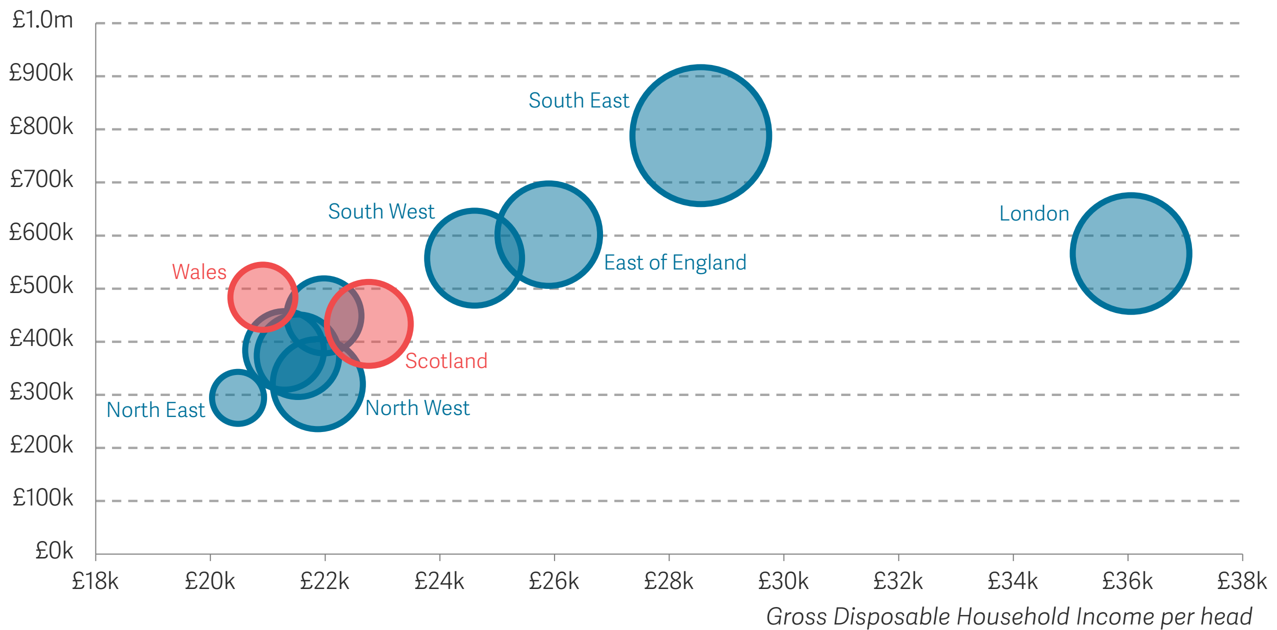
One way to overcome the distortions created by demographic variation is to compare wealth for people at or around the age of retirement, when household wealth usually reaches its lifecycle peak. Comparing people in their 60s, the typical family wealth of Londoners in 2018-20 was £570,000 in today's prices – higher than anywhere else in Britain apart from the South East and East of England. Nevertheless, given their incomes, Londoners' 'peak' wealth remains somewhat lower than the relationship across Scotland, Wales and the other English regions would suggest. Once again, Wales is an outlier in

2 ONS, Census 2021; ONS, Population estimates for the UK, England, Wales, Scotland and Northern Ireland: mid-2021.

the opposite direction, with typical peak wealth higher than anywhere outside the South and East of England, despite incomes being lower than anywhere other than in the North East. This appears to be due to higher pension savings than elsewhere in the country, including greater prevalence of defined benefit pension schemes.

FIGURE 4: **'Peak' lifecycle wealth is more closely related to income**

Median net family wealth per adult aged 60 to 69 and GDHI per head, by region and nation: GB, 2018-20 and 2021



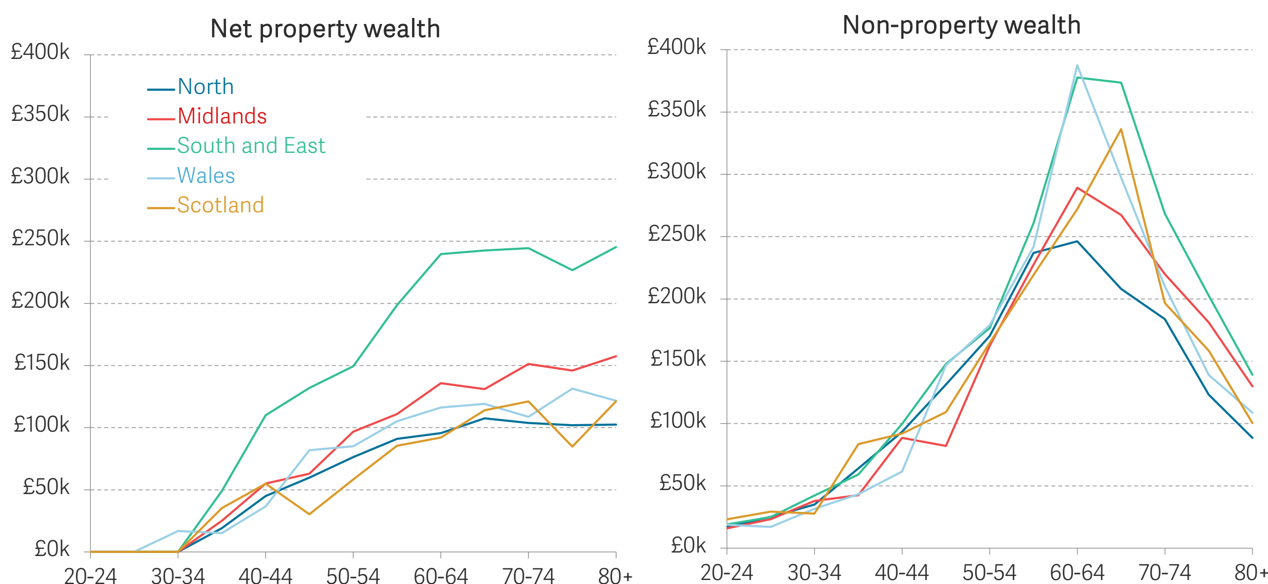
NOTES: Data adjusted to June 2023 prices using CPIH. Bubble size represents total household wealth in each nation and region.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; ONS, Regional gross domestic product.

Differences in house prices are another key driver of differences in regional wealth

Income and demographic variation between areas explains most of the spatial variation in levels of household wealth. But the composition of that wealth also varies starkly from one area to another in line with house prices. In Scotland and the North of England, typical housing wealth among those around retirement age (aged 60-69) was £98,000 and £101,000 respectively. Meanwhile in the South and East of England, median housing wealth for the same cohort was around £240,000, nearly two and a half times more than in Scotland and the North of England (Figure 5).

FIGURE 5: **There is greater variation in housing wealth than pension wealth**

Median family net property wealth per adult (left panel) and median family net wealth per adult excluding net property wealth (right panel), by broad region and nation and age group: GB, 2018-20



NOTES: Broad English regions are defined as follows: North: North East, North West and Yorkshire and the Humber; Midlands: East Midlands and West Midlands; South and East: East of England, South East, London, South West. Data is adjusted using CPIH into June 2023 prices.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

By contrast, pension and other wealth is significantly more equal between different parts of the country. Across the South and East of England, non-housing wealth is only around 50 per cent higher than in the North around retirement age, and comparable to non-housing wealth holdings in Scotland and Wales.[3] This suggests that typical after-housing living standards in retirement are more similar from one place to another than variation in overall wealth holdings would suggest.

We can see this by exploring how the allocation of wealth at the peak of the lifecycle varies with local income levels at a more granular level. Figure 6 shows that in areas with higher household incomes, a greater proportion of wealth among those aged 60-69 is held in housing. In London, the region with by far the highest income, 42 per cent of wealth is housing, while in the North East the proportion is 21 per cent and in Scotland just 20 per cent. This reflects the fact that higher incomes in a place tend to become capitalised into house prices, leaving non-housing wealth and incomes after-housing costs more equal.[4] But even once income variation is accounted for, Scotland is a

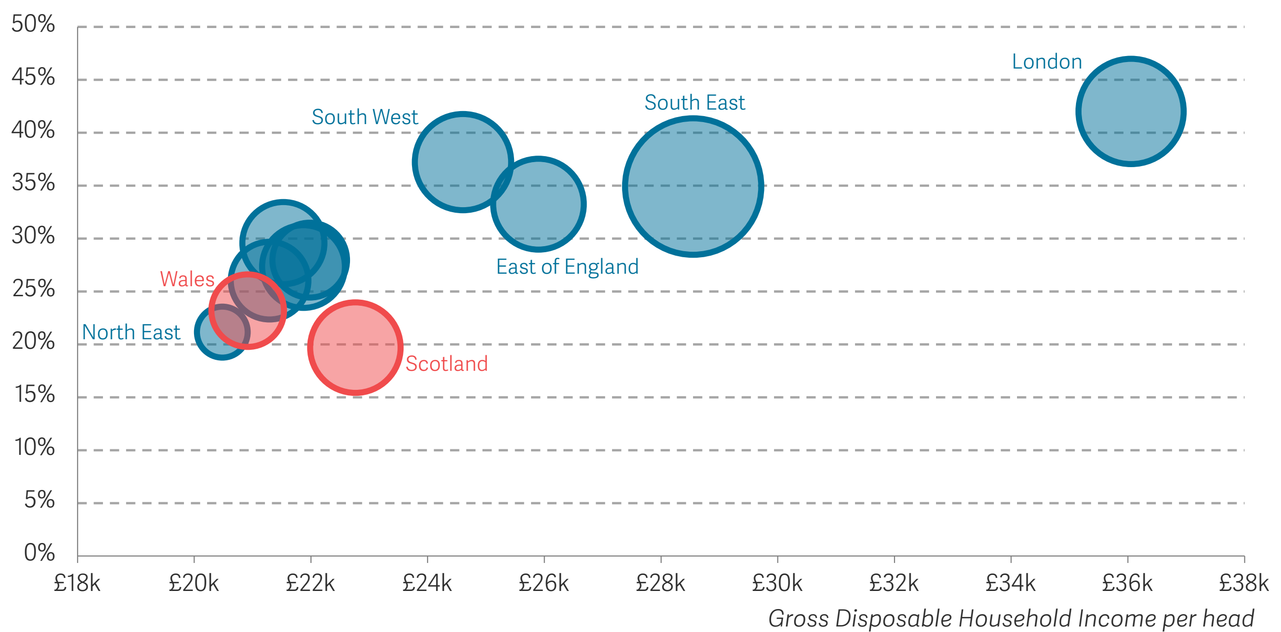
3 Compared to the North and Midlands, higher levels of pension wealth among those aged 60-69 in Scotland and Wales are driven by larger defined benefit pension pots and pensions in payment. One factor that is likely to contribute to this is differences in labour markets across regions and nations, such as the relatively higher share of public sector employment in Wales and Scotland. According to the ONS Annual Population Survey, between 2004 and 2022 the public sector accounted for 29 per cent of employment in Wales and 28 per cent in Scotland, compared to 25 per cent in the North and 22 per cent in the Midlands.

4 P Collier & A Venables, Who gets the urban surplus, Journal of Economic Geography, Volume 18, Issue 3, May 2018, Pages 523–538.

notable outlier. The typical Scottish adult at the point of retirement holds a significantly smaller fraction of their wealth in housing than counterparts in other nations or regions despite relatively healthy household incomes. This is because Scottish house prices are on average over a third lower than England's and more than 10 per cent below Welsh houses.[5]

FIGURE 6: **Wealth is more dominated by housing in high-income areas**

Proportion of net family property wealth per adult and GDHI per head, by region and nation: GB, 2018-20 and 2021



NOTES: Data is in current prices. Bubble size represents total household wealth in each nation and region.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; ONS, Regional gross domestic product.

The distribution of wealth within nations and regions has become more unequal

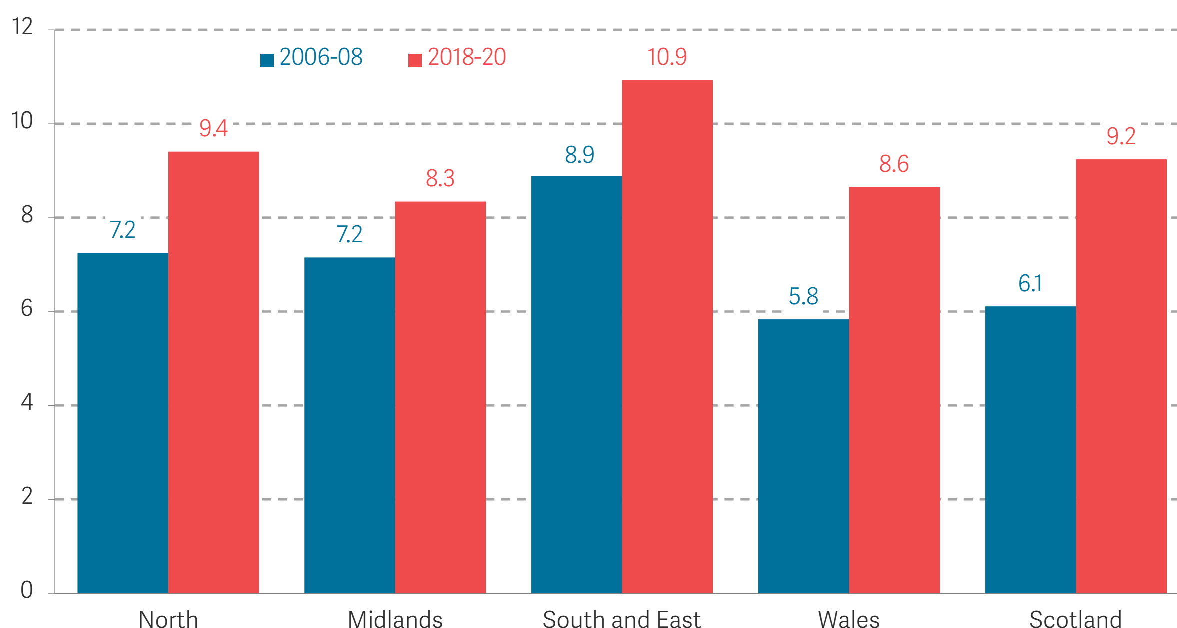
Up to this point we have explored typical wealth in the nations and regions of Britain, but the distribution of that wealth within different parts of the country is notoriously unequal. How do different areas of Britain compare in terms of wealth inequality? A common measure of inequality is the Gini coefficient. This has been broadly flat in recent years at the national level.[6] Recent increases in wealth holdings at the bottom end of the wealth distribution due to pensions auto-enrolment have put downward pressure on the Gini, obscuring rises in relative inequality in the top half of the wealth distribution.

5 ONS, UK House Price Index, August 2023.
6 M Broome & J Leslie, Arrears fears: The distribution of UK household wealth and the impact on families, Resolution Foundation, July 2022.

For a more informative measure of wealth inequality in the top half of the distribution, we therefore take the ratio of average family wealth per adult in the ninth decile of the distribution to wealth in the fifth decile.[7] As shown in Figure 7, this measure of relative inequality has increased across the UK since the years before the financial crisis, particularly in Wales and Scotland, whose relative inequality has now caught up to the levels seen in the North of England and the Midlands, driven by an increase in the relative inequality of pension wealth. Relative inequality is extremely high in London – where families in the ninth decile have 23 times the level of wealth per adult than families in the fifth decile – which pulls up relative inequality across the South and East of England as a whole. In fact, other parts of the South and East of England have the lowest measures of relative wealth inequality in the UK, with the ratio of wealth per adult between the ninth and fifth deciles varying between 6.1 and 7.5.

FIGURE 7: **Wealth gaps have risen in every region across Britain over the last decade**

Ratio of mean net family wealth per adult in the ninth decile and the fifth decile, by broad region and nation: 2006-08 to 2018-20



NOTES: Broad English regions are defined as follows: North: North East, North West and Yorkshire and the Humber; Midlands: East Midlands and West Midlands; South and East: East of England, South East, London, South West.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

But, as we have highlighted in previous research, relative measures of wealth inequality only provide a partial picture. The pound and pence gaps between families at different points of the wealth distribution, which are determined by the size of the wealth stock as

7 For a discussion of these issues, see: G Bangham & J Leslie, Rainy days: An audit of household wealth and the initial effects of the coronavirus crisis on saving and spending in Great Britain, Resolution Foundation, June 2020.

well as its relative distribution, are also important. Wider wealth gaps deepen economic inequality by making it harder for families to acquire housing and pension assets through saving out of their own incomes.[8]

In cash terms, the gaps between the families in the fifth and ninth deciles of the wealth distribution are largest in London and the South and East of England, at an average of £690,000 per adult in today's prices. This gap amounts to around 24 times average household income, measured by GDHI per head. Wealth gaps in Scotland and Wales are smaller in cash terms (at £550,000 and £500,000 respectively) but also amount to 24 times each nation's average income. Moving up the top half of the regional wealth distribution by saving out of income appears to be similarly difficult for an average household in all three areas of the UK. The task is only marginally easier in the North and Midlands, where the gaps between the fifth and ninth deciles are, respectively, worth 20 and 21 times each region's average income.

Turning now to the bottom half of the wealth distribution, an important facet of wealth inequality is the share of families with insufficient precautionary savings. This share varies only slightly across the UK. It is highest in the North of England, where around one-in-three families (34 per cent) have less than £1,000 per adult in accessible savings, compared to around one-in-four families (27 per cent) in the South.

Over the past decade-and-a-half, the share of families with few savings has fallen across Britain, but the fall has been sharpest in Scotland and Wales. In 2006-08, nearly half (46 per cent) of Scottish and Welsh families had less than £1,000 per adult in accessible savings in today's prices. By 2018-20, that share had fallen to less than a third (31 per cent and 30 per cent respectively).

The cost of living crisis has prompted a sharp fall in wealth

Up to this point we have been exploring the nature and spatial distribution of British household wealth up to just before the Covid-19 pandemic and subsequent cost of living crisis. Since the pandemic struck, however, household wealth has been subject to violent crosswinds that have begun to reshape it, with rather different implications across nations and regions.

In our previous work we estimated that during the pandemic wealth surged to a peak of 840 per cent of GDP in late 2021, in an acceleration of the trend of the previous 30 years.[9] Active savings, made by households unable to spend during rolling lockdown periods, reached record levels, with the saving ratio peaking at an unprecedented 25 per

8 P Bourquin, M Brewer & T Wernham, Trends in income and wealth inequalities, IFS Deaton Review of Inequalities, November 2022.
9 M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.

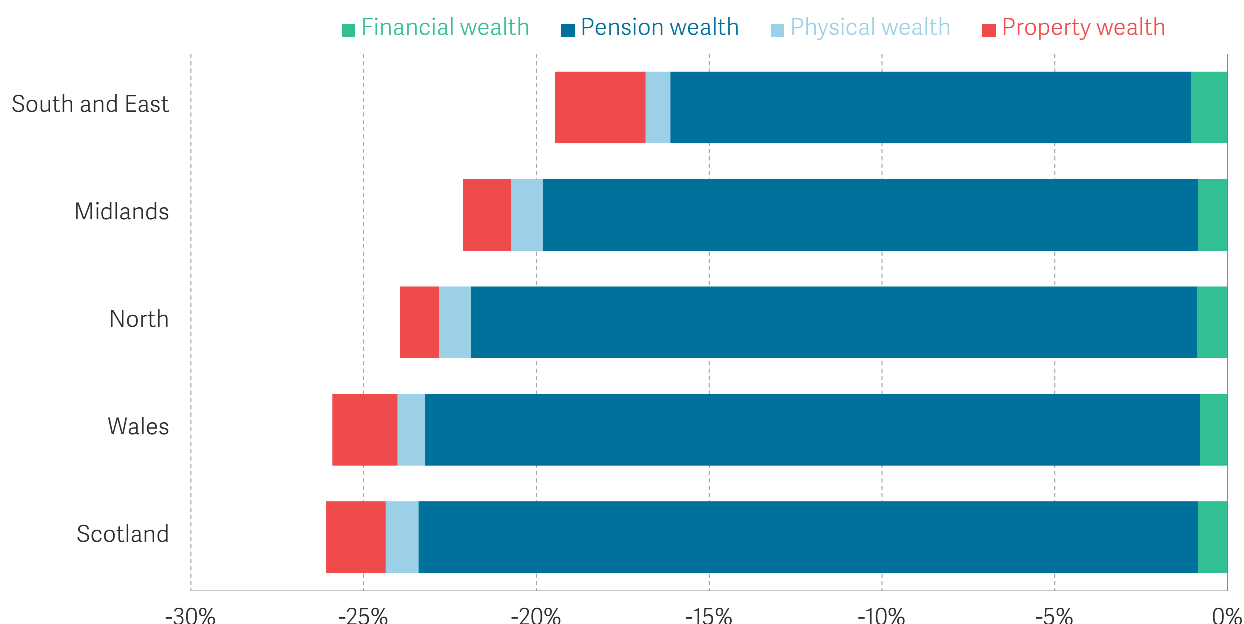
cent during the first lockdown, and remained unusually high until late 2021. But perhaps surprisingly this contributed only a small proportion of the increase in household wealth, with asset price changes contributing much more. While active saving added around 11 percentage points of GDP to aggregate household wealth over the first year of the pandemic, surging property prices and pension valuations boosted the wealth to GDP ratio by around 110 percentage points over the same time period.

These dominant 'passive' wealth effects then went into reverse in 2022. As the cost of living crisis took hold from late 2021, surging inflation triggered a rapid monetary policy response, which together with rising global long-term real interest rates has caused a sharp reversal in measured wealth levels. With real gilt yields up by around 2.5 percentage points on their pre-pandemic levels, the value of government and corporate bonds has fallen sharply. The overall effect by the second quarter of 2023 was to cut the value of household wealth by around 210 per cent of GDP from its 2021 peak, to stand at around 630 per cent.

Nationally this has wiped £2.2 trillion from household wealth in cash terms relative to its peak level, but the geographic distribution of the losses is surprising. Scotland, Wales and the North of England have seen the biggest wealth drops since a higher proportion of their wealth is held in pensions, whose underlying assets have been hit hardest by rising interest rates. While Scottish households' wealth has fallen by 26 per cent since the start of 2022, household in the South and East of England have so far seen a reduction of just 19 per cent. Within the South and East, the fall has been shallowest in London, at just 17 per cent. Since the asset price falls behind these reductions reflect rising rates of return since 2022, these dramatic reductions in (mostly) pension wealth have largely not translated into lower incomes for pensioners.

FIGURE 8: **Lower-wealth nations and regions have been hit hardest by recent wealth falls**

Estimated change in net household wealth due to passive changes, as a percentage of total wealth in Q1 2022, by broad region and nation: GB, Q1 2022 to Q2 2023



NOTES: Data is adjusted using CPIH to June 2023 prices. Broad English regions are defined as follows: North: North East, North West and Yorkshire and the Humber; Midlands: East Midlands and West Midlands; South and East: East of England, South East, London, South West. The value of household wealth is estimated by modelling changes in the value of individual wealth sources at the household level since the most recent wave (Q2 2018-Q1 2020) of the ONS Wealth and Assets Survey (WAS). For details on the modelling methodology, see: M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.
SOURCE: RF analysis of ONS, UK Economic Accounts; ONS, Wealth and Assets Survey; Bank of England, Effective interest rates; FTSE Russell, FTSE All-Share Index TR; MSCI, MSCI World Index TR; S&P Global, S&P UK Gilt Index; The Annuity Project from William Burrows; ONS, UK House Price Index.

This is a further reflection of the regional variation in the composition of household wealth. By the second quarter of 2023, house prices had fallen by 7 per cent in real terms from their peak in September 2021, but they have been far more resilient to rising interest rates so far than more-liquid assets such as investment grade bonds. As a result, areas of Britain with a higher proportion of wealth in property – like the South and East of England – have so far seen a smaller shock.

It is likely that volatility in wealth will continue

What can we expect in the years ahead given the asset composition of household wealth and the prospects for interest rates? The outlook is highly uncertain. Many economists argue that the global factors that have pushed interest rates down in recent decades,

such as an aging global population and declining growth, will reassert themselves.[10] If this occurs we can expect to see a further surge in asset prices and household wealth.

But signals from financial markets tell a different story. In the medium term, with inflation falling, market prices for government bonds indicate that long-term real interest rates will fall back somewhat from their current high levels. Nevertheless, they are expected to remain around 2 percentage points above their pre-pandemic levels, representing a stark change from the pre-pandemic era.[11]

This would cause pension valuations to recover slightly from current levels, boosting those parts of Britain – especially Scotland, Wales and the North of England – that have seen the largest proportionate reductions in wealth since 2021. But our analysis suggests that, despite interest rates edging down, we may see a significant adjustment in house prices relative to earnings in the years ahead as prices come to reflect significantly higher mortgage interest rates.

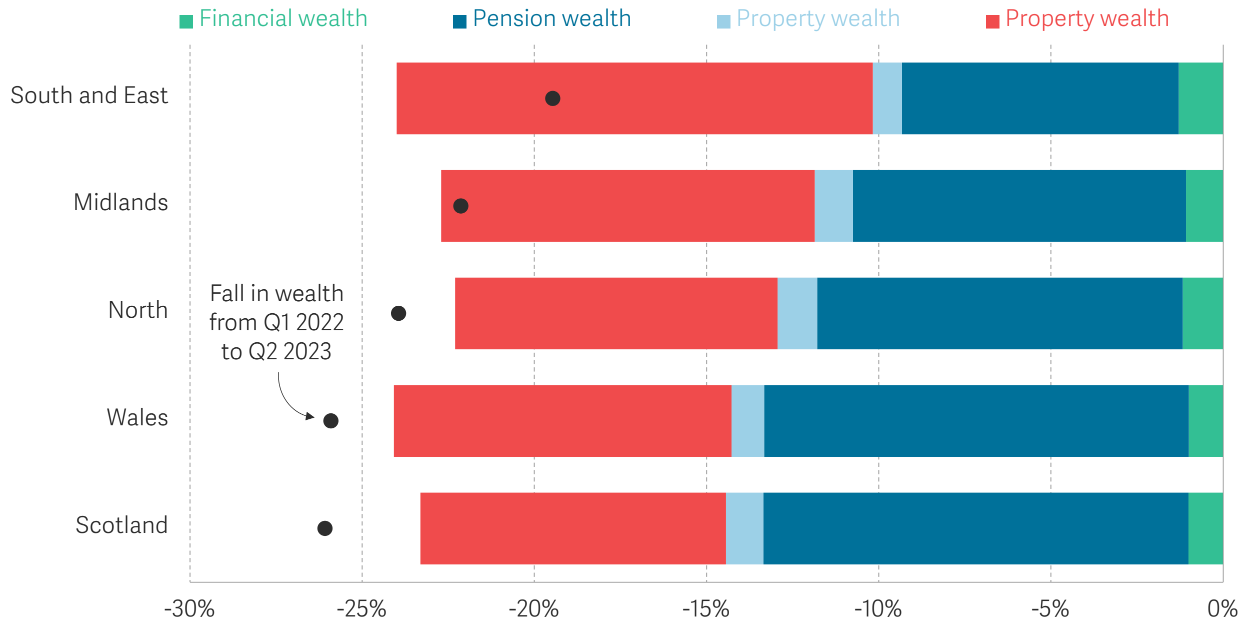
Applying our national estimate of house price-to-earnings ratios dropping to 5.6 uniformly across Britain would produce very large losses on housing wealth in London and the South of England. The net effect would be broadly to equalise the total wealth effect of higher interest rates across nations and regions. Whether such an adjustment in house prices will happen and over what time period remains highly uncertain.

10 See, for example: A Bailey et al., Structural change, global R* and the missing-investment puzzle, Bank of England Staff Working Paper No. 997, October 2022; K Holston, T Laubach & J C Williams, Measuring the Natural Rate of Interest after COVID-19, Federal Reserve Bank of New York Staff Reports No. 1063, June 2023.

11 M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.

FIGURE 9: **A house price adjustment could substantively change the regional picture of wealth**

Estimated change in net household wealth due to passive changes, compared to total wealth in Q1 2022, in a scenario of 3 per cent long-term interest rates, by broad region and nation: GB



NOTES: Data is adjusted using CPIH to June 2023 prices. Broad English regions are defined as follows: North: North East, North West and Yorkshire and the Humber; Midlands: East Midlands and West Midlands; South and East: East of England, South East, London, South West. The value of household wealth is estimated by modelling changes in the value of individual wealth sources at the household level since the most recent wave (Q2 2018-Q1 2020) of the ONS Wealth and Assets Survey (WAS). For details on the modelling methodology, see: M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.
SOURCE: RF analysis of ONS, UK Economic Accounts; ONS, Wealth and Assets Survey; Bank of England, Effective interest rates; FTSE Russell, FTSE All-Share Index TR; MSCI, MSCI World Index TR; S&P Global, S&P UK Gilt Index; The Annuity Project from William Burrows; ONS, UK House Price Index.

The impact of falling wealth is likely to differ significantly across the country according to the composition of that wealth. Falls in the value of pension wealth are largely a reflection of an offsetting rise in yields on the underlying assets. For people with defined contribution pension saving, these higher returns cushion the drop in capital value as the price of the underlying assets falls. Meanwhile, people with defined benefit pensions or receiving an annuity are guaranteed a given income, so fluctuations in the capital value of that income do not affect their standard of living. Consequently, large proportionate drops in the value of pension wealth in Scotland, Wales and the North of England are unlikely to have major consequences for the living standards of people at or near retirement.

Falls in housing wealth are potentially more concerning, especially for highly-leveraged households who are at risk of falling into negative equity. The overall level of wealth is most sensitive to changes in house prices in the South and East of England, where

housing makes up a relatively larger share of overall wealth.

But the risk of households falling into negative equity is higher elsewhere in Britain. Households are most at risk of falling into negative equity when their mortgage balance is high compared to the value of their home – that is, when their loan-to-value (LTV) ratio is high – and they have little equity to cushion a fall in house prices. Prior to the pandemic, the share of mortgaged households with LTV ratios of more than 75 per cent (meaning a 25 per cent fall in house prices would wipe out all of their equity) was 27 per cent in the North East and 21 per cent in Scotland, compared to just 7 per cent in the South East, East of England and London.[12] This could reflect a combination of stronger house price growth in the South and East of England in the second half of the 2010s, which has boosted the equity buffers of homeowners in the region, and banks issuing fewer new mortgages at high LTV ratios (where they are more exposed to losses if the borrower can't repay) in parts the country where house prices are high and affordability is stretched.

Policy makers cannot ignore these seismic changes in household wealth

After more than 30 years of rising household wealth, is a drop in its value a cause for concern or celebration? The answer largely depends on individual circumstances. For retirees on fixed incomes, falling pension and housing wealth triggered by rising interest rates is likely only to have a limited impact on their standard of living. For middle-aged mortgagors, the effect of rising interest rates on their housing equity and mortgage repayments is likely to be painful.

Meanwhile for younger workers, not yet on the housing ladder and at the start of saving for a pension, lower asset prices are very good news: they mean that, on the current outlook, it will be significantly easier to afford a home or build a decent pension for retirement than it was in the last decade.[13] For example, as we showed in our previous work, based on current market expectations for interest rates, a typical 40-year old would need to save around 20 per cent less – around £1,000 per year – from their income compared to the savings rate required in the late 2010s to achieve the same income in retirement.

Just as rising house prices and falling returns tipped the intergenerational scales in favour of older people in the first 20 years of the century, so rising returns and falling house prices may be beginning to tip them back towards today's younger generation.

12 ONS, Wealth and Assets Survey.
13 M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.

But, stepping back from the implications for different individuals, the striking lesson of recent years, and the huge uncertainty about the path for long-term interest rates ahead, is just how vulnerable families are to fluctuations in asset prices that have a huge bearing on intergenerational fairness and the living standards of different cohorts. Is it desirable that households looking to buy a home and provide a basic income for themselves in retirement should be exposed to such risks, or should policy aim to do more to insulate them from these forces that are well beyond their control?

In our previous work we also outlined some of the policy levers that could help to achieve that.[14] Periodically reviewing the adequacy of the default contribution rate for auto-enrolment into a pension scheme in response to the changing outlook for returns would help to avoid people having a false sense of security about the adequacy of their pension savings. More importantly, there is a case for looking at mechanisms that can share a degree of investment risk across cohorts in order to give people more certainty about what they can expect in retirement from any given rate of saving. A generous State Pension would be part of that, but so could other mechanisms such as the introduction of 'collective' defined contribution schemes.[15]

For housing, families are very exposed to price fluctuations with substantial implications for their lifetime consumption. While house price and interest rate volatility are a fact of life, mechanisms like mortgage insurance and expanded provision of long-term fixed-rate mortgage products could help to cushion their impact on families. Using macroprudential tools to insulate the housing market to some degree from external shocks could also be explored.

When it comes to taxation, an important insight from recent experience is that the appropriate way to tax wealth depends to a large degree on its source. When driven by falling interest rates, rising asset prices are accompanied by falling returns, which means that the holders of assets don't see increases in the incomes they get from their wealth. These people are better off, but can only realise those benefits at the point where they sell the assets and consume the proceeds. Rather than pointing to an annual levy on the value of household wealth as some have called for, these attributes suggest that capital gains should be taxed at the point where assets are transacted and their owners crystallise the gains.[16]

Our recent report on tax reform, proposed a number of measures that accord with these principles including: addressing Capital Gains Tax loopholes by ending the writing-off of

14 M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.
15 M Broome, I Mulheirn & S Pittaway, Peaked interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.
16 For a more detailed discussion, see: I Mulheirn, Sources of wealth and their implications for taxation, Wealth Tax Commission, October 2020; A Fagereng et al., Saving behaviour across the wealth distribution: the importance of capital gains, May 2021.

capital gains upon death and raising marginal rates to match earnings taxation; reforming Inheritance Tax by eliminating the Residence Nil-Rate Band; and gradually reducing the tax-free pension lump sum from £270,000 to £100,000.[17] These kinds of measures would shift the taxation of wealth to lean against the strong regional wealth inequalities illustrated above. Areas with very high housing and financial wealth in particular – especially across the South and East of England – would pay more tax.

Many of the policy levers discussed above – relating to the mortgage market, pensions regulation and taxation – are reserved powers for the UK Government. It is, therefore, unlikely that they would ever be varied according to the level and distribution of wealth in different parts of the UK. However, one effective wealth tax that is under the control of the Scottish and Welsh devolved administrations and forms a critical part of the tax base across Britain is Council Tax.

Council Tax is expected to raise £44 billion, some 1.7 per cent of GDP, in 2023-24 across the UK, making it by far the largest tax on wealth in the tax system. But it is in critical need of reform, as we have argued previously.[18] Most obviously the administration of the tax is woefully out of date, with Council Tax banding based on house values in 1991 in Scotland and England, and 2003 in Wales. This means that houses that may have diverged markedly in value over the intervening years are treated the same for Council Tax.

More troubling still is the regressive nature of Council Tax, which has a strong regional pattern. In England, houses valued at £100,000 pay Council Tax equivalent to around 1.2 per cent of the property's value each year, while houses worth £1 million typically pay just over 0.2 per cent.[19] In Scotland and Wales the disparity is similarly stark.

Finally, there is a strong case for raising a reformed Council Tax since taxes on property, especially if levied on land or if derogations are made for improvements to properties, tend not to distort economic activity in the way that taxes on labour and capital income do. We have previously proposed an approach to tackling these problems with the Council Tax regime.[20] It should begin with revaluing properties and moving to a system of annual revaluation going forward. That revaluation process should ignore changes in value that result from improvements to the property until it is sold, in order to avoid disincentivising investment.

But reforms should go much further to address the regressive nature of Council Tax and shift to a flat rate proportional tax on the value of properties. If done nationally, this would

17 M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
18 Office for Budget Responsibility, Economic and Fiscal Outlook, March 2023.
19 M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
20 M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.

entail substantial changes in the Council Tax levied on different properties with many seeing major increases or reductions in their bills. The political barriers to such a change are formidable. A more achievable initial step would be to make the tax proportional within each local authority, such that the same amount of revenue is raised as currently but the tax rate varies from one area to another. It would then be possible to move gradually to equalise the property tax rate between local authorities.

While there is no sign that any reform of Council Tax is on the cards in England, there has been much more innovation in Wales and Scotland. How do those proposals measure up? The Welsh Government has led the way on revaluation and has recently consulted on plans to revalue properties based on April 2023 prices, and thereafter put in place rolling revaluations to ensure that the Council Tax burden always reflects the most up-to-date relative property values.[21] The process would also allow for Council Tax bandings to be changed, albeit with a commitment that the new system would not seek to raise more revenue overall than the current one.

The Scottish Government, meanwhile, also recently consulted on reform proposals which explicitly aim to shift the incidence of Council Tax further towards more valuable properties.[22] These plans have now been abandoned, with the Scottish government instead opting to freeze Council Tax rates for 2024-25. It is nevertheless worth examining the proposals, which would have been a repeat of changes made in Scotland in 2017 and indicate the Scottish Government's likely approach to reform in the longer term.

The proposed reforms were due to come in from April 2024 and involve raising the tax rate on houses in tax bands E to H by between 7.5 per cent and 22.5 per cent relative to band D tax rates, the same scale of relative increase implemented in 2017. Taken together, the 2017 and planned 2024 changes would have increased Council Tax on band H properties to three times that on band D ones, compared to a multiple of two before 2017 (see figure 10). Even under these now-mothballed plans, however, there was no plan to revalue properties.

21 Welsh Government, A Fairer Council Tax, July 2023.
22 Scottish Government, Consultation on a fairer Council Tax, July 2023.

FIGURE 10: **Scrapped reforms to Scottish Council Tax would have gone some way to make the system more progressive**

Annual Council Tax bill as a percentage of 1991 property value: Scotland

SOURCE: Scottish Government, Council Tax Collection Statistics: 2022-2023.

As other research has shown, these reforms would have represented a relatively modest shift towards making the Council Tax regime more proportional, with band H properties worth at least eight times band A ones, but facing a Council Tax bill only 4.5 times as much.[23] Nevertheless, they would have meant Scotland taking meaningful steps towards a fairer proportional system than the ossified tax regime in England. The apparent cancellation of the changes underlines the political sensitivity of taking steps to improve Council Tax and the need to deliver reforms well before the political pressure of looming elections starts to be felt.

The kind of reforms seen in the past in Scotland and planned in Wales only go part of the way towards resolving the many problems with Council Tax in Britain. But they demonstrate that it is possible to take meaningful steps towards improving the Council Tax regime – both through revaluation and improving the progressivity of tax – at the appropriate political moment. It is past time that England began a similar journey of its own.

23 D Phillips, Scottish council tax proposals are a small step in the right direction but duck the biggest issue: revaluation, Institute for Fiscal Studies, September 2023.

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