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<th>November 2013</th>
<th>Tax Research LLP</th>
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Disappearing fast: the falling income of the UK’s self-employed people
Disappearing fast: the falling income of the UK’s self-employed people

November 2013

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Disappearing fast: the falling income of the UK’s self-employed people

Contents

Summary 3
1. The boom in self-employment: the ONS data 10
2. The boom in self-employment: the HMRC data 13
3. The income of the self-employed: HMRC data 18
4. Alternative views 24
5. What the data might mean 30
6. Is the data right? 32
Endnotes 34
Disappearing fast: the falling income of the UK’s self-employed people

Summary

This report addresses an aspect of a problem economists have faced in explaining UK economic performance since 2008. Many economists, the author of this report included, expected unemployment to have risen to more than 4 million by 2013 given the collapse in economic activity in the UK economy, but it has not. It has remained at around 2.5 million people.

One reason for this failure to record increasing unemployment has, of course, been the changes made in the right to claim benefits that has resulted in many people simply giving up the search for work. That, though, cannot explain all the difference. It has been quite widely concluded that the fact that unemployment has not risen has been the result of the productivity of those at work falling. In other words, output per head has declined to ensure people have stayed at work.

This report examines this idea in the context of the UK’s self-employed and covers the period 1999-00 to 2010-11, which is the least year for which HM Revenue & Customs (HMRC) data, which is fundamental to the report’s findings, is available.

The conclusions are stark. Although by all measures the number of self-employed has risen significantly over this period, from (according to HMRC data) 4.17 million to 5.11 million the share of GDP that they have enjoyed has fallen significantly, as this graph demonstrates:
Expressed individually the consequence is that each self-employed person has, over the last
decade or so, enjoyed a steadily declining share of GDP, which might be considered an
inflation adjusted indicator of real income:
This data, comparing the Office for National Statistics (ONS) statistics on the number of full time self-employed with the part of GDP that the total declared income of the self-employed earned according to HMRC the share of GDP that each self-employed person has enjoyed fell proportionately by 32.4% over this period whilst the number of self-employed people increased by 22.2%.
When looking at average earnings of those who declare they have self-employed income to HMRC, this sum was almost constant at about £15,000 from 2000 to 2005 in current prices, then climbed to £18,000 in 2008 and then fell back again to £15,000 in 2010-11. However, this data is heavily distorted by the behaviour of one small group amongst the self-employed, who are those earning more than £100,000 a year, whose number never exceed 2% of the total sample during the period. Their earnings rose constantly from 1999 to 2010, from an average of just over £200,000 in current prices to just over £280,000 in current prices in 2010 before falling back to £260,000 as the recession appeared to hit in 2011. When this group are removed from the earnings data for the remaining self-employed their average income fell from £12,196 in 2000 to just under £10,400 in 2011:

Adjusted for inflation the position is more stark:
In inflation adjusted terms the self-employed have seen an almost steady fall in their income since 1999.

This data is, admittedly, skewed by the presence of very large number of people making very little from their self-employment: about 1.1 million on average made less than £2,000 a year from their self-employments during the course of this period according to HMRC data and are therefore unlikely, based on the data sets being compared in this report, to be included in the ONS data for full time self-employed people. The combined total earnings of these marginally self-employed make up a tiny proportion of the total income of the self-employed according to HMRC. Taking them out of consideration clearly changed average pay ratios. The following graph is removes these people from consideration in its calculations:
Whilst on the basis of this data the self-employed earned more on average than employed people from 1999 to 2008 the picture then changes dramatically with the earnings of the self-employed declining rapidly from 2008 onwards whilst those of the employed still grew, albeit more modestly. Inflation adjusted figures have also been provided, using the consumer prices index for adjustment purposes, whilst polynomial trend lines (used because with this data linear trend lines would make no sense) make clear how stark the change in well being for the employed and self-employed have been on average.

A number of conclusions might be drawn. The first is that rising self-employment appears to hide markedly falling productivity amongst the self-employed, and this is most marked for the vast majority of the self-employed who are earning less than £100,000 a year.

Secondly, and as a result, the claim that unemployment is being beaten since the period covered by this review as a result of increasing numbers of self-employed people – with it
being suggested by the ONS in 2013 that 400,000 or more people have entered self-employment since the economic crisis began – is not necessarily good news for those actually undertaking that activity, who can expect modest and maybe falling return on their effort from doing so. With such modest income expectations the conclusion that many of these in supposed self-employment will in fact be little more than disguised unemployed people is hard to avoid.

Thirdly, at least part of the fall in UK productivity appears to be because of the rapid decline in the earnings of the self-employed.

Lastly, and not considered in depth in this report, is the possibility that the data on both the number of self-employed people and their earnings may be seriously misstated.
1. The boom in self-employment: the ONS data

The UK is seeing a boom in self-employment. According to the Office for National Statistics the growth in numbers look like this:

![Number of people considered to be mainly in self employment by the ONS 1999-2011](chart.png)

This data is interesting: it is the basis for unemployment statistics for one thing. More than 700,000 people have, in net terms, according to the ONS, entered self-employment in a little over a decade.

This is not just a numerical trend; it is an absolute one as well. The percentage part of the workforce in self-employment over that period has increased according to the ONS:
The proportion of the workforce who consider that self-employment is their main activity has risen from about 10.5% to almost 12.5% over this period. That suggests a significant behavioural shift.

Surprisingly this data may understate the significance of the change in self-employment. The ONS data is based on their Labour Force Survey. This is fundamentally a perceptions index i.e. whether or not a person considers themselves self-employed or not and whether or not they consider themselves to be full time or not. As the ONS has confirmed in a Freedom of Information request made in connection with this review:

*The employment status of an individual is established based on the activity in the reference week.*

The person surveyed is asked:

*Were you working as an employee or were you self-employed?*

1 Employee
2 Self-employed
3 Government Scheme
4 Unpaid family worker
The definition of self-employment is based on the respondents view of the type of work they do.

Tellingly, the ONS added:

The estimates published directly from the Labour Force Survey are not directly reconciled with HMRC data.

Estimates of LFS self-employment used in the estimation of Workforce Jobs remove any instance of 'self-employed working owners' as these are counted as employees in the HMRC data. These are identified as individuals who respond to the question to say they are self-employed and are later determined to be a 'sole director of a limited company'.

The result is that whilst the ONS data is used for the purposes of employment statistics and has been used to justify a claim in 2013 that more than 400,000 people have entered self-employment since the economic crisis of 2008 began\textsuperscript{11} it is not the only data on the number of self-employed people in this country and nor may it be the most reliable because it is a perceptions index and not based on objective data.

The obvious alternative source of information on self-employment in the UK is that published by HM Revenue & Customs based on the self assessment tax returns and data supplied by employers covering more than 30 million people in the UK on average each year.
2. The boom in self-employment: the HMRC data

HM Revenue & Customs publishes a wide range of statistical data. The data used in this research comes mainly from its annual report on Income of individuals with self-employment sources, by range of self-employment income and source.

HMRC data is based on the number of people completing self-assessment tax returns declaring that they have self-employed income in a year. There are a number of reasons why this data is likely to suggest more people have self-employed income than that prepared by the ONS.

Firstly, it will include those who have part time self-employed income and also have an employment as their main activity. These people will not be considered self-employed by the ONS.

Secondly, the ONS data is survey information. It is therefore point specific whereas HMRC data will include all those who might give up self-employment in a year but still have income to declare. As a measure over time it is likely to be higher.

Thirdly, the HMRC data will include those who make losses who may not be inclined to declare that they have an income source to the ONS, although this cannot be proven.

All are reasons why it should be expected that HMRC will report higher figures for those self-employed, and they do. The following graph covers currently available data from 1999-00 to 2010-11:

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Whilst the trend shown by the two data sets is very obviously similar the actual number of people considered to be self-employed by HM Revenue & Customs over this period was on average about 1.1 million higher each year, with the gap growing over time.

The break down of the HMRC data helps explain this potential difference because that information is stratified by net income earned:

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Disappearing fast
The disparity in growth by category is stark: large numbers have entered marginal self employment over this period and the very high earning have enjoyed good fortune; the middle ground where most would make a living from self employment has remained extraordinarily static.

Expressed graphically, if the cumulative data for those earning £2,000 and less a year (including those making nothing at all) is compared to the difference between the HMRC figures for those self-employed and the ONS data then the following graph results:

On average over the twelve-year period the difference between the two data sets is just 2,000 people a year. That does not, of course, mean that the data is conclusive evidence that the ONS data set on the number of self-employed people simply excludes from
consideration just those making very small sums indeed from their self-employment, but it seems to provide some fairly clear indication that this might be the case.

What is clear is that whilst ONS data noted in the previous chapter suggests the proportion of the population who are self-employed has increased from 10.5% to almost 12.5% in 12 years HMRC data on the number of the self-employed who are taxable as such (source: table 3.11 of HMRC statistics) does not support this view:

The trend line that has been added for clarity suggests a small underlying upward trend that recent data belies.

This raises a number of issues. For example, in February 2013 the ONS said of its data relating to the number of self-employed people working in the UK:

*Today’s report shows that self-employed people work longer hours than employees – on average 38 hours a week compared with 36 for employees. Self-employed workers tend to be older than employees and are more likely to be male – in 2012 the average age of the 4.2 million self-employed was 47, and 70% of them were men, while the average age of the 25.0 million employees was 40 and only 51% of them were men.*
The four most common occupations for self-employment were taxi or cab drivers (166,000), ‘other construction trades’ (161,000), carpenters and joiners (140,000) and farmers (123,000). Some 58% of self-employed people used their home for work purposes to some extent, either working there (15%), using it as a base (38%) or working on the same grounds or building as their home (5%).

There are some very obvious inconsistencies being disclosed here: the ONS thinks that its data relates to people working full time and yet to be consistent HMRC data on the self-employed has to include all those earning more than £2,000 a year from such activity. This is surprising. It suggests that enquiry is required on three fronts. The first is that data on the income of the self-employed is needed. The second is to consider whether that income is appropriately stated. The third is to ask whether or not the numbers declaring they are self-employed is correct. Each will be considered over the coming chapters.
3. The income of the self-employed: HMRC data

The Office for National Statistics provide data on the number of people they consider self-employed but only HM Revenue & Customs provides data on what those people declare that they earn.

The analysis of that data that follows relies upon HMRC statistics (principally, as already noted, table 3.10 from 1999-00 to 2010-11, which is the latest available) on the number of self-employed people as well as table 3.11 for the same years on the declared income by band of those same people who have declared themselves to be self-employed.

The two tables are summarised as follows, the data for 2008-09 in each case being the average of the years either side as HMRC did not publish data for that year:

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<td>3,863</td>
<td>4,627</td>
<td>4,776</td>
<td>4,888</td>
</tr>
<tr>
<td>2008-09</td>
<td>4,885</td>
<td>627</td>
<td>812</td>
<td>960</td>
<td>1,949</td>
<td>3,010</td>
<td>3,947</td>
<td>4,640</td>
<td>4,777</td>
<td>4,894</td>
</tr>
<tr>
<td>2009-10</td>
<td>4,880</td>
<td>660</td>
<td>851</td>
<td>1,002</td>
<td>2,009</td>
<td>3,130</td>
<td>4,030</td>
<td>4,653</td>
<td>4,778</td>
<td>4,879</td>
</tr>
<tr>
<td>2010-11</td>
<td>5,110</td>
<td>723</td>
<td>938</td>
<td>1,059</td>
<td>2,181</td>
<td>3,344</td>
<td>4,262</td>
<td>4,887</td>
<td>5,013</td>
<td>5,109</td>
</tr>
<tr>
<td>Average</td>
<td>4,640</td>
<td>547</td>
<td>716</td>
<td>861</td>
<td>1,872</td>
<td>2,809</td>
<td>3,744</td>
<td>4,417</td>
<td>4,555</td>
<td>4,639</td>
</tr>
</tbody>
</table>

Some data will not exactly balance due to roundings.
This data is the basis for much of the reporting that follows, but other data has also been used as appropriate including ONS mid year population data for the years in question, Treasury GDP data (September 2013 version) for those years, the consumer prices index for those years published by the ONS, ONS employment data and HM Revenue & Customs data on earnings in employment.

The first thing to note about the data is the remarkably low level of income that a great many of the self-employed report, as this graph makes clear:

Over 80% of the self-employed did, during this period, report income on average of £20,000 or less and 60% reported income of less than £10,000 a year. Less than 2% on average reported income of more than £100,000 a year.

By 2010-11 the data was actually worse than average, as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Number self employed (thousands)</th>
<th>% earning £0</th>
<th>Cumulative % earning &lt; £500</th>
<th>Cumulative % earning &lt; £1,000</th>
<th>Cumulative % earning &lt; £5,000</th>
<th>Cumulative % earning &lt; £10,000</th>
<th>Cumulative % earning &lt; £20,000</th>
<th>Cumulative % earning &lt; £50,000</th>
<th>Cumulative % earning &lt; £100,000</th>
<th>Total self employed, cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010-11</td>
<td>5110</td>
<td>14.15%</td>
<td>18.36%</td>
<td>21.51%</td>
<td>42.29%</td>
<td>65.44%</td>
<td>83.41%</td>
<td>95.64%</td>
<td>98.10%</td>
<td>99.58%</td>
</tr>
</tbody>
</table>
This most recent pattern of data compared to the average over a twelve-year period is counter-intuitive. Given inflation over the period it would be expected that the numbers earning less than either £10,000 a year or £20,000 a year as a proportion of the total would fall; instead that proportion has increased.

There is reason for this. The average pay of all self-employed people in current prices (i.e. the actual sums paid) over this twelve-year has moved as follows:

The post dot.com era financial crisis appears to have had an impact on average self-employed earnings which flat-lined from 2000 to 2005. The average earnings then rose quite markedly until 2008 before collapsing again to no more than that in 2000 despite intervening inflation. However, what the data also reveals is that average income across all income brackets flat-lined right across the 12 year period with the exception of one bracket, which is for those earning over £100,000 a year for whom the change was as follows:
The income of the fewer than 2% of all self-employed people who make up this small number of self-employed people have such a high level of average income that they distort the statistics for all the remaining self-employed people in the sample.

Very few people earn more than £200,000 a year. Those likely to be included are lawyers and accountants, some GPs, maybe some estate agents and potentially some working in the City. In a very real sense they are outliers in this system, and by their inclusion they distort the data on the average earnings of the self-employed, actually making them appear higher than they are for the vast majority. This is reflected in the change of the average earnings of all self-employed people earning less than £100,000 a year (representing more than 98% of all self-employed people over this period):
The situation is worse when inflation is taken into account because to compare incomes in 2011 with those of 1999 without taking inflation into account is unrealistic. The Consumer Price Index has been used for this purpose even though many would consider the Retail Price Index more appropriate for this purpose. This graph is the data in the previous graph adjusted for inflation:
On this basis the average earnings from self-employment have, in 2011 prices, over a twelve year period fallen from just under £15,000 to just under £10,400. That is a decline of about 31% in real terms.

This is a stark finding. To check whether it is plausible the HMRC data has been checked in its macroeconomic environment and against other data, which is the subject of the next chapter.
4. Alternative views

To check whether the impression given by HMRC data on the income of the self-employed is reasonable a number of other checks have been undertaken. Whilst data on average earnings of 98% of the people declaring themselves to be self-employed would appear to be a fairly significant sample set there is risk that HMRC’s data does, by using income bands that have remained fixed over time, distort findings and bias results downwards. It is for that reason that other data is considered in this section.

Firstly, and importantly, the total earnings of those who are self-employed need to be averaged over the number of people who declare this to be their main economic activity. Since as, has already been noted, the two sample sets are of equivalent size when those earning more than £2,000 a year from self-employment are considered and those people’s share of total self-employed earnings is very small (about 1.5% of the total, on average) the comparison is fair. In the following graph ONS data on the number of people who are both self-employed and employed is used to produce an average reported income per person when compared with total declared earnings for those with this source of income as per HMRC statistics (table 3.11). The data is then adjusted to 2010-11 prices in both cases using the consumer prices index and a trend line is added on the CPI adjusted data:
Exclusion of the million or so people making very small sums from self-employment, which
the use of the ONS data on the numbers of such people has the effect of doing without
changing in any material way the aggregate of the income that they earn, has the initial
effect of making earnings from self-employment appear higher than those from employment
whether current value or CPI adjusted data is used. However, the collapse in the income of
the self-employed remains apparent: the financial crash of 2008 hit them hard and it is
unlikely that they have recovered as yet. The employed are now better off, based on this
data, than the self-employed with a very clear trend in their favour. It should be noted that
the data used includes those earning more than £100,000 per annum.

This is also clear from data on the share of GDP that the income of the self-employed
represents over time:
This has happened despite the fact that the proportion of taxpayers who are self-employed has risen very slightly over time:
The trend remains clear from this data (which comes from Table 3.11 of HMRC’s statistics); as the following graph shows the proportion of taxable self-employed people (i.e. excluding these with marginal small incomes, roughly approximating to the ONS data on the number of self-employed as a result) to the total assessable income of all taxpayers in the UK has fallen significantly over time despite the number of taxable self-employed people in the population as a whole rising:
The conclusion is inescapable: the self-employed are, despite their growing numbers, becoming worse off.

It is fair to note in comparison that the proportion of earnings from employment to total assessable income has not shown this tendency over time:
The earnings of the employed recovered after the recession; those of the self-employed did not and, as shown in the previous chapter, this was most marked amongst the self-employed earning less than £100,000 a year.
5. What the data might mean

The data presented here suggests that the self-employed have suffered a serious fall in their real income both individually and as a group as a whole over the last twelve years, especially when inflation is taken into account. However the data is viewed they have fared very badly during this period, not least when compared with those in employment, who have relatively speaking fared better. This leads to the inevitable question of what this might mean.

Given that the proportion of the population in taxable self-employment has remained fairly stable over the period, at around 11.5% of all taxpayers, it is notable that the GDP attributable to this group has fallen markedly.

When the number of self-employed people is significant – there are 3.5 million taxable self-employed people; 3.9 million who consider this their main economic activity and 5.1 million people who declare some self-employed income to HM Revenue & Customs – this decline in their earnings is a powerful economic trend.

One of the major discussions that has taken place about the UK economy since 2008 has been why unemployment has not risen as much as might have been expected and yet growth has not happened. The answer is, of course, that productivity has fallen\(^\text{10}\). This is especially true in self-employment. The following graph does, perhaps, most tellingly express this:
Disappearing fast

Productivity of the self-employed has, by this measure, fallen by 32.4% over the period whilst the number self-employed over this period has risen by 22.2%. This is not the sole explanation for falling productivity in the UK economy, but it is a good explanation for part of it.
6. Is the data right?

The final, obvious, remaining question with regard to this review is whether or not the data on which it is based is right, or not.

The decline in self-employed income for those earning less than £100,000 a year is most marked in the period after 2007-08. This was, of course, the period when the financial crisis emerged. It has not been a period of seriously rising self-employment according to the ONS although HMRC may beg to differ, as the following graph shows:

It is not, of course, the case that full time self-employment equates to taxable self-employment but what is very clear is that the two equate more closely than the mere
presence of having self-employed earnings and being full time self-employed appear to do. That said, the disparity between ONS data and HMRC data on taxable self-employment from 2005 onwards is notable, a difference also apparent from the resulting income data already noted, above. The implication is clear: once the crash came many of those who are self employed saw their income fall below taxable levels.

It does seem at the very least possible that ONS data may be wrong, especially when post 2008 so many more people were declaring taxable self-employed income than were telling the ONS that they were self-employed (although for reasons noted earlier in the report, that would seem to be logically likely, the ONS being a figure at a point in time and the HMRC data a figure over time, but this then makes the data from 2004 to 2008 for the ONS hard to explain).

It is also, of course, possible that the HMRC data is wrong. This is not the place to discuss the tax gap; suffice to say that HMRC have little evidence of the real size of the shadow economy and the ONS think it at most an implausibly low 1.7% of GDP\(^{16}\). Both are likely as a result to seriously underestimate the number of self-employed people.

As to the income declared, HMRC note the following in their ‘Measuring Tax Gaps 2013’ report\(^{14}\):

<table>
<thead>
<tr>
<th>Table 6.4: Business taxpayers: Self Assessment returns with under-declared tax liability (per cent)(^1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>Proportion</td>
</tr>
<tr>
<td>of which, under-declared liability per annum</td>
</tr>
<tr>
<td>£1 to £500</td>
</tr>
<tr>
<td>£501 to £1,000</td>
</tr>
<tr>
<td>over £1,000</td>
</tr>
</tbody>
</table>

\(^1\) Figures rounded to the nearest 1 per cent. As a result components may not appear to sum.

Behaviourally it is hard to believe that self-employed people improved their honesty so dramatically from 2005-06 to 2009-10. What is clear either way is that HM Revenue & Customs expect a significant number of tax returns from these people to be materially understated as to the true level of income earned. The data used for this report may be understated as a result, and what might be the case is not that this situation with regard to under declaration has improved, as HMRC wish to suggest, but has got worse, as the collapsing level of declared income might imply. Only further research might answer those points: this report deals with the data as presented in the government’s official statistics.
Endnotes

ii http://www.ons.gov.uk/ons/dcp29904_299038.pdf
iii http://www hmrc.gov.uk/statistics/tax-statistics.htm
iv Data on a wide range of income tax related issues was not published by HMRC for 2008-09. For the purposes of the current report averaged data for 2007-08 and 2009-10 has been used as proxy data for 2008-09.
v Table 3-10 e.g. http://www hmrc.gov.uk/statistics/income-by-year/table3-10.pdf
vi http://www.ons.gov.uk/ons/dcp29904_299038.pdf
vii See Martin Wolf on this theme here http://www.ft.com/cms/s/0/a0b0892e-3bf4-11e3-9851-00144feab7de.html#axzz2lGetXj7M Many others address the issue.
viii http://www.taxresearch.org.uk/Blog/2013/10/16/the-ons-says-the-uk-shadow-economy-is-1-7-of-gdp-when-hmrc-says-12-2-of-all-vat-is-missing/