

The Real Cost of Living

Nicola Smith and Ivan Mathers

Summary

- In recent years families have experienced both downward pressures on their incomes and upwards pressures in the prices of the most essential goods they buy. This has led to a strain on their incomes.
- This report aims to highlight the impact of these financial pressures on low income families. Using interviews conducted directly with our service users we show how low income families increasingly feel that the rising costs of “essentials” – such as food, energy, transport and childcare are putting a strain on the family budget.
- The report also contains new analysis of economic data which confirms it is currently low income families who are feeling the biggest impact from rising prices. Examining the goods and services that families on the lowest incomes buy reveals that in 2012 families on low incomes saw an inflation rate of around 0.4 – 0.5 percentage points higher than the average.
- In this context Barnardo’s is concerned that the recent Welfare Benefits Up-rating Act 2013 exposes families to a substantial inflation risk. Committing to increasing benefits by only one per cent in future years means that living standards for poor households could be substantially reduced.
- Barnardo’s is calling on the Government to ensure that it shields the poorest families from the worst effects of rising prices. In particular we believe the Government should commit to reviewing the decision to increase benefits by one per cent if inflation increases beyond 2.5 per cent.
- Furthermore, the Government should take steps to help families with the increasing burden of high childcare costs and energy prices. It should do this by extending the increased subsidy for childcare within Universal Credit to all low income working families (not just those working full time), and by using revenues from its carbon tax to support energy efficiency schemes particularly targeted at low income households.

Section one: Introduction

On April 8 2013 the Welfare Benefits Up-rating Act will come into force. This legislation will restrict rises in working age benefit to only 1 per cent for the next two years irrespective of how much prices rises in this time. Such a move is concerning at a time when we believe that low income families are experiencing significant upward pressure in the price of essential goods and services. Items such as food, fuel and childcare have all seen above inflation increases in recent years and families Barnardo's work with have told us this is putting increasing pressure on household budgets. New analysis of existing economic data done for this report also confirms that that current price increases on essential goods and services means that low income families are currently experiencing higher inflation rates than average.

This legislation is coming at a time when the impact of the current economic downturn on low income families has been both large and long lasting. The most recent figures suggest that there are around 3.6million children living in relative poverty and around 1.4million children living in absolute poverty in the UK and that during 2010-11 average household incomes fell by 3.1 per cent, the largest year on year fall since 1981.^{1,2} Furthermore, the Institute for Fiscal Studies (IFS) projected that by 2013 there would be 900,000 more children living in absolute poverty than there were in 2009.^{3,4} The Government's measure of absolute poverty uses a fixed income benchmark as a way of assessing whether living standards are increasing or decreasing, and so gives a clear sign that incomes and living standards for many families are likely to have declined in recent years.

This report will take a closer look at households' spending habits and how low income families are being affected by inflation in the current climate. We use information about spending habits gathered from a number of focus groups we held at Barnardo's children's centres and family support services across the UK between December 2012 and February 2013.⁵ Here we asked what families were spending their money on, how they were budgeting, and how they dealt with the challenges of ensuring that a low income is stretched to meet the family's needs. The families we spoke to came from a diverse range of situations. In some of the families there was no one in paid employment, but many had at least one parent in a low waged job, although they needed to rely on the top ups of tax credits and Child Benefit in order to survive. We spoke to both single parent families, and couple families, younger parents and those who were more mature. Most of the children in the families we

¹ DWP (2012) *Households below average income*. Department for Work and Pensions, London.

² Brewer, M. et al. (2011) *Child and Working-Age Poverty from 2010 to 2020*. Institute for Fiscal Studies, London

³ Cribb, J. et al. (2012). *Living standards, poverty and inequality in the UK: 2012* Institute for Fiscal Studies, London

⁴ Brewer, M. et al. (2011) *Child and Working-Age Poverty from 2010 to 2020*. Institute for Fiscal Studies, London

⁵ We held seven focus groups in all, these were held in Leicester, Kidderminster, Sandwell, Newcastle Upon Tyne, Belfast, North West Wales and Glasgow.

spoke to were under 10, and one focus group was specifically undertaken with parents of children who had additional needs. Section two of this report details what these families told us about their spending habits.

We then combine this information with the analysis of the most up to date economic data. Section three of the report compares what our families tell us they are spending their money on with how the prices of these goods has changed in recent years and highlights how our families told us they were responding to these rising prices (including cutting back and changing their spending habits). Section four takes this analysis further by looking to survey data to give a detailed analysis of how low income families across the UK spend their money (with similar goods and services identified as those highlighted by our families). This section also looks at the living cost increases that low income families have experienced in recent years compared to those with higher incomes. Finally, section five concludes and sets out some key measures that Barnardo's believes could help improve the situation for families both by helping to shield them from the cost of inflation and by helping them to bring their costs down in the two key areas of childcare and energy prices.

Section two: What did the families we interviewed tell us was most important?

"Everything has gone up but the wages haven't, they've just stayed the same" (mother of a nine month old Newcastle)

The resounding message we received was that families are finding it increasingly difficult to cope financially. Many families had been hit hard by the economic situation. A number reported that at least one parent had been made redundant – particularly as a result of cuts in public sector employment. Two families had been reliant on self employment but the business had folded as a result of the poor economic climate. Many of those in work also reported that their employment situation had become more precarious. One family reported that the husband had lost his shift allowance; another that their son had been forced to work only four days a week, because there wasn't enough work for a full time post. A number of people reported having to take up jobs offering only temporary, fixed term contracts, or flexible contracts where the amount of hours offered varied considerably from week to week. This meant they were less and less sure how much money they would get paid from week to week, or for how long they would be working.

Families also reported being hit by changes in welfare. Reductions to Child and Working Tax Credit had hit some. Others were concerned about impending changes, such as changes to Disability Living Allowance (DLA) and the move to Personal Independence Payments (PIP) – one parent with fibromyalgia and arthritis reported they had already lost their DLA payment because "I was too happy at the interview". Others reported their concerns around the new rules on under occupancy in social accommodation - the so

called Bedroom Tax, particularly in areas where it was felt there was a lack of smaller two bedroom properties to move into.

In addition to concerns about money coming in, families also reported that they were finding that prices for their main outgoings were going up considerably – meaning many families had had to adapt their lifestyles as section four of this report shows. Added together with a more precarious employment situation, lower welfare payments and higher prices meant many families were finding themselves worried about money more than they had been in the past which was causing strain within families

"Dealing with all this makes you really tired. You cope by going into a wee bubble: a wee happy place. You just tell yourself 'It's fine, we'll cope.' It brings you even more down if the whole community is feeling like this. If nobody bursts out of their bubble the whole cycle will just keep on repeating." **(parent Glasgow)**

"I don't look forward to pay day, it causes anxiety trying to decide what to pay" **(parent, North West Wales)**

Putting money away in case of unexpected or one off expenses such as a washing machine breaking down or the car tax being due was becoming increasingly difficult for families and many reported feeling very vulnerable since they had no safety net. This meant that the only option was to spend available money on day to day expenses and rely upon borrowed money – either from family or from formal sources (including the soon to be abolished social fund) for unexpected expenses. Previous Barnardo's research has emphasised the importance of an adequate safety net for families in helping them avoid falling into unmanageable debt.⁶

"I used to be a saver all my life I've always worked luckily you know? And then I lost my job and all our savings now have gone, my husband has been off work and because of that and the kids we have no savings now and this is by far our worse fear because we always have had a little bit, a safety net and we have nothing now" **(mother of two children, Kidderminster)**

"When I moved into my house I didn't have a thing, I didn't have a sofa or nothing and I had to buy it on credit just so I had something to sit on and that's the way we've got to live". **(mother of a two year old, Newcastle)**

Families across the UK reported their main outgoings as falling roughly into 3 or 4 areas. The main outgoings reported by families were as follows:

- Food
- Heating
- Transport – particular car costs and bus fares

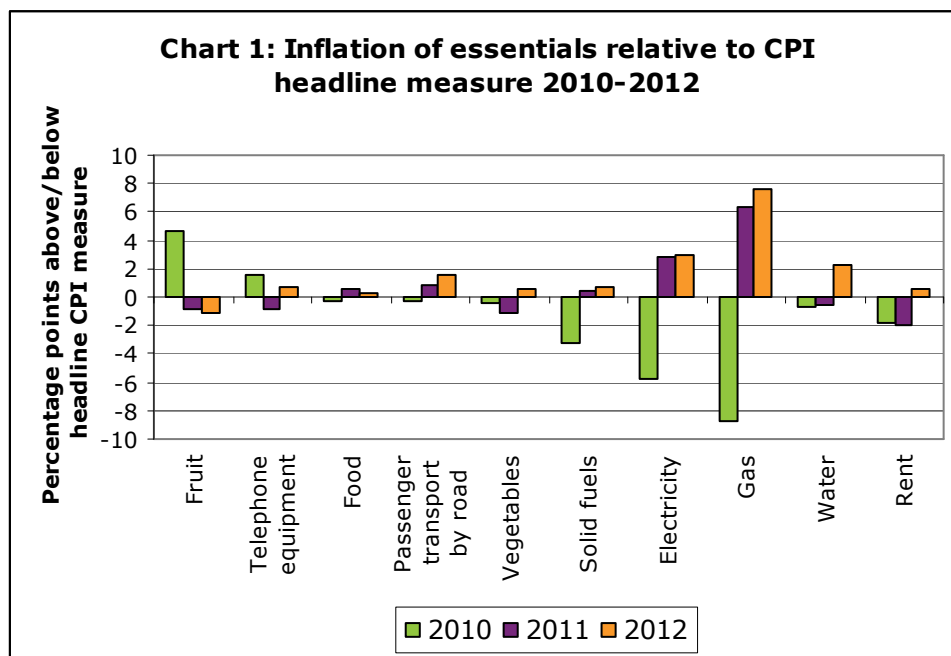
⁶ Mathers, I. & Sharma, N. (2011). *A Vicious Cycle*. Barnardo's, Barkingside.

- Childcare

Section three: What has happened to living costs for poor families recently?

Based on the focus groups we decided to undertake some more in depth analysis to see whether the messages from the families we work with were evidenced more widely. We found that the results closely matched with what service users told us. We found that not only do families on the lowest incomes spend a higher proportion of their budget on essentials, but also that the price of these essentials has generally been increasing rapidly, particularly in 2012.

Chart 1 shows how far above or below the headline Consumer Price Index (CPI) inflation rate a range of goods were during 2010-2012. Where the chart shows a positive value it means that the price of that good was growing above the headline rate of inflation during that year, and where it is negative, prices were growing below the headline.



Energy

"I think gas has gone up, I've been spending too much on gas but its one of those things you can't cut back on or you'd freeze!" (mother of a two year old, Newcastle)

2010 and 2011 was notable for substantial, above inflation growth in the prices of liquid fuels (such as oil and kerosene). The prices in this area grew by over 20 percentage points above the headline inflation rate in each year. However, in 2010 this was offset to some extent by electricity, gas and solid fuels rising below inflation. By 2012 liquid fuel price growth was close to the

overall rate of inflation. However, other domestic fuels and utilities saw above inflation increases, most notably the price of gas but also electricity, water and solid fuels.

Electricity and gas came up as an area of significant spending in our focus groups. Many of the focus groups were conducted during a significant cold snap, and families reported difficulties keeping their homes at a suitable temperature. Some families reported prioritising heating at a time when the children were awake but turning it off or down otherwise.

"We are trying to turn our heating down a little bit at the moment, where I can I used to run it at 17 and I am now taking it down to 15"
(mother of two children, Kidderminster)

"When the kids are up you know I put it on for the kids but as soon as they're in bed I leave it running for about half an hour you know after they've gone and then turn it off and you sit there with jumpers and covers round you"
(mother, Northern Ireland)

Lack of insulation meant that one parent in particular reported that their home was difficult to keep warm without significant cost.

"I've still got single glazing windows and my curtains well I've got really thick curtains and they still don't keep the heat in and like how do they expect people to keep warm?"
(mother of a two year old, Newcastle)

Wider evidence shows that when the prices of domestic utilities increase consumers tend to scale back their expenditure in this area, but that in the short term this effect tends to be relatively modest as there is not much scope to cut back. In the longer term households tend to cut back more.⁷ In addition, there is also a small body of evidence which suggests that low income households may suffer disproportionately when prices rise.⁸ A study from the Centre for Sustainable Energy highlighted a significant number of households with low incomes but high energy consumption – these represented around 18 per cent of electricity customers and 17 per cent of gas customers⁹. In a discussion paper The Office of Gas and Electricity Markets (OFGEM) highlighted that these customers were the most likely to respond to increasing energy prices by directly cutting back on heating. Households on low incomes and in private rented accommodation suffer the

⁷ See for example DECC (2010) *Alternative Reference Projections*.
<http://archive.theccc.org.uk/pdfs/DECC%20-%20CE%20Alternative%20Ref%20Projections%20Appendix.pdf>, accessed 27 March 2012

⁸ See for example a study from California: Reiss, P; White, M (2002) *Household Electricity Demand, Revisted*
<http://www.stanford.edu/~preiss/demand.pdf>

⁹ Centre for Sustainable Energy (2008) *Assessing the social impacts of a supplier obligation: report to DEFRA*

most as they are less able to implement energy efficiency measures when the price of utilities increases.¹⁰

The ultimate impact of fuel poverty is on the health of children. Through previous reports¹¹ and recent work Barnardo's has conducted with the Energy Bill Revolution campaign demonstrated the real impact of living in cold homes on children's health. Children living in cold homes are twice as likely to suffer from asthma and other respiratory problems compared to those whose families can afford to keep the house warm.¹²

'Individuals who are already suffering from financial poverty are increasingly having to decide between keeping themselves and their families warm or having sufficient food to keep them healthy. This then impacts in all other areas of their life from relationships to mental health and other general health issues.' (**Barnardo's worker, Priced Out**)¹³

Food

"Everything has gone up but the biggest [item] that has gone up is food" (father of two, Kidderminster)

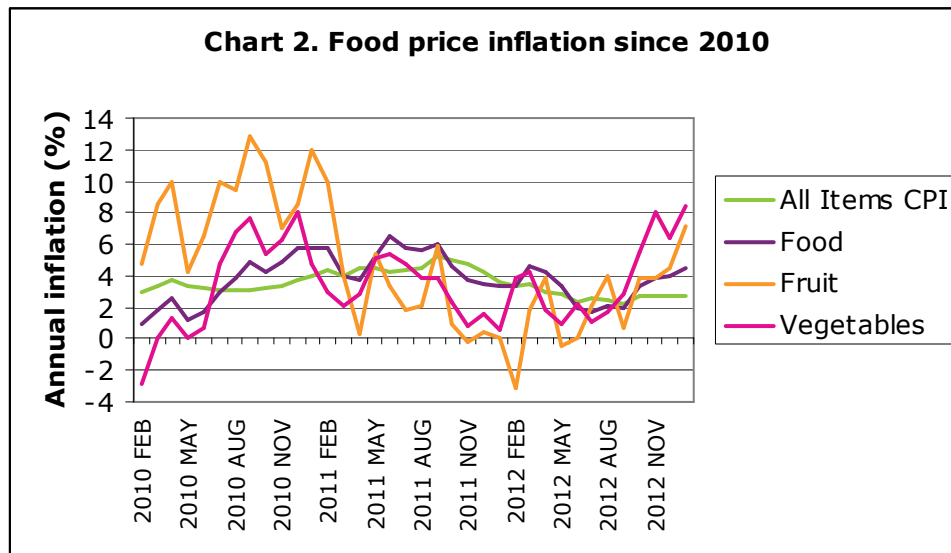
Chart 1 shows that over the period 2010-2012, general food prices grew closely in line with the overall rate of inflation, growing slightly below inflation in 2010 and slightly above inflation in 2011 and 2012. Chart 2 shows these trends in more detail. It demonstrates that from mid 2010 to the beginning of 2011, the year on year change in food prices was higher than the overall rate of inflation. This was particularly noticeable in the fruit and vegetables categories. During the remainder of 2011 and early 2012 fruit and vegetables increased at below the headline inflation rate. However, in recent months the price of food, and in particular fruit and vegetables, has again started to increase more quickly than the Consumer Price Index (CPI) again.

¹⁰ Ofgem (2009) *Can energy charges encourage energy efficiency?*
<http://www.ofgem.gov.uk/Sustainability/Documents1/Final%20discussion%20paper%2022%20July.pdf>
accessed 27 March 2013

¹¹ Barnardo's (2012). *Priced out*. Barnardo's, Barkingside.

¹² Barnardo's (2013) Press Release <http://www.barnardos.org.uk/news/latest-news.htm?ref=86655>, accessed 27 March 2013

¹³ Barnardo's (2012). *Priced out*: Barnardo's, Barkingside.



Families in all focus groups reported having to adapt their food spending habits, in the face of rising food prices, and reduced incomes. Many families reported simple measures such as switching to cheaper stores, or buying less “named brand” goods - branded food was increasingly being seen as a luxury item. Many also reported doing more meal planning, particularly by planning meals around what was on special offer in the supermarket. Changing how they paid for their shopping also came up in a number of groups, with some families preferring to shop for food using cash to keep control of how much was being spent and being able to put things back rather than go over budget.

“Definitely changed the way that I shop for food, there are no luxuries anymore” (mother, Sandwell)

“The first thing you do is move down a brand” (mother of a four year old, Kidderminster)

“[if I had extra income] I could buy nicer beans, Heinz” (parent, North West Wales)

Other families reported having to take bigger steps, cutting back on expensive food such as fresh meat, or fresh fruit and vegetables, even if this meant buying unhealthy alternatives, or even missing meals entirely, to save money.

“Fruit is expensive - it’s difficult to afford the five-a-day the Government says you should eat. You can buy giant “super saver” packs at (some supermarkets) - but they go off really fast so they can make eating fruit even more expensive if you have to throw them away” (mother, Leicester)

These stories are reinforced by academic evidence that has examined how households respond when prices rise. Notably, a report conducted for the

Department for Environment, Food and Rural Affairs (DEFRA) found that households facing lower prices for fruit and vegetables tend to have better diets and that if consumers face increased prices for fresh fruit and vegetables they tend to switch towards canned fruit and vegetables and juices. The authors concluded that this could potentially impact on health and wellbeing, given that fruit juice only counts as one of the target “five a day”.¹⁴ Furthermore, the study also highlighted how households tend to move towards cheaper meat with a higher fat content when faced by higher prices in this area.

Transport

“I drive but I try not to go anywhere” (mother, Northern Ireland)

One category of expenditure not included on chart 1 is the fuels and lubricants category (which included the price of petrol and diesel), which during 2010 and 2011, grew by more than ten percentage points above CPI each year. This, coupled with above inflation increases in the price of passenger transport in 2011 and 2012, helps to explain the sentiments commonly expressed in our focus groups, that the price of transport has increased substantially in recent years, relative to families’ budgets.

Families in our focus groups reported that rising transport costs were impacting on what the family could do, making it increasingly difficult to go anywhere that wasn’t within walking distance – even if activities were free when the family got there. One particular family in the North West Wales focus group reported being frequently unable to afford urban bus fares meaning that the parent has to walk significant distances carrying heavy goods on a daily basis to provide for their family.

“Its changed how we use the car, we are finding that we are putting in just enough to do us for what we need to do that week and then we think if we are going to take [son] to “just play” or something we have to think about that” (father of two, Kidderminster)

“Even things that are free – like museums and parks - you’ve still got to pay for transport etc” (mother, Glasgow)

“I got rid of my car, I don’t have a car now, I have to get lifts everywhere, its hard to give it up once you’ve had it” (mother, Northern Ireland)

Childcare

“I can’t afford to work, but I can’t afford not to work”. (mother, Leicester)

¹⁴ Tiffin, R. et al (2011). *Estimating food and drink elasticities*. University of Reading, Reading

The high cost of childcare is an area that Barnardo's has previously highlighted as being particularly important to the poorest households. Not only can high childcare costs cause a strain on household budgets but they can also act as a significant disincentive for parents looking to move into work or increase the hours that they work.¹⁵ Evidence from the Daycare Trust suggests that childcare costs have grown substantially above inflation in recent years. The most recently available publication suggested that nursery costs rose 6.6 per cent and childminder costs rose by 5.2 per cent for children aged over 2 during 2012, both substantially above the general level of CPI.

In the focus groups families reported that childcare was becoming so expensive that if they had to bear the full cost themselves, then it often didn't really pay to work. Some mothers reported staying in employment because they had worked hard for their jobs, but there was little financial benefit for the family after childcare costs. This can lead to a general perception within communities that work doesn't pay when you have small children.

"I've gone back to work (after having kids) because I want to keep my career; I've worked hard to get there. But I'm out of pocket because of childcare and transport" (mother, Leicester)

"My friend, she's working but she's literally having to pay the childminder ...then she's literally taking out a loan every week to pay the childminder then paying it back with other loans and then another loan and then she's in debt for so much" (mother, Northern Ireland)

An additional problem for parents who were working on flexible contracts was that if they were not guaranteed the wage then they couldn't commit to childcare, which was often not available on a flexible basis.

"Childcare would have been so difficult if I didn't have grandparents... if they're saying you may work 7 and half hours or you may work 30 this week then you could never have paid for anything because you could never have guaranteed the wage" (mother of a 13 month old, Kidderminster)

Many of the families reported that they were cutting back on childcare costs by avoiding them completely. Some were relying on grandparents where possible, although since many grandparents were themselves still of working age, this restricted employment options. Others reported that they were only taking up offers of formal childcare where there was help available to meet the costs. Many reported feeling they were restricted to jobs which could be done around the free hours of pre-school education offered for 3 and 4 year olds.

¹⁵ Barnardo's (2013) *Paying to work: childcare and child poverty*. Barnardo's, Barking.

"I have a childminder at the moment, she lives across the road from me so I know her but I only use because I go to Tech and I get a grant from the Tech to pay for the childcare, otherwise I wouldn't...the prices are mad, like if I had to pay [her] out of my own pocket it's a hundred and five pound a day, for three kids" (mother, Northern Ireland)

"I've got two sets of grandparents who are able to look after him but otherwise there would have been no point in me going to work because I would have ended up paying" (mother of a nine month old, Kidderminster)

In the 2013 Budget the Government announced that around £1 billion will be invested in improving childcare affordability for parents.¹⁶ However Barnardo's is concerned that this investment is insufficiently targeted on the families who need it most. Only around £200 million of the total funding package will be targeted on low income families receiving Universal Credit. With the new announcement the proportion of childcare costs covered by Universal Credit will increase from 70 per cent to 85 per cent. Unfortunately, this increase will only be for families who are paying income tax, meaning that the part-time workers are effectively excluded. Barnardo's has previously demonstrated that many part time workers will face poor incentives to increase the hours they work and lift themselves out of poverty under Universal Credit once childcare costs are factored in. We therefore believe that the proportion of childcare costs covered under Universal Credit should be extended to 85 per cent for all families.

Section four: What does this mean for the living standards that families have experienced in recent years?

We highlighted the costs of food, energy, transport and childcare specifically, as time after time they were raised by families as being amongst the most important items in their budgets. However, to get a more complete picture of how rising living costs have impacted on low income families it is necessary to examine more comprehensive survey evidence on where households spend their money. It may be that whilst prices in these areas have been rising, other areas of household spending may have been falling, therefore helping to offset the impact on families.

To examine this in more detail we used the Living Costs and Food Survey from 2010, which asks households a range of detailed questions about how they spend their money, and allows this information to be broken down by their household characteristics. To understand how households experience inflation we broke down information on their expenditure into 85 categories. By matching each of these categories to the price increases seen recently in that area, we were able to get an idea of the 'personal' inflation rate experienced by each individual household in the survey.¹⁷

¹⁶ HM Treasury (2013) *New scheme to bring tax-free childcare for 2.5 million working families* http://www.hm-treasury.gov.uk/press_29_13.htm, accessed 27 March 2013.

¹⁷ For a full explanation of the methodology please see Annex A

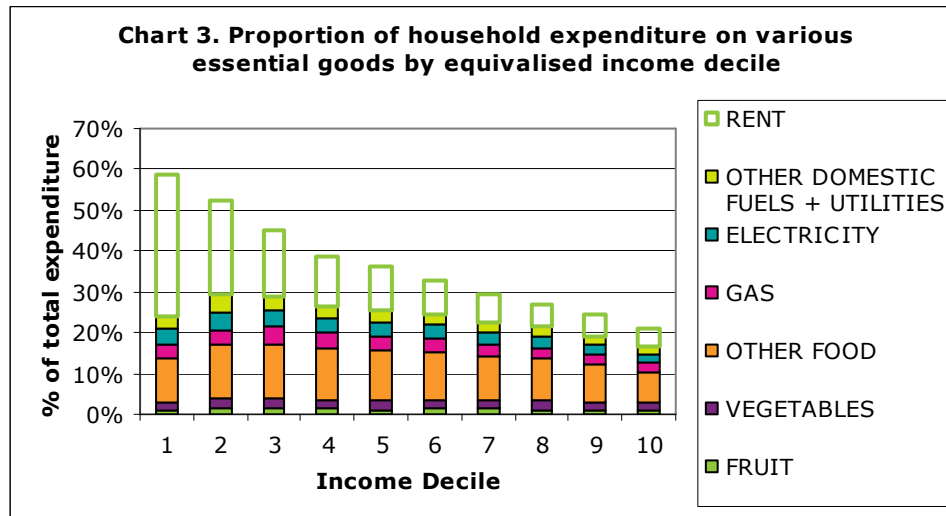
One especially important thing to consider is that the most recent information on expenditure that is publicly available is from 2010. In order to get a feeling for what has happened to living costs for low income households we made an assumption that household expenditure patterns in subsequent years have remained the same as they were in 2010. This is a strong assumption, as in reality, when the prices of goods and services change, consumers will make changes to the way they spend their money. In fact as we have already highlighted, families spoke at length during our focus groups about how they were changing their spending habits in response to increasing living costs. For this reason, figures for 2011 and 2012 should therefore be treated as only indicative, rather than a definitive picture of how households experienced inflation. A more detailed discussion of this assumption is provided in Annex A.

The first thing that our analysis confirms is the importance of essentials in the budgets of low income households, as demonstrated in chart 4. Taken together the proportion of expenditure devoted to essentials such as food, domestic fuel and utilities, is substantially higher in households with lower incomes. For those in the second income decile, 29 per cent of their total expenditure was on food, fuel or domestic utilities, compared to only 17 per cent for those in the top income decile.¹⁸ Once expenditure on rent is included the disparity increases further, with the proportion of spending on these essentials being over twice as high for those in the second income decile compared to the highest.¹⁹ For the most part, as income increases the proportion of expenditure devoted to these essential categories decreases. The main exception is the lowest income decile who report whose expenditure on gas, electricity and food is lower than the income deciles directly above. This may reflect research which shows some households who report the lowest incomes in surveys actually have relatively high living standards²⁰. However, it is noticeable that including rent substantially increases the proportion of their expenditure devoted to essential goods to a point where it is much higher than any other income group.

¹⁸ To calculate deciles we ranked the households on the survey according to their income and then split them into ten equal groups. Decile one therefore represents the households with the lowest 10 per cent of incomes, and decile ten those households with the highest 10 per cent of incomes.

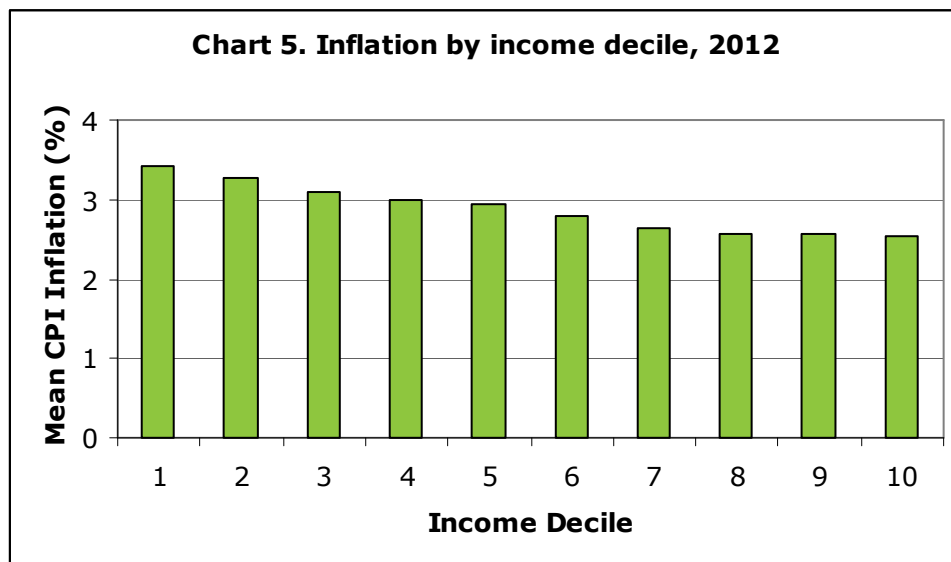
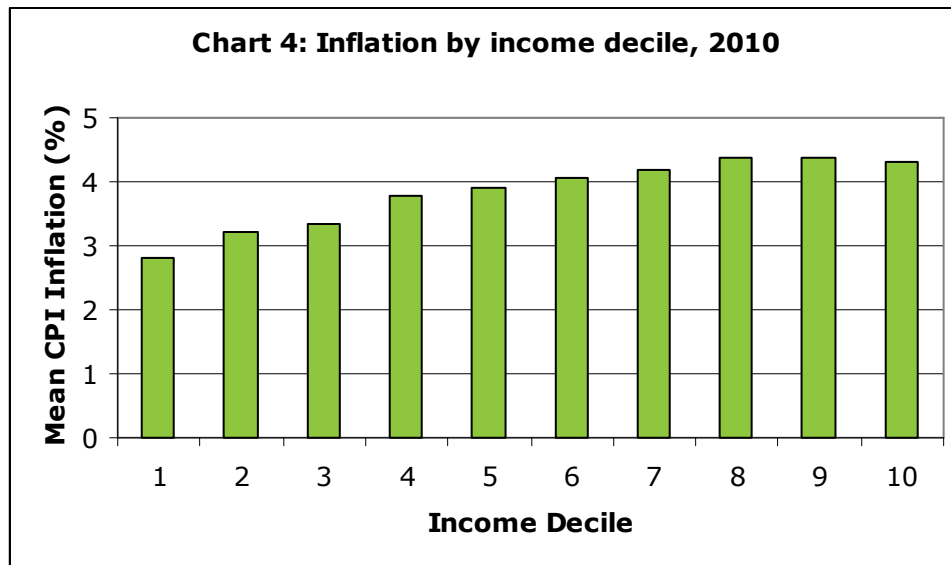
¹⁹ See Annex A for a discussion of how housing costs are treated in inflation measures

²⁰ Brewer, M. et al. (2009). *The living standards of families reporting low incomes*. DWP Research Report No. 577. Department for Work and Pensions, London



Because households on the lowest incomes make a higher proportion of their spending in these essential areas, it means that they are disproportionately hit when these prices increase. Combining the information on spending patterns with data on price increases from the Office for National Statistics (ONS) confirms this.

Charts 4 and 5 highlight what has happened to the average inflation rates of low income households since 2010. The picture reinforces the headline inflation trends highlighted in the section above, and the messages that individuals in our focus groups told us. During 2010 the average inflation rate faced by the lowest income households was below the average experienced by other households. A more detailed examination of the data shows that taken together, falling prices of gas, electricity, and to a lesser extent water, combined to reduce the average inflation experienced by those in the lowest income decile by over a quarter of a percentage point. Whilst fuel and rent costs exerted a substantial upward pressure on living costs, the falling price of utilities helped to ensure that those on the lowest incomes experienced a below average inflation rate. Furthermore, the impact of increasing fuel prices on the cost of motoring had a greater impact on those households further up the income distribution that spent a greater share in this area. Items such as motor insurance and the price of second hand cars also exerted substantial upward pressure on living costs for richer households, and whilst this was tempered to some extent by falling energy prices, this effect was less significant than for lower income households.



By 2012 the average inflation rate for low income households had moved to being substantially above the rate experienced by other households. Households in the bottom two income deciles experienced an average inflation rate of around 0.4-0.5 percentage points above the average for all households. For the lowest income group the largest contribution to their overall inflation rate was typically rent, which accounted for around one third of their average inflation. Gas, electricity and water accounted for a fifth of the average inflation experienced in this decile, and taken together the meat, vegetables and bread, rice and cereals categories accounted for a further 8 per cent of the overall inflation rate. There is a similar picture for households in the second income decile, with rent contributing slightly less to their experience of inflation, but domestic utilities accounting for slightly more.

Section five: Conclusions and recommendations

Traditionally families on low incomes would be shielded from these price rises as welfare benefits would increase in line with inflation. From April 2013 the majority of benefits will be increased only by one per cent, rather than in line with the CPI measure of inflation. This will, in all likelihood, reduce living standards for families on low incomes who receive benefits. However, the analysis above demonstrates that if the price of essentials increases substantially over this time period, the impact on living standards will be compounded.

Barnardo's is concerned that the impact of benefits up-rating policies on the health and wellbeing of children in low income households is highly uncertain. The Government is clear that the impact of this policy will be to push around 200,000 more children into relative poverty. However, the real impact of this policy on the living standards of children will be determined by how quickly prices, and in particular the prices of key essentials such as food and domestic utilities, increase over this period.

The stories we heard from focus groups demonstrate that families are especially sensitive when the prices of essential goods and services increase. The analysis that we have conducted confirms this, showing that when prices of essential goods increase it is those on the lowest incomes that feel it most.

With recent policy reform in the Welfare Benefits Up-rating Act 2013 it is clear that in coming years families on the lowest incomes will be less protected from price rises. Not only will benefits fail to keep up with the general cost of living as they are increased by only one per cent each year, but this impact could be magnified if the price of essentials increases rapidly.

Our focus groups also highlighted the direct link that many families feel between rising prices and their standard of living. We heard many stories about how increases in the cost of living were causing families to scale back their expenditure on key essentials, often to the detriment of their wellbeing. Again, this is something that is reinforced by wider evidence in this area, suggesting that rising costs of essentials often do act to directly reduce the living standards of poor families.

Barnardo's is focussed on the wellbeing of the UK's most vulnerable children and as such, we have deep concerns regarding the risk to children's living standards and life chances that has been introduced by the policy of increasing benefits at only one per cent. For this reason, we urge the Government to:

- a) Commit to reviewing its decision to increase benefits below inflation if September CPI inflation is above 2.5 per cent over the next two years.
- b) The Government must tackle the poor incentives that childcare costs create for part-time workers by increasing the proportion of childcare

costs covered by Universal Credit to 85 per cent for all families, not just those paying income tax.

- c) The Government must also take steps to better insure low income households are protected from rapid price increases in the goods that are most essential to them. As part of the Energy Bill Revolution campaign Barnardo's is calling for the Government to ensure that revenues from its carbon tax are recycled into supporting energy efficiency schemes particularly targeted at low income households. Committing to this will help to ensure the most vulnerable households can better protect themselves against rising energy prices – something that will become even more important in future years.

Annex A – Methodology

To establish the inflation rate for each household we took a similar approach to that employed previously by the IFS.²¹ This involves three main steps:

- Separating expenditure for each household in the Living Costs and Food Survey into 85 high level categories designed to match the classification of individual consumption by purpose (COICOP) categories used for the calculation of the CPI measure of inflation.
- Establishing the annual change in living costs faced by each household, for each of the 85 expenditure categories. We matched the CPI data relevant to the month that the household was surveyed (E.g. If they were surveyed in January then the CPI data for January was used)
- Deriving a 'personal' inflation rate for each household by weighting the proportion of expenditure in each of the categories by the price growth in each of those categories.

One clear limitation of using the CPI measure of inflation to understand how living standards vary across the income distribution, is that housing costs for home owners are not included in the basket of goods. Expenditure in this area is higher for households further up the income distribution, meaning that analysis of CPI across the income distribution may give an unrepresentative picture of how living costs vary. However, as for the majority of the analysis period, growth in the cost of mortgage interest has only shown modest increases, as highlighted in the Retail Price Index (RPI) measure of inflation, we believe that this issue should not impact the results of our analysis too much.

In order to get an understanding of the potential inflation rates experienced by households across the income distribution in 2011 and 2012, we had to assume that households allocated the same share of expenditure to different areas in 2011 and 2012 as they did in 2010. However, there are a number of reasons to believe that this assumption will not hold true. For example:

- Over time households' incomes will increase or decrease, inducing them to change their spending patterns to take account of their changed income.
- On a related point, the changing prices of goods and services will result in changes in households' real (inflation adjusted) incomes, again causing them to adjust their patterns of expenditure.
- Finally, as the prices of goods and services change in relation to each other, this may create incentives for households to substitute between different categories of expenditure.

To begin to understand the extent to which this may have impacted on the analysis, we examined expenditure patterns across the income distribution in each of the 85 expenditure categories between 2009 and 2010, and 2007 and 2010. Whilst this does not get around the fact that we don't know

²¹ Levell, P. & Oldfield, Z. (2011) *The Spending Patterns and Inflation Experience of Low-Income Households over the Past Decade*. IFS Commentary C119

expenditure patterns after 2010, it does help lend some credibility to the assumption of using 2010 expenditure to estimate what happened in subsequent years.

First we examined the correlation of average expenditure in each of the 81 expenditure categories between 2009 and 2010, and between 2007 and 2010 for households in each income decile. This revealed a strong correlation between expenditure in each category over time. The correlation was slightly stronger between 2009 and 2010, than between 2007 and 2010, and slightly higher for those at the bottom end of the income distribution than at the top. This suggests that at the aggregate level the share of expenditure allocated to each category has remained relatively constant over time. However, it is important to note that there have been some changes to expenditure patterns. Goods that could be considered as essentials, such as rent and utilities, have tended to show the biggest rise in budgets attached to them, whilst more luxury goods such as holidays and cars have tended to see declines in expenditure attached to them.

	Changing expenditure over time			
	Correlation coefficients between expenditure categories		Largest increases and decreases in expenditure	
	2007-2010	2009-2010	Biggest increase (2007-2010)	Biggest decrease (2007-2010)
Lowest income decile	0.998	0.999	Rent	Second Hand Cars
Decile 2	0.997	0.997	Electricity	Package Holidays
Decile 3	0.995	0.996	Gas	Package Holidays
Decile 4	0.990	0.991	Fuels & Lubricants	Package Holidays
Decile 5	0.986	0.985	Rent	Package Holidays
Decile 6	0.988	0.990	Rent	Second Hand Cars
Decile 7	0.981	0.971	Rent	Tobacco
Decile 8	0.989	0.989	Package Holidays	Furniture
Decile 9	0.971	0.987	Rent	Second Hand Cars
Highest income decile	0.945	0.970	Rent	Package Holidays

Glossary of Terms

Consumer Price Index – a measure of inflation which shows how the year on year price changes of goods and services. Uses a representative basket of goods and services to calculate a weighted average to demonstrate how prices are changing

Retail Price Index – a measure of inflation similar to the Consumer Price Index, but with some methodological differences. For example, housing costs for homeowners are included in the Retail Price Index but not in the Consumer Price Index.

Inflation – a measure of the price changes of goods and services in the economy. Typical measures of inflation are the Consumer Price Index or Retail Price Index.

Welfare Benefits Up-rating Act 2013 – new Government legislation to increase benefits by one per cent each year, rather than in line with the Consumer Price Index

Income Decile – represents ten per cent of the income distribution. For example, the lowest income decile represents the households with the lowest ten per cent of incomes.

The Real Cost of Living

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Written by Barnardo's Strategy Unit



www.barnardos.org.uk

Head Office, Tanners Lane,
Barkingside, Ilford,
Essex IG6 1QG
Tel: 020 8550 8822

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