POVERTY AND INEQUALITY IN BRITAIN: 2004

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Preface

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Contents

Executive summary

Introduction

This Commentary provides an update on trends in poverty and inequality in Great Britain, based on the latest official government statistics. It uses the same approach to measuring incomes and poverty in Great Britain as the government employs in its *Households Below Average Income* publication.

The income distribution in 2002/03

1. In 2002/03, almost two-thirds of the population had incomes below the national average income of £396 per week. The distribution is skewed by a long tail of people on relatively high incomes. Median income in 2002/03 was £323 per week.

2. Median income has grown 2.6 per cent a year to date under the Blair government, compared with 0.7 per cent a year under Major and 2.1 per cent a year under Thatcher. Income growth has not been evenly distributed across the population – income inequality as measured by the Gini coefficient was slightly higher in 2002/03 than in 1996/97, and at historically high levels. However, the Gini coefficient has fallen in the last two of these years, but not yet by an amount large enough for this to be statistically significant.

3. The slight rise in inequality since 1996/97 reflects what has happened at the extremes of the income distribution. In the middle 70 per cent of the distribution, poorer individuals have done better than richer ones, which, on its own, would result in greater equality. However, the pattern is reversed for both the richest and poorest 15 per cent of individuals, where income growth is increasing with income. This is in contrast to the 1980s, when the incomes of richer individuals grew faster than those of poorer individuals throughout the income distribution, and income inequality rose sharply.

4. The current government's tax and social security changes have been redistributive, in that they have tended to favour the less well-off more than the better-off. Although the current government has not reduced inequality, its tax and social security changes have slowed its increase: if the government had simply uprated the tax and social security system it inherited in line with inflation, the rise in the Gini coefficient since 1996/97 would have been more than twice as large as that which has in fact taken place.

Poverty in Britain

1. In 2002/03, 12.4 million individuals lived in households with incomes below 60 per cent of the median, measuring incomes after housing costs, down from 13.9 million in 1996/97. Generally, relative poverty has been on a downward trend since 1996/97, following a large increase during the 1980s and a flat or slightly falling trend during the early 1990s.

2. The government has a target to reduce the number of children in relative poverty by a quarter between 1998/99 and 2004/05 using a poverty line of 60 per cent of

median income, from 4.2 million to less than 3.2 million (after housing costs, AHC) and from 3.1 million to 2.3 million (before housing costs, BHC). In 2002/03, child poverty stood at 3.6 million (AHC) and 2.6 million (BHC), so the government has reduced child poverty by around 60 per cent of the required amount in 66 per cent of the available time. But the introduction of the child tax credit in 2003/04 and the extra spending announced for 2004/05, neither of which is reflected in the most recent data, suggest that the government is on course to meet its target.

3. The proportion of pensioners below 60 per cent of median income measured AHC has fallen particularly sharply since 1996/97. This reflects the fact that many pensioners receiving the means-tested minimum income guarantee and its predecessors have moved from just below this poverty line to just above it, as entitlement to these benefits has become more generous. However, since Labour came to power, pensioner poverty rates have shown almost no change BHC. This difference may partly reflect the fact that people reaching pension age in recent years are more likely to have owned their own home, and therefore have relatively low housing costs, than in the past. Pensioners are also continuing to become richer relative to the rest of the population. For the first time in almost 20 years, a pensioner drawn at random from the population is less likely to be in poverty than a non-pensioner, measuring incomes AHC.

4. The government has focused its financial support through the tax and benefit system on pensioners and families with children. Poverty rates among the population who are of working age and without children – almost 40 per cent of individuals – are slightly higher in 2002/03 than when Labour came to power. But poverty rates for this group are still lower than those for pensioners and families with children.

5. Poverty rates do not tell us how far people fall below the poverty line. We should be more concerned about the welfare of people who fall a long way below the poverty line, and the policy response required to help them may be different. There is tentative evidence that, while the number of people living in poverty has fallen under the current government, the seriousness of the poverty problem for many of those remaining poor has not improved.

The government's new child poverty measure

1. The government's new child poverty measure consists of three indicators: an absolute low-income indicator, a relative low-income indicator and an indicator that combines relative low income and material deprivation. Child poverty will be deemed to be falling when all three indicators are falling.

2. All three measures will focus on incomes measured BHC rather than both BHC and AHC, which means that they will not take account of the effect of housing costs on the living standards either of the poor or of the median household with which they are compared. Fewer children are considered poor when measuring incomes BHC rather than AHC.

3. The measures will also adjust incomes for household size and composition in a way that gives greater weight than previously to the needs of very young children and children in lone-parent households.

4. Around 23 per cent of children were poor on the new relative income measure in 2002/03, compared with 21 per cent under the BHC measure used for the current child poverty target to reduce poverty by one-quarter, and 28 per cent under the targeted AHC measure on which Ministers used to place most emphasis. The 7 per cent of children (around 900,000) no longer poor compared with the old headline AHC measure tend to be in households with higher housing costs and are more likely to live in the south and east of England, to be in a household where either or both of the parents work, and to be in a lone-parent household than those children who are poor on both the old headline measure and the new measure.

5. By moving to a relative child poverty measure based solely on BHC incomes, fewer children have to be moved out of poverty for the government's targets to be met. This may make achieving the targets less expensive than had the focus on incomes measured AHC been maintained.

6. Around 14 per cent of children were poor in 2002/03 on the new absolute low-income measure; they are roughly the poorest three-fifths of those poor on the relative measure. The government has not yet defined the material deprivation indicator, but the poverty rate on this basis is likely to be closer to that derived from the absolute income measure than that derived from the relative income measure.

Poverty targets

1. The government's long-term aim is to ensure that there are no children in poverty by 2020. But it argues, not unreasonably, that some children will always be measured as poor because their household income is low temporarily. So it has suggested that abolishing poverty would be consistent with relative poverty rates being amongst the best in Europe. A plausible interpretation of this would be to reduce the relative low-income rate of child poverty to 5–10 per cent and the material deprivation rate to below 5 per cent. For its goal of halving child poverty by 2010, the government might aim to have each of the three poverty indicators at half their 2000 level by 2010 or – less demandingly – to halve the distance between their levels in 2000 and where it wants them to be in 2020.

2. If these targets are to be achieved, low-income parents will have to see their incomes rise more quickly than the median – either through employment and earnings growth or through increases in financial support from the government.

3. The government may be contemplating a target for pensioner poverty in the 2004 Spending Review, but such a target may not be necessary. Given that the minimum income guarantee brings pensioners very close to 60 per cent of median income AHC, if the government raises the maximum level of means-tested support available to pensioners in line with earnings, then a target for relative pensioner poverty is essentially equivalent to a target for the take-up of the pension credit.

1. Introduction

This Commentary presents an analysis of the government's latest low-income figures, released by the Department for Work and Pensions (DWP) on 30 March 2004 (Department for Work and Pensions, 2004). These figures tell us about the extent of income inequality and relative income poverty in Great Britain up to and including the financial year 2002/03.

We begin by outlining how the income statistics produced by the government are measured, and then, in Chapter 2, our analysis commences by looking at the current distribution of income. This chapter also examines what has been happening to the gap between the rich and the poor in Britain, compares the record of Labour with that of previous governments and assesses what impact Labour's policies have had on inequality.

Following our analysis of inequality, we then examine the recent trends in relative and absolute poverty in Chapter 3, looking at the experiences of the key groups of children and pensioners in detail, as well as poverty amongst those who have been less favoured by government tax and benefit policies. In Chapter 4, we assess the government's new child poverty measure, announced in December 2003, considering how poverty has changed on this new definition. In Chapter 5, we discuss what targets the government might set to pursue its goals of eliminating child and pensioner poverty. Chapter 6 concludes.

1.1 How are incomes measured in this Commentary?

All the figures in this Commentary rely on household income data derived from the latest official *Households Below Average Income* (HBAI) statistics (Department for Work and Pensions, 2004). These use weekly household income from all sources, including benefits and net of direct taxes (income tax, National Insurance and council tax) as a measure of living standards. The incomes are calculated using information collected from the annual Family Resources Survey (FRS), a representative survey of around 45,000 people in 25,000 households in Great Britain.[1] In this section, we describe briefly the main features of the HBAI income measure on which our analysis is based, and discuss some of the advantages and disadvantages of measuring living standards in this way.

Income as a measure of living standards

Most people would consider that human well-being consists of more than a simple measure of material circumstances. However, even if we wanted to, it would be extremely hard to define an objective index of human well-being or happiness, let alone to measure it. The approach to living standards taken here is to focus solely on material circumstances, and to use income as a simple proxy.

[1] The results we present for years prior to 1994/95 are derived from the Family Expenditure Survey (FES), a sample of 7,000–8,000 households.

Even as a measure of material well-being, the HBAI income measure has some important limitations. For example, the income measure here is a 'snapshot' measure – reflecting actual, or in some cases 'usual', income around the time of the FRS interview. Income measured in this way will reflect both the temporary and the long-run circumstances of individuals, although the latter would generally be regarded as a better measure of welfare. Income-based statistics will also attribute the same level of welfare to people with the same income, regardless of how much savings or other assets they have, or how much they spend. Consumption would arguably make a better measure of well-being, though reliable data can be harder to collect.

The treatment of housing costs

The government's HBAI publications look at two measures of income. One measure captures income before housing costs are deducted (BHC) and the other is a measure after housing costs have been deducted (AHC). Until recently, the government has generally treated these as complementary indicators of living standards, presenting both in its HBAI publications and in its annual audit of poverty, *Opportunity for All*.[2] Both measures were used in setting its short-term child poverty targets for 2004/05 (see Chapter 3). However, as we discuss in Chapter 4, the government's new child poverty measure focuses solely on BHC income, with some important consequences.

The case for using these different income measures arises from variation in housing costs. When deciding whether or not to measure living standards on an AHC basis as well as BHC, the main issues are whether people face genuine choices over their housing and whether housing cost differentials accurately reflect differences in housing quality.

It is often argued that some individuals do not have much choice over the type or cost of housing services that they consume, whereas they have considerably more choice over the purchase of other consumption goods (such as food or clothing). For these individuals, it could be argued that an AHC measure is a more suitable measure of their well-being. However, for individuals who do exercise a considerable degree of choice over cost and quality, housing can be seen more like a consumption good like any other, and a BHC income measure may therefore be preferable. Even if people do have choices over their housing, differences in housing costs between households may not reflect differences in housing quality, and this may also lead us towards measuring incomes AHC.

Lack of choice over housing cost and quality is particularly important in the social rented sector, where individuals tend to have little choice over their housing and where rents have often been set with little reference to housing quality or the prevailing market rents. For this reason, commentators have often focused on AHC incomes when considering the living standards of individuals at the lower end of the income scale or when measuring poverty.

Pensioners are another group for whom an AHC measure has often been considered appropriate. This is because around 65 per cent of pensioners own their homes outright

[2] See Department for Work and Pensions (2003a), for example.

(most of the remainder are social renters). People who own their homes outright will be able to attain a higher standard of living than individuals with the same income level but who have mortgage or rental payments, since housing is an asset which is of benefit to those who own their own homes. On a BHC measure, an individual who owns her own house will be treated as being as well off as an otherwise-identical individual who is still paying off a mortgage; an AHC measure, though, would indicate that the former was better off.[3]

As we will see in Chapters 2 to 4, our assessment of what has happened to inequality and poverty is often sensitive to the precise treatment of housing costs in the definition of income. For this reason, we set out in Chapter 4 some concerns about using BHC income alone in the government's new child poverty measure.

Income sharing

To the extent that income sharing takes place within households, the welfare of any one individual in a household will depend not only upon their own income, but also on those of other household members. By measuring income at the household level, the HBAI statistics implicitly assume that all individuals within the household are equally well off and therefore occupy the same position in the income distribution. For some households, this assumption may provide a reasonable approximation – for example, some couples may benefit equally from all income coming into the household. For others, such as students sharing a house, it is unlikely to be appropriate. However, given the data available, it is one of the least arbitrary assumptions that can be made.[4]

Comparing incomes across households

If household income is to reflect the standard of living that household members enjoy, and if we are to compare these incomes across different household types, then some method is required to adjust incomes for the different needs that different households may face.

The official HBAI income statistics currently use the McClements scale[5] to adjust incomes on the basis of household size and composition, expressing all incomes as the amount that a childless couple would require to enjoy the same standard of living. For example, when income is measured before housing costs, the McClements scale asserts that a single person would require 61 per cent of the income that a childless couple would require to attain the same standard of living. This process is referred to as 'income equivalisation'.[6]

[3] A better solution to this problem would be to impute an income from owner-occupation and add this to BHC income. Unlike the AHC measure, this would also capture the benefits to individuals living in better-quality housing than others.

[4] This is by no means the only 'reasonable' assumption that we can make: for example, we could assume that there is complete income sharing *within* the different benefit units of a household, but not *between* them.

[5] See McClements (1977).

[6] See Department for Work and Pensions (2003c, appendix 2) for more details.

Since this Commentary is based on the latest HBAI statistics, we also follow the HBAI convention, using incomes equivalised using the McClements scale. However, the DWP's new child poverty measure described in Chapter 4 uses a different equivalence scale (the Modified OECD scale). As we discuss in Chapter 4, the choice of equivalence scale, through the relative weight that it places on different household members, can have important implications for our conclusions concerning the level and evolution of inequality and poverty.

Neither the McClements equivalence scale nor the Modified OECD scale takes into account other characteristics of the household besides the age and number of individuals in the household, although there may be other important factors affecting a household's needs. An important example of these would be the disability or health status of household members. Someone with additional income due to the receipt of disability benefits will be located higher up the income distribution than someone without these benefits. But if this higher level of income only compensates the individual for the greater needs that they have, then the standard of living of this person may not be any higher.

Sample weighting, and adjusting the incomes of the 'very rich'

The incomes used in this Commentary are derived from the Family Resources Survey and, prior to 1994/95, the Family Expenditure Survey. These surveys are designed to provide a broadly representative sample of households in Great Britain.[7] However, because they are voluntary surveys, there is inevitably a problem of non-response, which may differ according to family type and according to income. Such non-response bias is dealt with in two ways. First, weights are applied to the data to ensure that the composition of the sample (in terms of age, sex, marital status, region and a number of other variables) reflects the true GB population (see Department for Work and Pensions (2004)). For example, if there are proportionately fewer lone parents in the sample than there are in the population, then additional weight must be placed upon the data from those who actually do respond.

Secondly, a special procedure is applied to the incomes at the very top of the distribution to correct for the volatility in reported incomes. This adjustment procedure uses data from the Inland Revenue's Survey of Personal Incomes (SPI) – a more reliable source of data for the richest individuals which is based on income tax returns rather than being a voluntary survey. The very richest individuals, for whom the SPI adjustment is applied, are assigned an income level derived from the SPI survey. For the most recent year's data, this correction was made to the incomes of around the top ½ per cent of the population (corresponding to around 290,000 individuals). The number of the richest individuals is then controlled for by a slight modification to the frequency weights that are applied. However, there is no corresponding correction for non-response, or for misreporting of incomes at the lower end of the income scale, a point we return to in Chapter 2.

[7] Both have samples from Northern Ireland, but these are not analysed here.

The income measure summarised

In the analysis that follows, we will therefore be following the government's HBAI methodology, using *household equivalised income after deducting taxes and adding benefits*, expressed as the equivalent income for a couple with no dependent children and in average 2002/03 prices, as our measure of living standards. For brevity, we shall be using this term interchangeably with 'income'.

1.2 How is poverty measured in this Commentary?

In the discussion of poverty in Chapter 3, we will classify individuals as being in poverty if they live in households whose income falls below some poverty line expressed as a fraction of median income. This is the same approach to measuring poverty as used by the government in its HBAI publications. Some of the measures analysed in Chapter 3 are also indicators in the government's annual report on its anti-poverty policies, *Opportunity for All*.[8] However, it is important to recognise that there are a number of limitations to measuring poverty in this way.

First, the poverty measure is entirely based on income. As well as the possible drawbacks of using HBAI income as a measure of living standards discussed earlier, there are particular issues arising when using this for the further aim of measuring poverty. Policy-makers, policy analysts and people in poverty are generally agreed that poverty is multi-dimensional; these statistics, though, attempt to capture just one dimension – insufficient resources.

Furthermore, none of the measures of poverty presented is explicitly based upon an assessment of needs, or what level of income would be adequate to achieve some standard of living. Nor do they take into account public perceptions of what poverty is. This criticism might lead one to view these estimates of poverty as merely another way of summarising the shape of the income distribution that focuses on the individuals with the lowest incomes. However, some recent studies have suggested that the popular conception of poverty is a relative notion rather than an absolute one.[9] For single pensioners, at least, a recent estimate of the cost of an adequate budget produced an answer that was close to 60 per cent of median income AHC.[10]

Even accepting the above limitations, such poverty measures are only informative about the number of poor people. They provide no information on the 'distance' that separates those with incomes below poverty lines from the poverty thresholds, and so contain no information on *how poor* the poor households are. Nor do they take into account *how long* people are poor for. Yet the 'seriousness' of poverty may be a very important issue and

[8] The indicators are the proportion of (separately) working-age adults, pensioners and children in absolute, relative and persistent poverty. Absolute poverty is measured with reference to median income in 1998/99, relative poverty is measured with reference to contemporaneous median income and persistent poverty is defined as the individual being subject to relatively low income in three out of the last four years. For absolute and relative poverty, incomes are measured both AHC and BHC, and three poverty lines are defined, corresponding to 50 per cent, 60 per cent and 70 per cent of the relevant median income. For persistent poverty, income is measured BHC only, and the poverty lines correspond to 60 and 70 per cent of the relevant median only.

[9] See Hills (2001 and 2002).

[10] See Goodman, Myck and Shephard (2003, table B1).

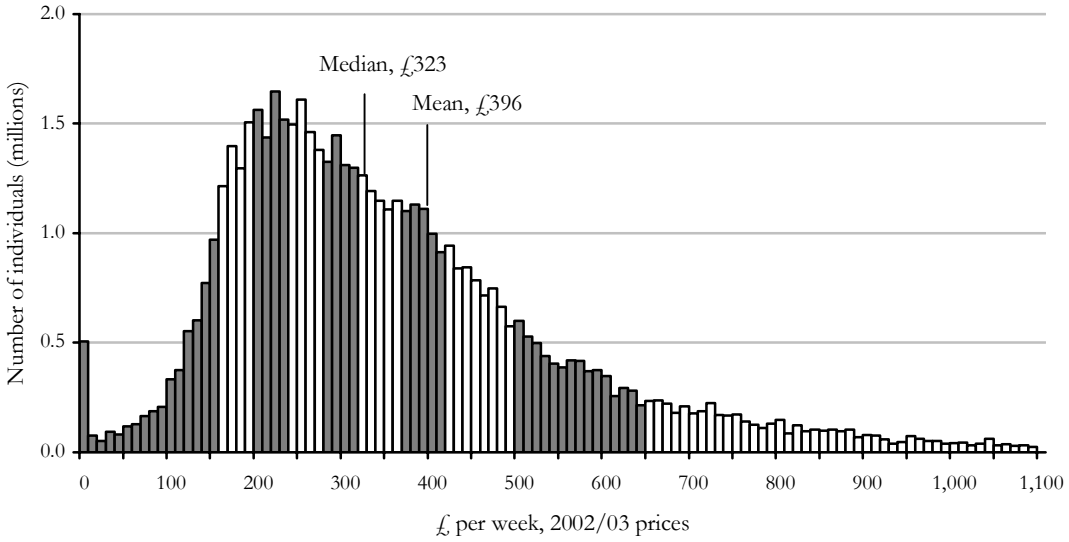
one requiring different policies from those aiming simply to bring people from just below the poverty line across it.

There are, of course, advantages to this way of measuring poverty. For example, the process of producing the eventual statistic is relatively transparent and does not require many subjective decisions on the part of the researcher or government statistician. Furthermore, the measures have been used for many years, they are well understood and it is easy to make comparisons with them over time and across countries.

2. The income distribution in 2002/03

A good place to start in understanding the distribution of income is to look at how many people are to be found at different income levels.[11] Figure 2.1 presents such a picture, showing the income distribution in 2002/03, the latest year for which complete data are available. This graph shows the number of people living in households with different equivalised income levels, grouped into £10 income bands. The height of the bars represents the number of people in each income band. As can be seen, the current distribution is highly skewed, with 65 per cent of individuals having household incomes below the national average. While the distribution shown in Figure 2.1 has been truncated at income levels in excess of £1,100 per week, 1.2 million individuals (out of a private household population of approximately 57 million individuals) have incomes above this amount.[12]

Figure 2.1. The income distribution in 2002/03



Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey, 2002/03.

When we assess the distributional implications of tax and social security changes, we often divide the population into 10 equally sized groups, called decile groups. The first decile group contains the poorest 10 per cent of the population, the second decile group contains the next poorest 10 per cent, and so on. In Figure 2.1, the alternately shaded sections represent these different decile groups, and, as can be seen, the distribution is particularly concentrated within a fairly narrow range of income in decile groups 2 to 5.

[11] Here, and throughout this chapter, we will be focusing upon income before housing costs have been deducted. We will, however, comment where there is any important difference when incomes are instead measured after housing costs.

[12] The graph also shows that there are approximately half a million individuals whose income is between zero and £10 a week. The reason that such a discontinuity in the distribution arises is because negative incomes have been set to zero. In the data, we observe around 400,000 individuals who have negative income, whether this be due to large self-employment losses or because of the various payments that are deducted.

However, as we move further up the income distribution, a widening of the decile group bands can be seen. Note that the tenth decile group band is much wider than is shown in Figure 2.1 because of the graph being truncated at incomes of £1,100 and above.

2.1 Where do you fit in?

Many individuals are unaware of their own position in the income distribution. Using the same methodology and data as used within this Commentary, IFS has developed an income distribution model that allows individuals to place themselves in the income distribution on the basis of their household income after adjusting for their household size and composition. Our 'Where do you fit in?' model is available online at www.ifs.org.uk/wheredoyoufitin.

2.2 Changes in average incomes

Having looked at the current income distribution, we now turn our attention to examining how incomes have changed over time. Here, we focus upon changes to incomes over the period 1996/97 to 2002/03, expressing all incomes in 2002/03 prices. Where appropriate, these changes will be placed in a historical context, looking at changes over a longer period.

In 1996/97, mean average income (before housing costs were deducted) was £333 in real terms, increasing to £396 by 2002/03. This corresponds to a real increase of around 19 per cent, or 2.9 per cent on an annualised basis. Similarly, median income increased by 17 per cent (2.6 per cent when annualised), from £277 to £323.[13] Growth over this period when income is measured after housing costs is stronger than this, with mean and median incomes increasing by 25 per cent and 22 per cent respectively. The evolution of average incomes from 1996/97 to 2002/03 is shown in Figure 2.2.

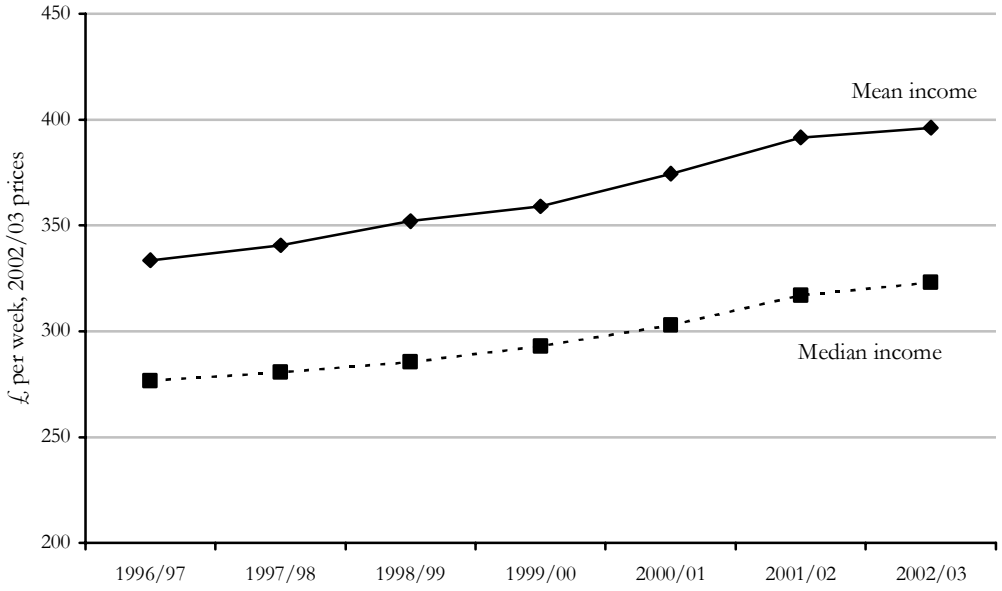
Looking at the time series in Figure 2.2, it can be seen that both mean and median real income growth have been very strong in recent years. In particular, in 2001/02, both these income measures increased from the previous year by over 4.5 per cent in real terms. Compared with the past few years, the most recently available data show weaker income growth: over the period 2001/02 to 2002/03, median income grew by a little under 2 per cent and mean income by 1.2 per cent. Indeed, growth in mean income in the latest year is the lowest experienced under Tony Blair's tenure as Prime Minister.

To put this income growth into context, it is necessary to look at what has happened over a longer period. Looking at periods of time defined by political events is one interesting way to do this, although it is important to realise that these periods cover different periods in the economic cycle, and income growth rates are very sensitive to this. Bearing this in mind, between 1990 and 1996/97, when John Major was Prime

[13] Mean income is obtained by adding up all incomes and dividing by the total number of people in the population. It gives equal weight to all observations and can therefore be quite sensitive to very low and very high incomes. In contrast, the median is a measure of average that divides the population into two equally sized groups. Half the population have incomes below the median and half have incomes above it. The median is not affected by the presence of very high and very low incomes in the distribution. It is because of the potential differences in these measures of average that it is useful to consider both.

Minister, both mean and median income increased by approximately 0.7 per cent on an annualised basis. This contrasts with the experience between 1979 and 1990 when, under the premiership of Margaret Thatcher, mean and median annualised income grew by 2.9 per cent and 2.1 per cent respectively. We can therefore conclude that average income growth in recent years has been much stronger under Blair than it was under Major, and of roughly comparable magnitude to what was experienced under Margaret Thatcher. (See Table 2.1.)

Figure 2.2. Changes in average incomes



Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey, various years.

Table 2.1. Annualised average income growth

	Mean	Median
Blair (1996/97 – 2002/03)	2.9%	2.6%
Major (1990 – 1996/97)	0.7%	0.7%
Thatcher (1979 – 1990)	2.9%	2.1%

Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey and Family Expenditure Survey, various years.

While we have seen how average incomes have changed across the population as a whole, to understand what has been happening to inequality it is necessary to examine how the entire distribution of incomes has evolved. Our earlier discussion has already demonstrated that income is distributed unequally across the population (see Figure 2.1), but now we will analyse how the extent of this unequalness (or inequality) has changed since 1979, focusing particularly upon experiences since 1996/97.

2.3 What has happened to income inequality?

Income inequality concerns differences in incomes between individuals. Any measure of inequality therefore seeks to measure the extent to which there is a departure from the equality of household equivalised incomes. Throughout this Commentary, we will be adopting a relative notion of inequality in our discussion of income inequality. This means that should all incomes increase or decrease by the same proportional amount, we would conclude that income inequality had remained unchanged. In other words, it is relative, rather than absolute, income differences that matter.

One common way to show how inequality has changed across the population is to consider the average annualised real income growth by quintile group. This is illustrated in Figure 2.3 for growth from 1996/97 to 2002/03; the growth rates under the premierships of both John Major and Margaret Thatcher are also shown.[14] Each quintile group contains 20 per cent of the population (about 11 million individuals), with the first quintile group containing the poorest 20 per cent and so on.

Figure 2.3 shows that under the present Labour government, average annualised growth was highest in the second quintile group, where it grew by 3.0 per cent, followed by the poorest group (2.8 per cent), the richest and third quintile groups (2.6 per cent) and finally the fourth quintile group (2.4 per cent). Compared with the previous Conservative governments, these gains are actually relatively equally distributed over the income distribution.[15] Although the magnitude of the income gains under John Major is lower, the poorest groups gained most, so reducing inequality.[16] This is in stark contrast to the changes that occurred when Margaret Thatcher was in power, during which time the poorest quintile group gained just 0.4 per cent on average per year, compared with the 3.8 per cent gain of the richest group.

The pattern in the top panel of Figure 2.3 suggests that there has not been any dramatic change in income inequality since 1996/97. However, in such analysis, we are only considering five percentile points in the entire income distribution. To understand fully what has been happening to income inequality, it is desirable to consider all points within this distribution, including those at the extremes. One way of doing this is to consider the Gini coefficient.

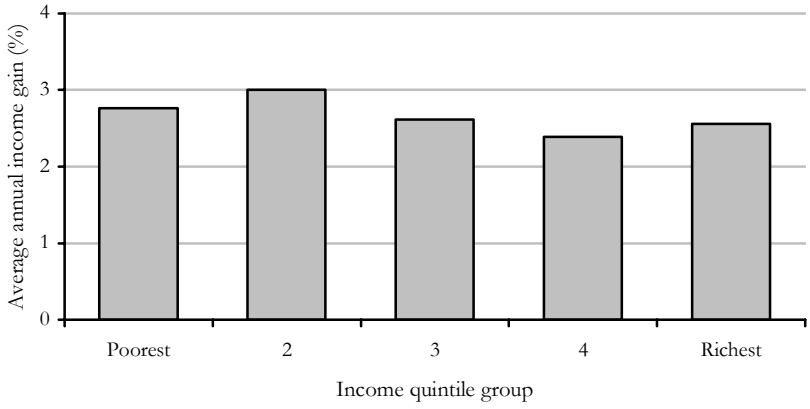
[14] These growth rates have been calculated using the median of each quintile group rather than the mean. However, because of the very different behaviour in the tails of the distribution over the period 1996/97 to 2002/03 (see Figure 2.6), a different pattern would emerge should the mean be considered instead, with income growth less evenly spread across these groups: the poorest group would have a growth rate of 2.3 per cent, compared with 3.4 per cent in the richest group.

[15] A similar pattern emerges when incomes are measured after housing costs, but the levels are slightly higher.

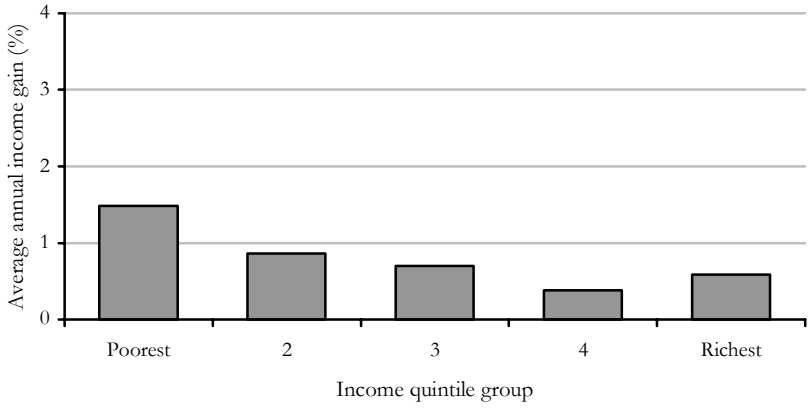
[16] The pattern of falling inequality under the Major administration reflects the recession of the early 1990s, with the increase in unemployment over this time arguably having a small equalising effect on the distribution of income (see Clark and Taylor (1999)). Clark and Taylor also point out that inequality growth was slower to pick up after the recession of the early 1990s in comparison with the experience of the recession of the early 1980s.

Figure 2.3. Real income growth by quintile group

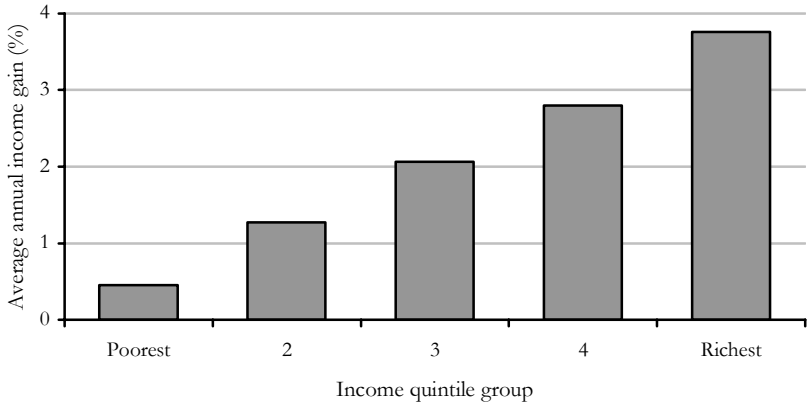
Blair: 1996/97 – 2002/03



Major: 1990 – 1996/97



Thatcher: 1979 – 1990



Notes: The averages in each quintile group correspond to the mid-points, i.e. the 10th, 30th, 50th, 70th and 90th percentile points of the income distribution. Incomes have been measured before housing costs have been deducted.

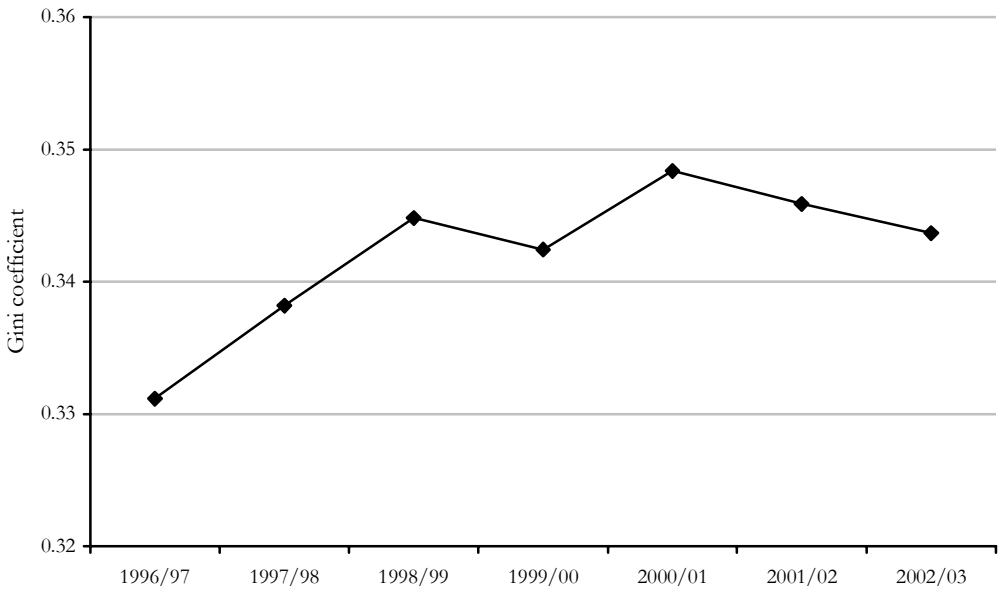
Source: Authors' calculations using Family Resources Survey and Family Expenditure Survey, various years.

The Gini coefficient

The Gini coefficient is a popular measure of income inequality that condenses the entire income distribution into a single number between zero and one: the higher the number, the greater the degree of income inequality. A value of zero corresponds to the absence of inequality, so that having adjusted for household size and composition, all individuals have the same household income. In contrast, a value of one corresponds to inequality in its most extreme form, with a single individual having command over the entire income in the economy. The Gini coefficient is discussed in detail in Appendix A.

Figure 2.4 shows the evolution of the Gini coefficient from 1996/97 to 2002/03.[17] Since 2000/01, the Gini has been falling, so that inequality in 2002/03 is at a similar level to what it was in 1999/2000. The decreases in inequality over the last year and over the last two years are not statistically significant,[18] but the rise in inequality over the entire period 1996/97 to 2002/03 is statistically significant at the 5 per cent level. This means that there is less than a 1 in 20 chance that inequality has not changed since 1996/97. However, when income is measured after housing costs have been deducted (AHC), the rise in inequality is smaller and is not significant.

Figure 2.4. The Gini coefficient, 1996/97 – 2002/03



Note: The Gini coefficient has been calculated using incomes before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey, various years.

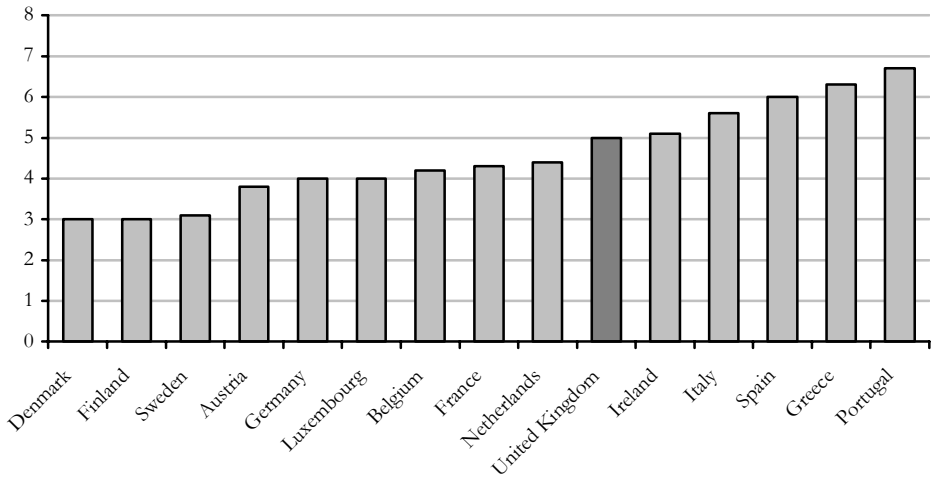
[17] If the Modified OECD equivalence scale is used, rather than the McClements scale, then the pattern is the same, although the level of inequality in each year is slightly higher. The Modified OECD equivalence scale is discussed in our analysis of the new child poverty measure in Chapter 4.

[18] Year-on-year changes in the Gini coefficient are rarely large enough relative to their standard error to be statistically significant. Since 1979, year-on-year changes in the Gini have only been significant at the 5 per cent level on four occasions: between 1984 and 1985, 1986 and 1987, 1987 and 1988, and 1989 and 1990.

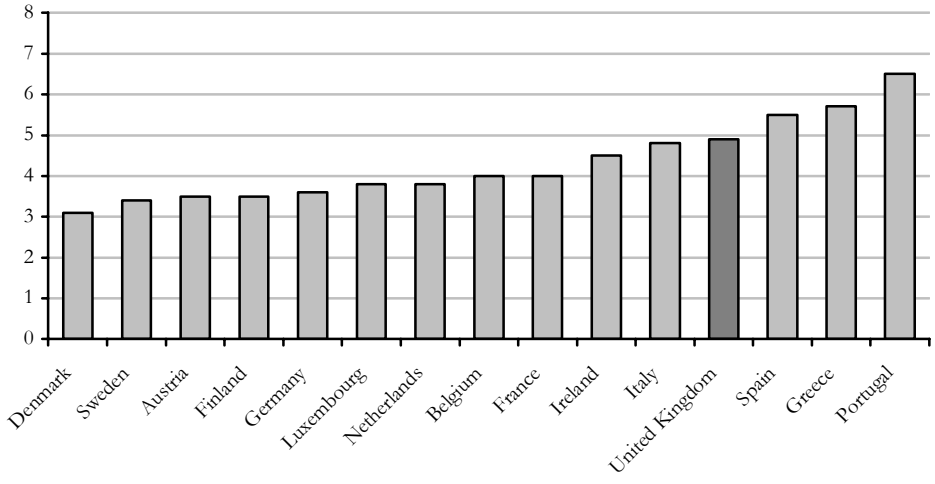
Box 2.1. European comparisons of income inequality

The graphs below show levels of inequality in the EU. They show the total income of the richest 20 per cent of individuals expressed as a multiple of the total income of the poorest 20 per cent; the higher is this number, the greater is inequality, with a value of 1 indicating complete equality. In the UK, for example, the richest 20 per cent of individuals had a total income that was approximately five times that of the poorest 20 per cent. Over the period 1996–2001, inequality on this measure either stayed the same or fell in most countries; the only notable increase occurred in Finland. So even though there has been little change in inequality in the UK over this period, its ranking appears to have deteriorated from sixth-worst to fourth-worst amongst the 15 EU countries.

European inequality compared, 1996



European inequality compared, 2001

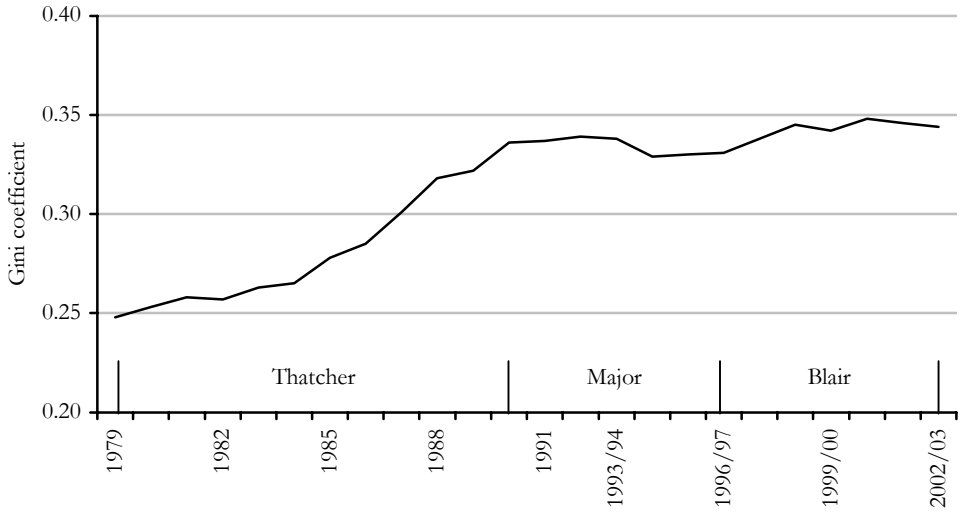


Note: Data for Sweden are for 1997 and 2001.

Source: Eurostat Structural Indicators, table SC010 (europa.eu.int/comm/eurostat/newcronos/queen/public/xml/theme0/strind/socohe-csv.zip).

While the *increase* in inequality since 1996/97 is not historically large (for example, between 1979 and 1990, the Gini increased from 0.25 to 0.34), the *level* certainly is. Indeed, since 1998/99, inequality as measured by the Gini coefficient has been at its highest level since at least 1961. Throughout the 1960s and 1970s, inequality as measured by the Gini fluctuated slightly but its level remained approximately constant at around 0.25. This was then followed by a large rise in the 1980s. Figure 2.5 shows the evolution of the Gini from 1979 to 2002/03.[19] Meanwhile, Box 2.1 provides some European comparisons of income inequality.

Figure 2.5. The Gini coefficient, 1979 – 2002/03



Note: The Gini coefficient has been calculated using incomes before housing costs have been deducted.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

Changing incomes across the distribution

We have seen that income inequality as measured by the Gini coefficient has increased between 1996/97 and 2002/03. Now we examine how incomes have changed across the entire distribution of income in order to establish what has been driving the slight increase in inequality. This is illustrated in Figure 2.6, which is similar to the graphs in Figure 2.3 earlier, where real annualised income growth was shown for different quintile groups. Here, however, we consider this income growth at 99 percentile points in the income distribution, with the differently shaded sections again corresponding to the different income decile groups. This graph gives a much more detailed impression about how the entire distribution of incomes has been changing.

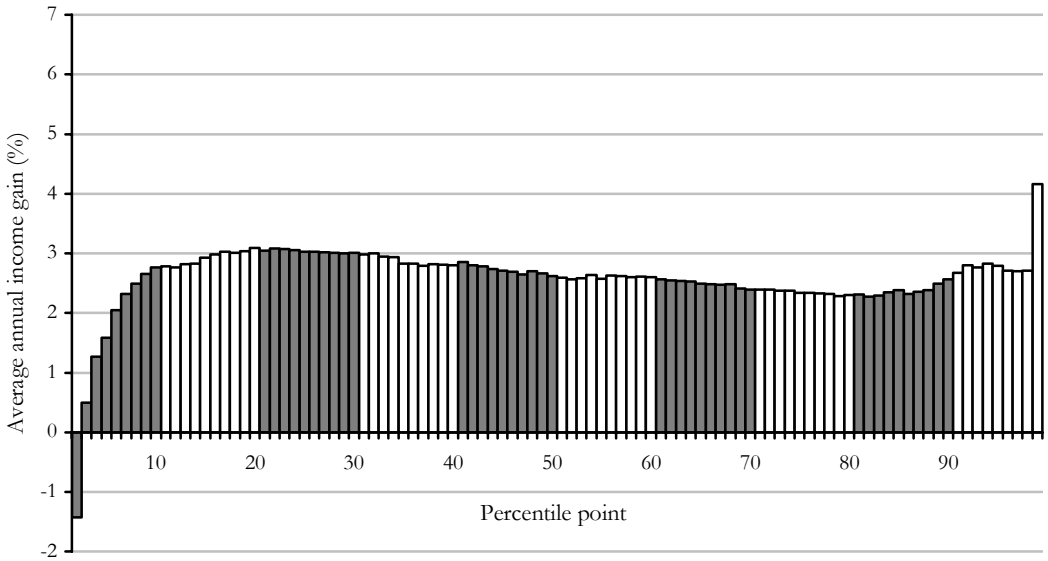
Between about the 15th percentile point and the 85th percentile point, it is generally the poorer individuals who have gained most over the period, and this would be consistent with falling inequality. However, it is the behaviour outside of this range that is more

[19] A picture of the evolution of the Gini coefficient since 1961 can be found in Goodman and Shephard (2002).

dramatic, and the likely cause of the increase in income inequality as measured by the Gini coefficient.

The changes at the very top of the income distribution are quite striking. Beyond the 85th percentile point, income growth is generally increasing in income, with a spike at the 99th percentile point where annual income growth stands at 4.2 per cent – higher than at any other percentile point. This growth in the top 1 per cent of incomes is confirmed by other recent research examining changes in the incomes of the rich using data from income tax returns (see, for example, Atkinson (2003)). Although we do not know for sure exactly what explains this rapid growth in top incomes – which started during the 1980s and has continued over the 1990s – some possible explanations include changes in the nature of executive remuneration, and the dynamic effects of the cut in top rates of income tax over the 1980s on capital accumulation (see Atkinson (2003) for Britain and Piketty and Saez (2003) for the USA).

Figure 2.6. Real income growth by percentile point, 1996/97 – 2002/03



Notes: The change in income at the 1st percentile is not shown on this graph (see footnote 20). Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey, various years.

The changes in incomes amongst the poorest are even less well understood. For individuals below approximately the 15th percentile point, income growth since 1996/97 is lower, the poorer is the individual; for the 1st and 2nd percentile points, the HBAI methodology suggests that growth is actually negative.[20] However, it is difficult to disentangle genuine trends from measurement error in incomes at the very bottom of the

[20] In Figure 2.6, growth at the 1st percentile point has not been shown in order to maintain a reasonable scale for the graph. However, at –14 per cent, it is certainly very different from anything observed elsewhere in the distribution.

distribution.[21] Income levels amongst the bottom 1 per cent of the income scale, in particular, appear to be especially unstable from year to year, and are most likely very unreliably measured.[22] In addition, we must recall that the annualised income growth rates given at the various percentile points of the income distribution are sample statistics. As such, they have a sampling variance attached, and so even in the absence of any measurement error, it is possible that the 'true' changes could be quite different. This is particularly the case at both extremes of the distribution, where the confidence intervals are quite wide (the wider is the confidence interval, the lower is the precision of the estimate), and in contrast to the richest group of individuals, there does not exist any administrative data for the poorest households against which we can corroborate what we observe in the HBAI data.

However, the fact that income growth has been lowest amongst the bottom 15 per cent is unlikely to be purely a measurement phenomenon. A number of other explanations are possible. For example, some individuals may not be taking up all the benefits to which they are entitled. This may be because their incomes are only temporarily very low; alternatively, it may be because of more serious take-up issues, as the reach of means-testing has been extended over the period.[23] While it may not necessarily be due to non-take-up, total benefit income accruing to the bottom income decile group has barely risen in real terms over the period in question, averaging about 0.3 per cent a year. By contrast, benefit income growth in the second decile group has been stronger, averaging over 2 per cent a year. It is clear that more research is required to understand the underlying causes better.

A comparison with the 1980s

It is important to realise that the increase in inequality seen since 1996/97 is very different in nature from that observed over the 1980s, when inequality also increased. Figure 2.5 has already shown the large increase in the Gini coefficient over this period, while Figure 2.3 showed income growth across quintile groups. In Figure 2.7, we now show the real income growth by percentile point under Margaret Thatcher. To aid comparison, a line has been superimposed that shows the associated percentile point growth under Blair as illustrated in Figure 2.6.

Almost without exception, over the period 1979 to 1990, the higher is income, the greater is income growth; if we instead looked at income over the period from 1984 to 1990, then this pattern would be even more pronounced. Individuals located in the lower decile groups have fared considerably better in recent years than they did in the 1980s. Clearly, therefore, the nature of increasing inequality over the 1980s is very different from that of the increased inequality since 1996/97.

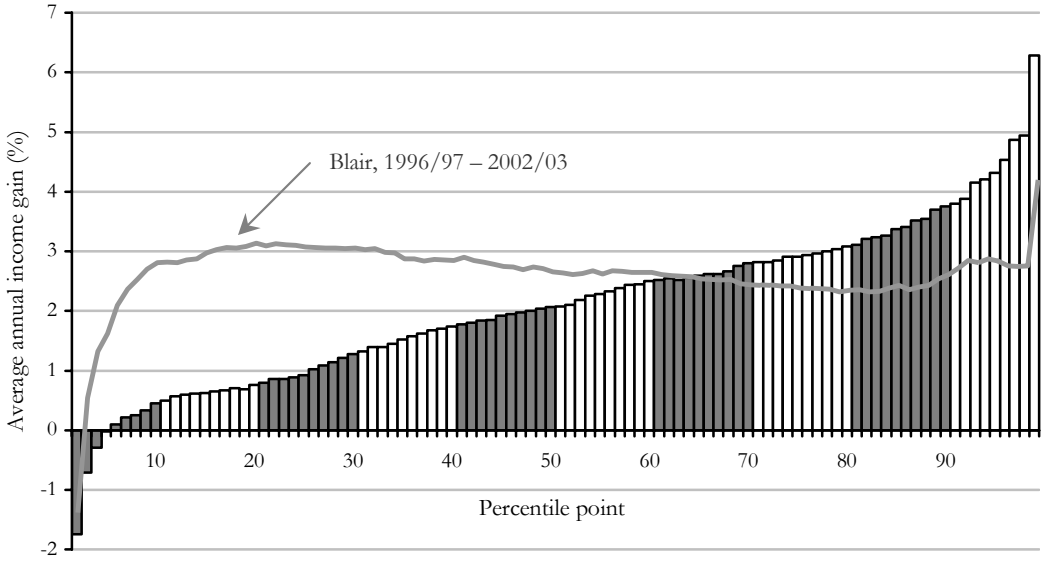
---

[21] Measurement error at the top of the income distribution is less of a problem because we are able to use data from income tax returns obtained from the Survey of Personal Incomes to correct for under-representation of the very richest, or misreporting of incomes at the very top. With the exception of bottom-coding incomes at zero, we do not have any similar corrections for incomes at the very bottom of the income scale.

[22] For example, real income at the 1st percentile point fell by over one-third in a single year between 1996/97 and 1997/98.

[23] Blundell and Preston (1998) offer the first as an explanation for rising income inequality over the 1980s.

Figure 2.7. Real income growth by percentile point, 1979 – 1990



Notes: The change in income at the 1st percentile is not shown on this graph. Incomes have been measured before housing costs have been deducted.

Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

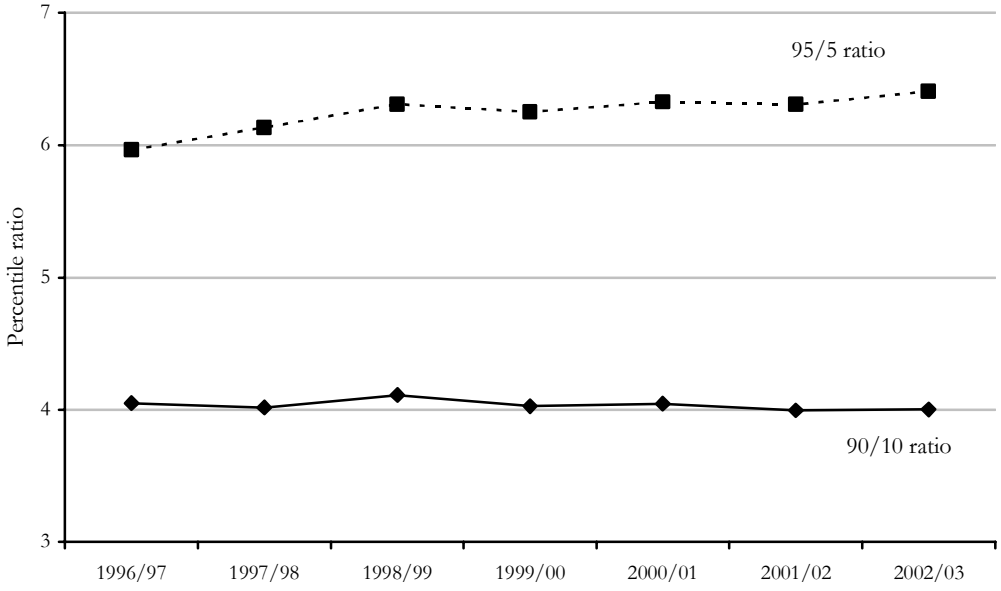
Alternative measures of inequality

The Gini coefficient is only one possible measure of inequality. There are additionally a number of alternative inequality indices,[24] which similarly consider all points in the distribution, which display the same pattern of rising income inequality since 1996/97. However, there are also other popular measures which measure income inequality by comparing incomes at different percentile points in the distribution – for example, at the 90th and 10th percentile points (the 90/10 ratio). Figure 2.6 demonstrates that income growth at the 10th and 90th percentile points have been of roughly equal magnitudes since 1996/97, and so inequality as measured by the 90/10 ratio remains approximately constant over this period (the income of the individual at the 90th percentile point is roughly four times that of the individual located at the 10th percentile point).

If we are genuinely concerned about the accuracy with which the incomes of the poorest and the richest individuals are recorded, then a percentile ratio that does not take into account the richest and poorest individuals may seem desirable as a measure of income inequality. However, such percentile ratios can easily be criticised since the choice of percentile points is largely arbitrary: if we were, for example, to consider the 95/5 ratio, then we would observe an increase in inequality. Furthermore, this measure ignores all the information contained in the middle of the income distribution – one of our motivations for considering the Gini as an inequality measure is that it takes into account

[24] These include the Mehran index, the Piesch index, the Kakwani index, the Theil entropy and mean log deviation indices, and the Atkinson inequality index.

Figure 2.8. Percentile ratios



Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey, various years.

all points in the distribution. Figure 2.8 illustrates the evolution of the 95/5 and 90/10 ratios since 1996/97.

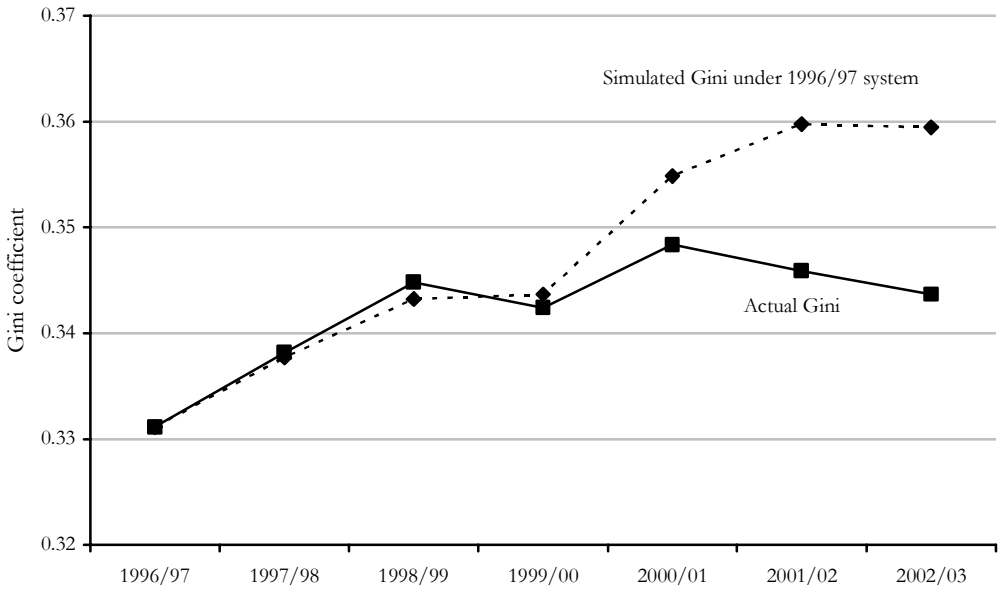
2.4 Increasing inequality, yet increasing redistribution

The slight overall increase in inequality measured by the Gini coefficient over the period 1996/97 to 2002/03 occurred despite a package of redistributive policies from the government. One way of assessing the impact of the government's tax and benefit policies on inequality is to ask how the change in income inequality we have observed compares with what would have happened if the tax and benefit system had remained unchanged. In other words, if the underlying distribution of incomes is becoming more unequal, then actual (observed) inequality remaining the same, or even increasing somewhat, could actually be considered an achievement.

Since we do not observe the distribution of income under an unchanged tax and benefit system over time, simulation techniques are necessary. Here, we use the IFS tax and benefit model, TAXBEN, to calculate what incomes would have been under an appropriately uprated April 1996 tax and benefit system.[25] From this calculated income series, the Gini coefficient and other inequality measures may be constructed.

[25] In calculating these simulated incomes, individuals are awarded all benefits for which they appear eligible and no behavioural responses are allowed for. Because modelled incomes may differ from reported incomes under any observed tax and benefit system, calibration techniques are also applied to the simulated income series.

Figure 2.9. Simulated and actual Gini coefficient



Notes: Incomes have been measured before housing costs have been deducted. Simulated income series has been calibrated to align it to the actual income series.

Source: Authors' calculations using Family Resources Survey, various years.

In Figure 2.9, we compare the actual Gini coefficient from 1996/97 to 2002/03 and the simulated Gini under the uprated April 1996 tax and benefit system.[26] Our analysis here suggests that from 1996/97 to 1999/2000, the tax and benefit reforms of the Labour government did little to affect inequality compared with what would have been observed if they had simply uprated the April 1996 system.

That the government did little to alter the course of income inequality through changes to personal taxes and benefits in its first few years is not surprising, since Labour's early Budgets contained relatively few redistributive measures affecting incomes before 2000/01.[27] However, since 2000/01, there has been a notable departure between the actual pattern of inequality and the simulated pattern under the April 1996 system.[28] This coincides with the introduction of large increases in means-tested benefits and tax credits, particularly those aimed at families with children and at pensioners (for a summary, see Brewer, Clark and Wakefield (2002)). While the actual level of inequality as measured by the Gini coefficient is similar in 2002/03 to what it was three or four years earlier, the simulations suggest that the Gini coefficient would have increased

[26] In uprating the tax and benefit system, it is assumed that council tax rises in line with the retail price index. When we instead construct this counterfactual using the observed increases in council tax, we obtain very similar results.

[27] An exception was the introduction of the working families' tax credit from October 1999, although the full effect of this measure would only be reflected in the 2000/01 data.

[28] The same pattern emerges when considering incomes on an after-housing-costs basis.

considerably if the tax and benefit system had remained unchanged.[29] This is consistent with the hypothesis that the underlying distribution of incomes has become more unequal: reasons why such widening inequality has continued over the 1990s and early 2000s are particularly associated with increases in the relative demand for more educated workers (see Machin (2003)), but have also been associated with other factors, such as changes to 'social norms' regarding top pay (see Piketty and Saez (2003), who put this forward as a possible explanation for recent changes in the income distribution in the USA). It could be argued that these changes in the primary (or underlying) income distribution are also under the influence of government, and in that case we might want to judge the government's success on whether inequality has fallen or risen, rather than on whether it is lower than in a hypothetical world where no personal tax or benefit changes were made. However, changing the primary income distribution is likely to be a longer-term task than altering the post-tax income distribution through taxes and benefits.

Our analysis suggests that the redistributive measures of the present government have reduced the increase in inequality that we would otherwise have seen. But it is sobering to note that even the relatively large redistributive programme introduced by Labour since 1997 has only been sufficient to just about halt the growth in inequality, and certainly not to reduce it. The orders of magnitude involved are also instructive: the tax and benefit measures introduced under Labour have lowered the growth in the Gini coefficient by around 1.5 percentage points; this compares with the total increase in income inequality over the 1980s and 1990s (up to its peak in 2000/01) of around 10 percentage points, or around six times the magnitude.

2.5 Conclusions

- In 2002/03, almost two-thirds of the population had incomes below the national average income of £396 per week. The distribution is skewed by a long tail of people on relatively high incomes. Median income in 2002/03 was £323 per week.

- Median income has grown 2.6 per cent a year to date under the Blair government, compared with 0.7 per cent a year under Major and 2.1 per cent a year under Thatcher. Income growth has not been evenly distributed across the population – income inequality as measured by the Gini coefficient was slightly higher in 2002/03 than in 1996/97, and at historically high levels. However, the Gini coefficient has fallen in the last two of these years, but not yet by an amount large enough for this to be statistically significant.

- The slight rise in inequality since 1996/97 reflects what has happened at the extremes of the income distribution. In the middle 70 per cent of the distribution, poorer individuals have done better than richer ones, which, on its own, would result in greater equality. However, the pattern is reversed for both the richest and poorest

[29] Our estimate of inequality if the government had not made any tax and benefit changes has assumed that people's labour market behaviour does not depend on the tax and benefit system. This is, of course, untrue. If Labour's tax and benefit changes have induced behavioural changes that have acted to reduce inequality further, then we will be understating the extent to which Labour's changes have reduced inequality. In general, though, it is very hard to know whether any particular behavioural changes would act to reduce or increase inequality.

15 per cent of individuals, where income growth is increasing with income. This is in contrast to the 1980s, when the incomes of richer individuals grew faster than those of poorer individuals throughout the income distribution, and income inequality rose sharply.

- The current government's tax and social security changes have been redistributive, in that they have tended to favour the less well-off more than the better-off. Although the current government has not reduced inequality, its tax and social security changes have slowed its increase: if the government had simply uprated the tax and social security system it inherited in line with inflation, the rise in the Gini coefficient since 1996/97 would have been more than twice as large as that which has in fact taken place.

3. Poverty in Britain

In this chapter, we summarise the trends in the most commonly used measures of poverty in Britain. The government's new measure of child poverty is discussed in the next chapter.

The government's main poverty indicators count the number of individuals below various fractions (50 per cent, 60 per cent and 70 per cent) of the income of the median individual – the individual in the middle of the income distribution. *Opportunity for All*, the government's annual audit of poverty,[30] also includes measures where the poverty line is fixed in real terms at its 1998/99 level, called absolute poverty. The word 'absolute' means that the poverty line is fixed in terms of the material living standards it can support, increasing only in line with prices rather than average incomes.[31]

We discuss changes in relative poverty in Section 3.1, including an assessment of how likely the government is to hit its child poverty target in 2004/05. Section 3.2 briefly discusses changes in absolute poverty. In both, we analyse poverty across the whole population, and then amongst the two groups at the forefront of the current government's concern – children and pensioners. But these statistics tell us only about changes in the proportion of people who lived in households with incomes below various poverty lines; they give no indication of how far from the poverty line those people were. Yet the depth of poverty is a very important issue. In addition, helping those in deep poverty might require very different policies from those that aim simply to move people from just below the poverty line across it. So we also measure the poverty gap – the distance between an individual's income and the poverty line – and we analyse how this has changed in Section 3.3.

3.1 Relative poverty

In this section, we first analyse recent changes in relative poverty amongst the whole population. We then focus on subgroups, examining poverty amongst the favoured target groups of children and pensioners and amongst a group that is rarely analysed separately – working-age adults without children.

Changes in the size of the population suggest that it is better to measure trends in poverty by the fraction of individuals that it affects, rather than by the numbers, but we report how many people are in poverty in the text. We also report estimates of whether the changes in poverty are statistically significant.[32]

3.1.1 The whole population

Figures 3.1 and 3.2 show the trends in relative poverty in Britain since 1979. These graphs show the proportion of individuals living in households with income below a

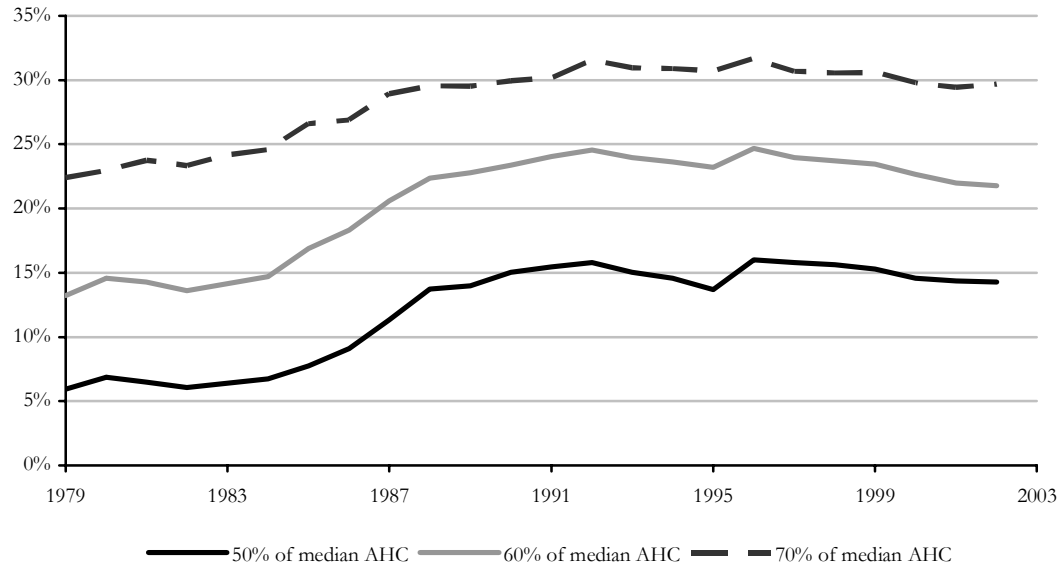
[30] Most recently, Department for Work and Pensions (2003a).

[31] There are also indicators that count individuals with persistent low incomes; we do not consider these here.

[32] These were calculated by bootstrapping the changes. This involves recalculating statistics for each of a series of random samples drawn from the original sample, as a way of approximating the distribution of statistics that would be calculated from different possible samples out of the underlying population. See Davison and Hinkley (1997).

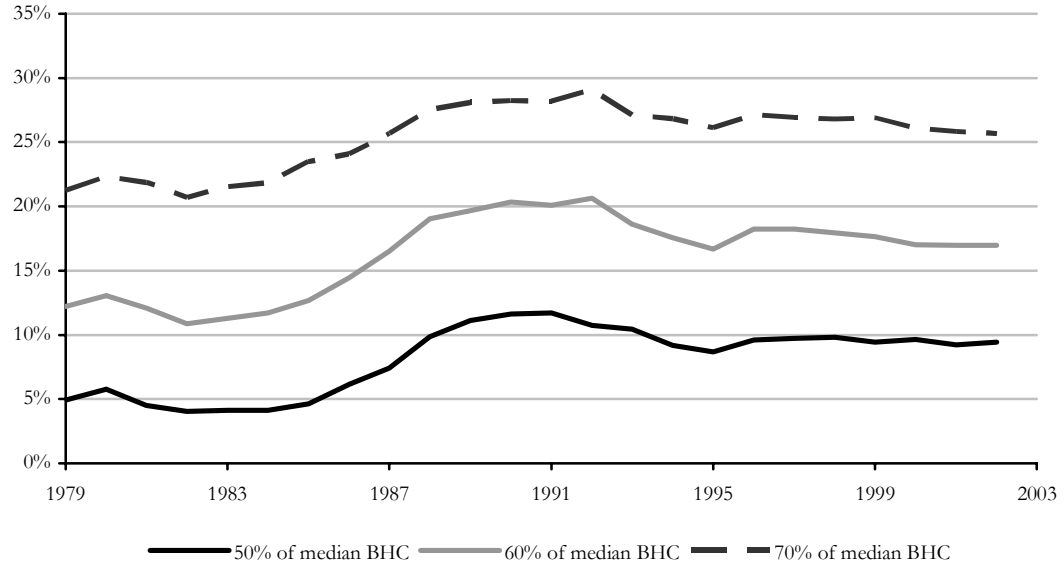
given poverty line, where the poverty lines are fractions of median incomes, measured either BHC (Figure 3.2) or AHC (Figure 3.1), as discussed in Section 1.1. They illustrate

Figure 3.1. Relative poverty in Britain: percentage of individuals with incomes below fractions of median AHC income



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.
Source: Authors' calculations based on Family Expenditure Survey and Family Resources Survey, various years.

Figure 3.2. Relative poverty in Britain: percentage of individuals with incomes below fractions of median BHC income



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.

Source: Authors' calculations based on Family Expenditure Survey and Family Resources Survey, various years.

the well-known trend that poverty rates increased dramatically during the 1980s, more slowly in the early 1990s, and then stabilised or fell from the mid-1990s. The two graphs also show the historic tendency for poverty rates measured AHC to be higher than those measured BHC; this is because the distribution of incomes is more heavily skewed towards the lower end when measured AHC.

As discussed in the previous chapter, this period of declining poverty was also one of increasing inequality. Inequality and poverty are very different concepts, however: when we measure inequality, we look at differences in incomes across the entire income distribution, but when we look at the poverty rate, we just look at the number of individuals who fall below some poverty line. For example, we saw in Chapter 2 (Figure 2.6) that income growth amongst the top decile since 1996/97 has been generally higher than that amongst the rest of the population, measuring income before housing costs. Other things equal, this will not affect poverty, since median income will not be affected, but it will increase income inequality as measured by the Gini coefficient.

Table 3.1. Relative poverty in Britain: percentage of individuals in households with incomes below various fractions of median income

	Percentage of the population						Population (million)
	After housing costs			Before housing costs			
	50% median	60% median	70% median	50% median	60% median	70% median	
1996/97	16.0	24.7	31.7	9.6	18.3	27.2	56.2
1997/98	15.8	24.0	30.7	9.7	18.2	26.9	56.4
1998/99	15.6	23.7	30.6	9.8	18.0	26.8	56.6
1999/00	15.3	23.5	30.6	9.4	17.7	26.9	56.7
2000/01	14.6	22.7	29.8	9.6	17.0	26.1	56.9
2001/02	14.4	22.0	29.4	9.2	17.0	25.8	57.0
2002/03	14.3	21.8	29.7	9.4	17.0	25.7	57.0
Change:							
Since 1996/97	*–1.7*	*–2.9*	*–2.0*	*(–0.2)*	*–1.3*	*–1.5*	
Since 1998/99	*–1.3*	*–1.9*	*–0.9*	*(–0.4)*	*–1.0*	*–1.1*	

Notes: Reported changes may not equal the differences between the corresponding percentages due to rounding. Changes in parentheses are not significantly different from zero at the 5 per cent level. Population totals are from the HBAI data-set.

Source: Authors' calculations based on Family Resources Survey, various years.

Table 3.1 contains more detailed information on poverty rates since 1996/97. Since the last year of the previous Conservative government, poverty has generally been on a downward trend. We have seen falls of between two and three percentage points in the last six years measured AHC, and of up to one-and-a-half percentage points when measured BHC. The table also shows the change since 1998/99, the baseline chosen by the current government against which to measure its progress. Poverty in 2002/03 is statistically significantly lower than it was in either 1996/97 or 1998/99 on all three AHC measures, and on two out of the three BHC measures.

Poverty in 2002/03 is about the same as in 2001/02 measured BHC, and either the same or slightly higher measured AHC. None of these changes is statistically significant, but the declines are slightly smaller than in previous years.[33] Setting the poverty line at 60 per cent of median income, the rates imply that there are now 12.4 million individuals in poverty measured AHC, and 9.7 million measured BHC, down from 13.9 million and 10.3 million respectively in 1996/97.

3.1.2 Child poverty

Table 3.2 shows the proportion of children in poverty. Child poverty has been on a downward trend since 1996/97, following a large rise in child poverty throughout the 1980s and early 1990s.[34] To the nearest percentage point, child poverty is lower in 2002/03 than in 2001/02 on all six measures, but none of the changes is statistically significant. However, the changes in child poverty since 1996/97 and 1998/99 are statistically significant. It is interesting to note that, of the six measures shown, the measure with the largest decline in absolute and proportionate terms is 60 per cent median income AHC – the measure that Labour politicians originally placed greatest emphasis upon.

Table 3.2. Relative child poverty: percentage of children living in households with incomes below various fractions of median income

	Percentage of the population						Population (million)
	After housing costs			Before housing costs			
	50% median	60% median	70% median	50% median	60% median	70% median	
1996/97	23.1	33.9	42.0	12.3	25.2	35.6	12.8
1997/98	23.2	33.1	40.9	12.5	24.9	35.7	12.8
1998/99	23.1	33.1	41.2	12.5	24.4	35.2	12.8
1999/00	21.7	32.1	40.7	11.4	23.3	35.4	12.8
2000/01	19.5	30.6	38.9	11.1	21.3	33.1	12.8
2001/02	19.2	29.8	38.5	10.4	20.9	33.4	12.8
2002/03	18.7	28.5	37.6	10.2	20.7	32.1	12.7
Change:							
Since 1996/97	*–4.4*	*–5.4*	*–4.4*	*–2.1*	*–4.4*	*–3.5*	
Since 1998/99	*–4.4*	*–4.6*	*–3.6*	*–2.3*	*–3.6*	*–3.1*	

Notes: Reported changes may not equal the differences between the corresponding percentages due to rounding. Changes in parentheses are not significantly different from zero at the 5 per cent level.

Source: Authors' calculations based on Family Resources Survey, various years.

The government has a specific, quantified, Public Service Agreement (PSA) target for child poverty in 2004/05 to be a quarter lower than its level in 1998/99, using a poverty

[33] When measuring incomes AHC, and setting the poverty line at 60 per cent of median income, the year-on-year changes were statistically significant between 1979 and 1980, during the large increase in poverty over the 1980s (1984 to 1988 inclusive), between 1995/96 and 1996/97 (when poverty rose again) and between 1996/97 and 1997/98 (when poverty fell). These correspond to (absolute) changes of between about one and two percentage points.

[34] Not shown here. See Brewer, Clark and Goodman (2002 or 2003).

line of 60 per cent of median income.[35] As discussed in Chapter 1, the government has not explicitly stated whether it has a preference for measuring income before housing costs (BHC) or after housing costs (AHC), and so it has become common to measure progress against both. However, as will be discussed in the next chapter, the new child poverty measure that the government is adopting would suggest that it has developed a preference for measuring incomes before housing costs.

Measured AHC, there were 4.2 million children in poverty in 1998/99 on this definition, so there will need to be fewer than 3.2 million children in poverty in 2004/05 for the government to meet its target. When poverty is instead measured BHC, there were 3.1 million children in poverty in 1998/99, so the target is for 2.3 million children or fewer to be in poverty in 2004/05. The respective levels in 2002/03 are 3.6 million and 2.6 million, 200,000 and 100,000 lower than in 2001/02.

The government's target for 2004/05 is for a reduction of a quarter over six years; so far (up to 2002/03), measuring income AHC or BHC, child poverty has fallen by 15 per cent. This means that the government is 66 per cent of the way through the six-year period and has reduced child poverty by 60 per cent of the amount required. However, it is generally agreed that the government is on track to meet its 2004/05 targets; this is partly because the latest available data do not reflect the impact on child poverty of the child tax credit, introduced in April 2003, which directed considerable extra resources to low-income families with children.[36] Table 3.3 shows that there was a relatively small increase in the amount of money directed to families with children in 2002/03 compared with previous and subsequent years.

Table 3.3. Changes in spending on policies affecting families with children

New policies with full effect in financial year:	
1998/99	£1,390m
1999/00	£1,430m
2000/01	£1,670m
2001/02	£3,090m
2002/03	£860m
2003/04	£2,830m
2004/05	£850m
Total:	
1998/99 – 2002/03	£8,440m
1998/99 – 2004/05	£12,120m

Source: HM Treasury, *Financial Statement and Budget Report*, various years; values presented in 2003/04 prices, uprated by the GDP deflator. See Appendix B for details.

[35] For details, see HM Treasury (2002). The median household is the one for which half the rest of the population has an income higher than it does and half has an income lower.

[36] See Brewer (2003) or Adam and Brewer (2004).

3.1.3 Pensioner poverty

Table 3.4 shows poverty rates amongst pensioners since 1996/97.[37] Pensioner poverty is slightly lower in 2002/03 than in 2001/02 on all six main measures, but none of these changes is statistically significant. When measuring the poverty line as 60 per cent of median income, the rates imply that there are now 2.2 million pensioners in poverty when measured AHC, down from 2.7 million in 1996/97. When measured BHC, pensioner poverty remains unchanged at 2.1 million. Since 1996/97, there have been declines on all three measures of poverty AHC but only one of the BHC measures. The largest decline has been when the poverty line is set at 60 per cent of median income AHC.

Table 3.4. Relative pensioner poverty: percentage of pensioners with incomes below various fractions of median income

	Percentage of the population						Population (million)
	After housing costs			Before housing costs			
	50% median	60% median	70% median	50% median	60% median	70% median	
1996/97	11.7	26.9	38.6	10.4	21.2	35.3	10.0
1997/98	12.2	26.8	37.7	11.3	21.8	35.4	10.0
1998/99	12.2	26.7	37.7	11.8	22.7	36.5	10.0
1999/00	11.8	25.4	36.5	10.8	21.5	35.0	10.0
2000/01	11.1	24.3	35.7	10.6	21.2	34.3	10.0
2001/02	10.7	22.4	36.0	10.9	22.1	33.9	10.0
2002/03	10.1	21.4	36.0	10.4	21.2	33.6	10.0
Change:							
Since 1996/97	*–1.7*	*–5.5*	*–2.6*	*(0.0)*	*(0.0)*	*–1.7*	
Since 1998/99	*–2.2*	*–5.2*	*–1.7*	*–1.4*	*(–1.5)*	*–2.9*	

Notes: Reported changes may not equal the differences between the corresponding percentages due to rounding. Changes in parentheses are not significantly different from zero at the 5 per cent level.

Source: Authors' calculations based on Family Resources Survey, various years.

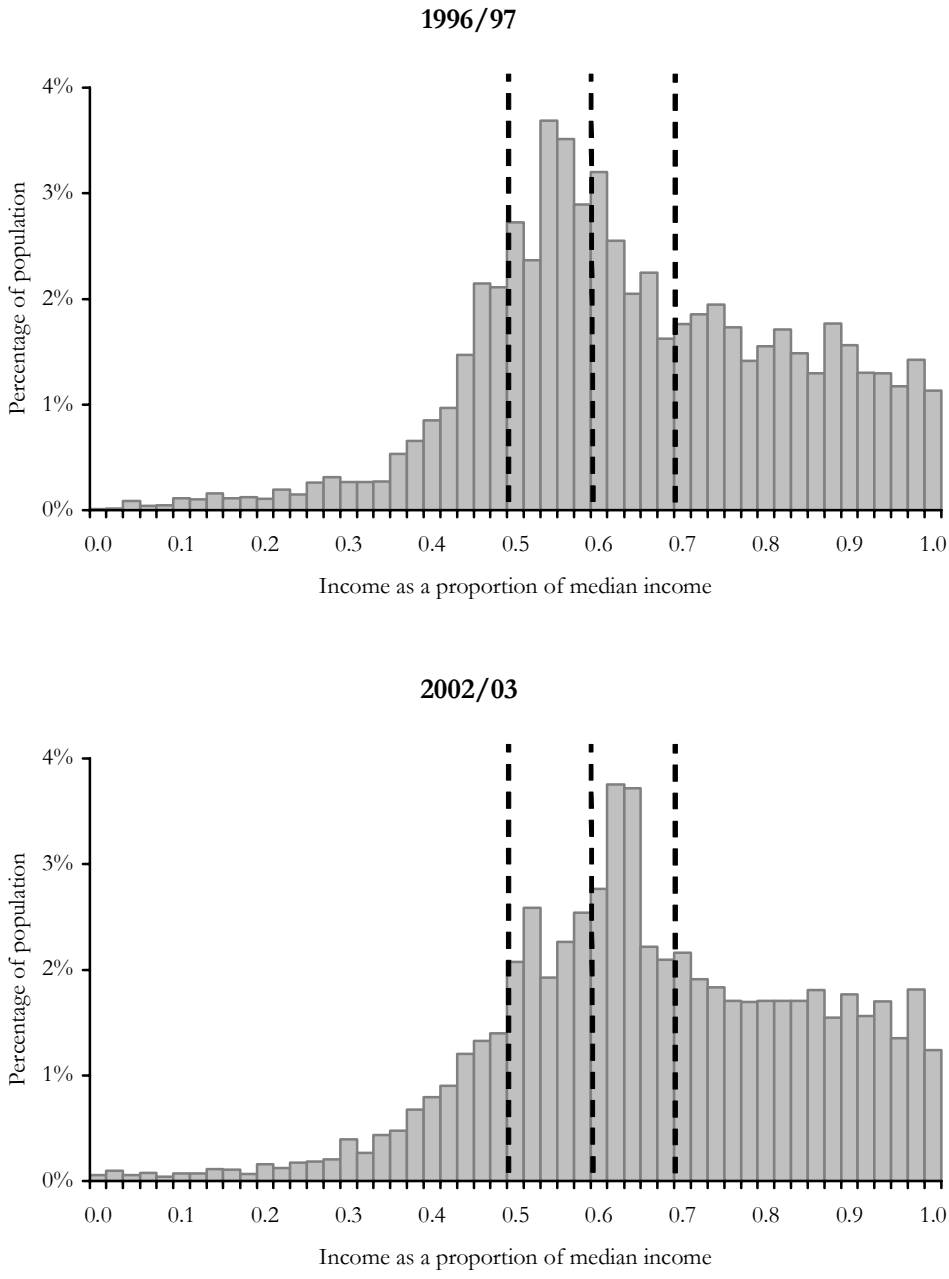
An important recent pattern has been the difference in the trends between poverty rates amongst pensioners when incomes are measured before housing costs and when measured after housing costs. Since the last year of the previous Conservative government, there has been almost no change in poverty measured BHC, but poverty measured AHC has been on a downward trend and is at the same level in 2002/03 as poverty measured BHC. Two main factors have contributed to this:

- Pensioners' housing costs have been falling while housing costs for non-pensioners have been rising: average real equivalised housing costs for pensioners have fallen by 12 per cent between 1996/97 and 2002/03; in the non-pensioner population, housing costs have risen by 11 per cent. These differential trends are partly due to changing patterns of home ownership: since 1996/97, the proportion of pensioners who own their property outright – and who therefore have very low housing costs –

[37] This shows the poverty rate amongst individuals above the current pension age – 65 for men and 60 for women – regardless of who else lives in their household.

has increased from 58.6 per cent to 65.1 per cent, whereas the proportion of non-pensioners who own outright has increased by only 2.6 percentage points, to 15.7 per cent.[38] This change may be due to those individuals reaching pension age between 1994/95 and 2002/03 being more likely to own their homes than pensioners in the past.

Figure 3.3. Pensioner AHC income relative to population median



Note: Graphs have been truncated at incomes below zero and incomes above the population median.
Source: Authors' calculations using Family Resources Survey, various years.

[38] In both groups, the rise has been broadly matched by a decline in the proportion who rent rather than the proportion who own but have a mortgage.

- There is a pronounced spike in the distribution of pensioner incomes measured AHC. In 1996/97, this spike, which consists mainly of pensioners receiving the minimum income guarantee (MIG) and its predecessors, lay just below 60 per cent of median income; in 2002/03, it lies just above. This is shown in Figure 3.3, which plots the income distribution for pensioners relative to median income; the height of the bars gives the proportion of pensioners who are located at each point in the income distribution. The modal point of the relative income distribution measured BHC is less pronounced (not shown here), but seems to have moved from just below to just above 70 per cent of median income.

These facts together explain why pensioner poverty has fallen the fastest when measured as the proportion with less than 60 per cent of median AHC income.

Part of the reason why pensioner poverty fell relatively slowly between 2001/02 and 2002/03 is that state benefits for pensioners rose relatively little in real terms in April 2002 compared with previous years.

In Table 3.5, we show how the increased spending on pensioners under Labour has been split across the years since 1997. The amount of new money directed to pensioners in 2002/03 is much lower than the amounts in the previous year, when there was a very large increase in the MIG for pensioners, and the subsequent year, when the pension credit was introduced. In addition, the extra spending in 2002/03 was primarily an increase in the basic state pension (BSP), which is worth nothing to low-income pensioners who claim the MIG (as an increase in BSP is exactly matched by a reduction in MIG). However, for those pensioners who do not claim the MIG, or who are not entitled to it (due to capital limits, for example), the change will represent a real increase in their income.

Table 3.5. Policies affecting pensioners

New policies with full effect in financial year:	
1998/99	—
1999/00	£1,070m
2000/01	£1,120m
2001/02	£3,330m
2002/03	£300m
2003/04	£2,700m
2004/05	£690m
Total:	
1998/99 – 2002/03	£5,820m
1998/99 – 2004/05	£9,210m

Source: HM Treasury, *Financial Statement and Budget Report*, various years; values presented in 2003/04 prices, uprated by the GDP deflator. See Appendix B for details.

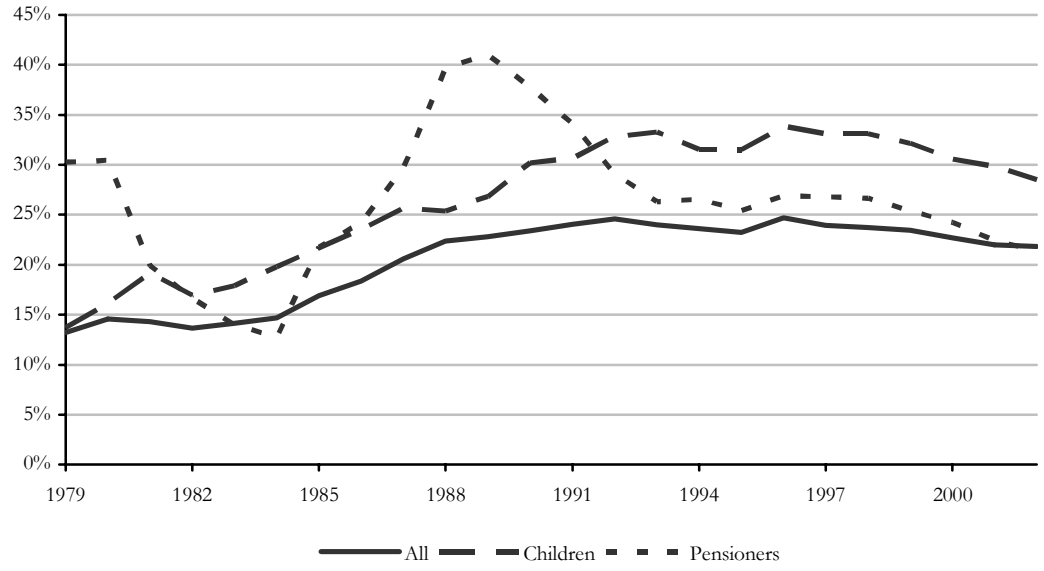
The long-run trends for pensioner poverty exhibit two important features:

- Until the late 1990s, relative pensioner poverty tended to move in line with the economic cycle, rising in booms and declining during slowdowns. Part of the current

government's achievement has been for pensioner poverty not to rise during the recent period of strong economic growth.

- Pensioners have been getting richer relative to the rest of the population. Measuring incomes AHC, pensioners were the group most likely to be in poverty in the 1970s and the late 1980s.[39] Since the early 1990s, pensioners have had a lower poverty rate than children, on average, and in 2002/03, pensioners had a lower poverty rate than all non-pensioners – something that last occurred (as a one-off blip) in the depths of the recession of the early 1980s. This is shown in Figure 3.4.[40]

Figure 3.4. Proportion of individuals below 60 per cent of median income AHC



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

3.1.4 Poverty amongst the rest of the population

The policy focus on families with children and pensioners means that changes in poverty amongst adults in neither of these groups are often overlooked. Figure 3.5 shows the long-run poverty trends, measuring incomes AHC, for individuals who are not parents, dependent children or pensioners, i.e. for working-age adults who are not parents. This group covered 39 per cent of the population in 2002/03, or 22.2 million individuals.[41]

Relative poverty rates are lower for this group than for children and pensioners, but the historical trends are similar: a rise in poverty during the 1980s that flattens off in the

[39] See Goodman, Myck and Shephard (2003).

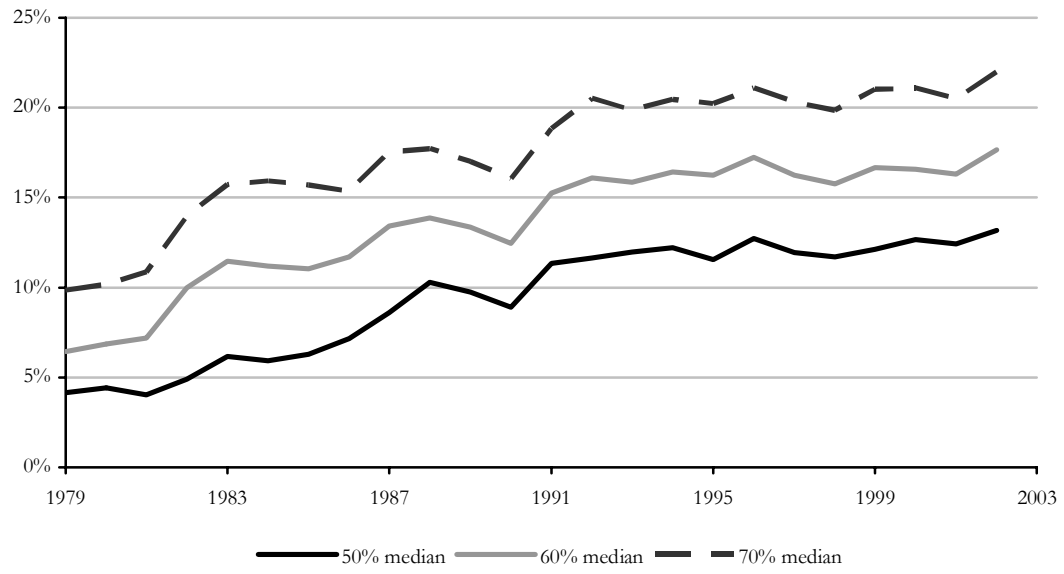
[40] Measuring incomes BHC, the trends are the same, but pensioners look less well off compared with the rest of society, with a poverty rate slightly higher than that for children in 2002/03.

[41] Amongst all working-age adults without children, the trends are identical, but the rates of poverty lower, when incomes are measured BHC.

early 1990s. However, the trends since the mid-1990s are different: relative poverty rates amongst adults without children in 2002/03 have not fallen, and indeed appear slightly higher than in 1996/97[42] – in fact, they are now at their highest levels since at least 1961.

The way that we have partitioned the population here is different from what is done in *Opportunity for All*, where the government presents poverty rates separately for children, working-age adults including parents, and pensioners; these three categories together include all individuals in the population. However, according to HBAI assumptions, parents experience the same poverty as their children, and it would make more sense to measure poverty separately for parents and children, pensioners, and working-age adults without children. These definitional points make a difference: poverty rates amongst all working-age individuals, as shown in *Opportunity for All*, have fallen since 1996/97 because a falling poverty rate for parents has more than offset the rising poverty rate for working-age adults without children.

Figure 3.5. Relative poverty rates for working-age adults without children, AHC



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

The population of working-age adults without children is not a homogeneous group:

- Just over a fifth (21 per cent) are relatively young single people (under 25), including full-time students. The poverty rate amongst this group – measured against 60 per cent of the median AHC – was 24.1 per cent in 2002/03.
- Around two-fifths (37 per cent) are aged over 50, including people who have taken voluntary or involuntary early retirement, and 17.3 per cent of these had incomes below 60 per cent of median income AHC in 2002/03.

[42] The increase in relative poverty for this group since 1996/97 is not statistically significant.

- Around two-fifths (42 per cent) are aged between 25 and 50, and 14.8 per cent of these had incomes below 60 per cent of median income AHC in 2002/03.[43]

Within these groups, the poverty rate for those aged under 25 is now slightly lower than in 1996/97 (although the recent trend is upwards); the other two groups have seen a slight increase since 1996/97. There has also been a small compositional shift towards individuals aged 50 and over at the expense of those aged 25 to 49, and this will also contribute to the increase in the average poverty rate.

These trends in poverty compared with those for children and pensioners are consistent with government policies, which have focused on redistributing income to families with children and to pensioners. Table 3.6 illustrates this by showing how maximum awards for means-tested benefits have changed for a single person without children, a lone parent, and pensioner families up until 2002/03 (i.e. the period covered by our data) and up to 2004. The main tax and benefit policy directed at working-age adults without children – the working tax credit – came into effect in April 2003 and is not yet captured by our data. The government's targeting may well reflect the view that there are more reasons to be concerned about relative low incomes amongst families with children and amongst pensioners than amongst those of working age without children, who might be thought to have more control over their own circumstances.

Table 3.6. Maximum means-tested benefit and tax credit awards for some example families

Family type	April 2004	Real increase, 1988–1997	Real increase, 1997–2002[a]	Real increase, 2002–2004
Single unemployed person aged 25 or over	£55.65	1%	1%	–1%
Unemployed lone parent, two children under 11	£156.18	4%	33%	6%
Low-income working lone parent, two children under 11[b]	£160.43	7%	39%	11%
Single pensioner under 75	£105.45	7%	31%	4%
Couple pensioner 75 or over	£160.95	11%	25%	4%

[a] Includes increases implemented in October 2002.

[b] Award is maximum tax credit award assuming part-time work and no eligible childcare costs plus child benefit.

Notes: Real increases calculated using values of ROSSI index in April of each year; benefits are uprated using the rate from the previous September, which explains why the rate for single people shows small real changes. Changes allow for abolition of one-parent benefit.

3.2 Absolute poverty

There have been large falls in the proportion of individuals living in households with incomes below the 1998/99 poverty lines, as shown in Figure 3.6.[44] These changes have been similar on the AHC measure and the BHC measure except amongst pensioners:

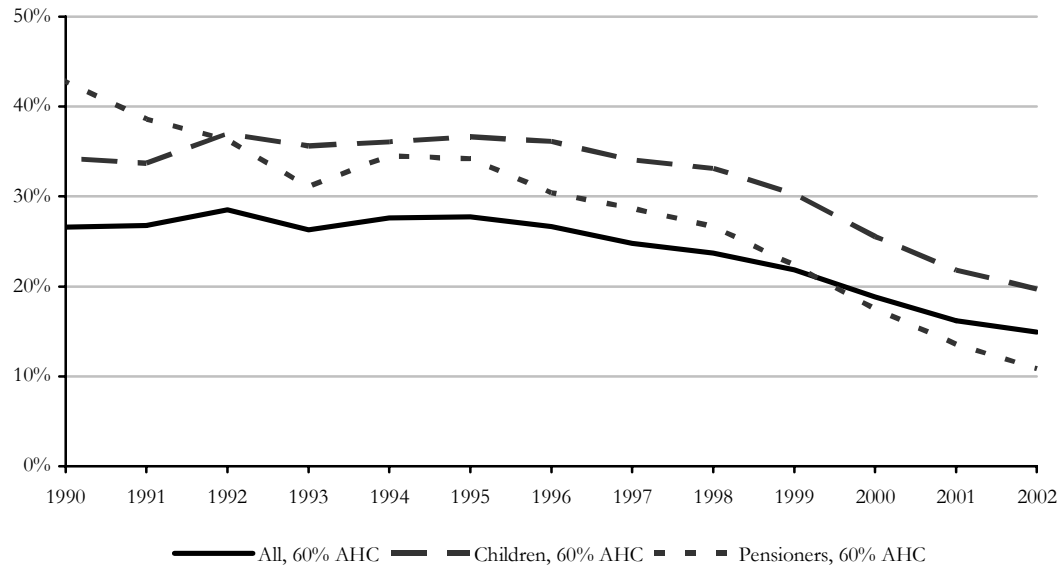
[43] These age distinctions are sometimes used by the government to target policy interventions: the New Deal and the working tax credit treat those under 25 more harshly than those over 25, and there is an extra working tax credit for adults aged 50 or over.

[44] These are the absolute poverty indicators used in *Opportunity for All*.

since 1998/99, absolute pensioner poverty has fallen by 59 per cent measured AHC or 40 per cent measured BHC.

The general direction of these trends is not surprising: the number of individuals living in households with incomes below a fixed real line tends to move counter-cyclically, falling when there is positive growth and rising during recessions. The fall in these absolute poverty indicators is partly due, then, to the strong economic growth in past years, and the corresponding large rise in incomes at most points of the income distribution.[45] Figure 3.6 reaffirms the fact discussed earlier that pensioners are less likely to be poor in 2002/03 than non-pensioners, measuring incomes AHC. More detailed figures can be found in the official HBAI publications.

Figure 3.6. Absolute poverty rates, AHC



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

3.3 Changes in the poverty gap

The statistics in Section 3.1 tell us only about changes in the proportion of people who live in households with incomes below various poverty lines; they give no indication of how far from the poverty line those people are. Yet the depth of poverty is a very important issue: we should be more concerned about those a long way into poverty than those just below the poverty line, and tackling deep poverty might require different policies from those that aim simply to move people from just below the poverty line across it. This concept can be measured with the poverty gap – the distance between an individual's income and the poverty line.

[45] Another way of thinking about these indicators is to note that the average annual real growth in median income since 1998/99 has been 3.1 per cent BHC and 4.0 per cent AHC. This means that the absolute poverty lines in 2002/03 are, respectively, 11.7 per cent and 14.4 per cent below the relative income poverty lines.

There are a number of different possible measures of the poverty gap. Estimates of the total poverty gap – which measures the total amount of income that, if perfectly distributed, would eliminate poverty – are very sensitive to the presence of those individuals with apparently very low incomes.[46] A more robust estimate is the median poverty gap, which measures the distance from the poverty line of the middle-ranking poor individual (the individual whose income just exceeds half of those in poverty). By dividing this gap by the value of the poverty line, we obtain the median poverty gap ratio, which tells us how far, in proportional terms, the median poor individual falls short of the poverty line.

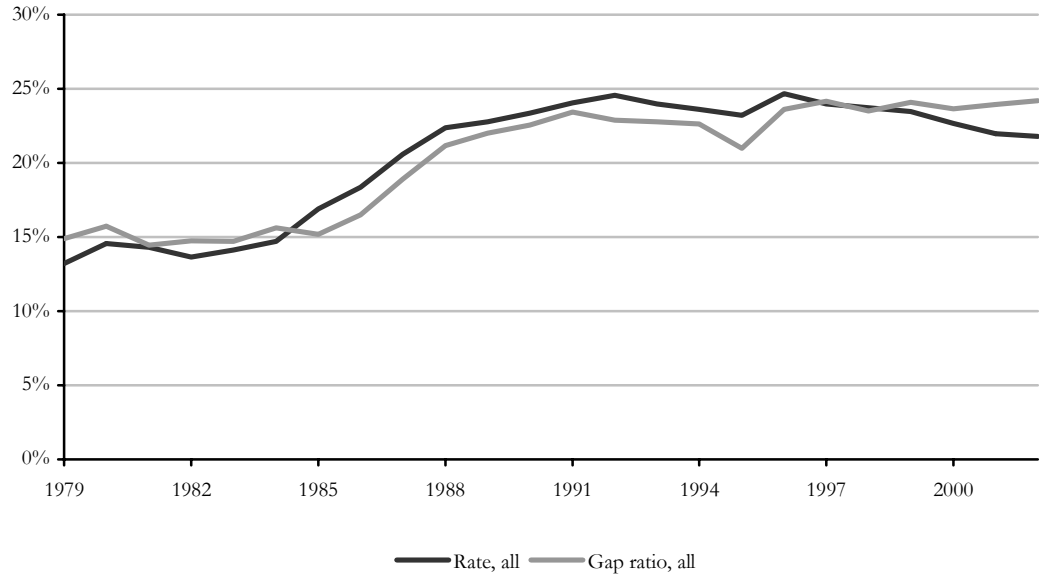
Analysing changes in the poverty rate and the poverty gap ratio together helps us understand a little more about changes in poverty. For example, in a hypothetical world where an individual moved from below the poverty line to above, the overall poverty rate would fall. The median poverty gap would fall if that individual had been located in the poorest half of the poor, but would rise if she had been in the richest half of the poor.

Figures 3.7 to 3.9 present the relative poverty rate and the median poverty gap ratio, at 60 per cent of median income AHC, for the whole population, for children and for pensioners respectively. The black line shows the familiar tale of relative poverty rising during the 1980s and then falling since the mid-1990s (late 1980s for pensioners). However, the grey line, showing the poverty gap ratio, has remained roughly constant since the early 1990s amongst the whole population (Figure 3.7) and amongst pensioners (Figure 3.9). For children, the picture is slightly different: although the median poverty gap has risen (not shown here), the median poverty gap ratio illustrated on Figure 3.8 shows a decline in recent years.[47]

[46] For example, Brewer, Clark and Goodman (2003) found that whether the total poverty gap amongst households with children had risen since 1996/97 depended on whether one allows AHC income to be negative (as the HBAI methodology allows) or whether one sets negative incomes to zero.

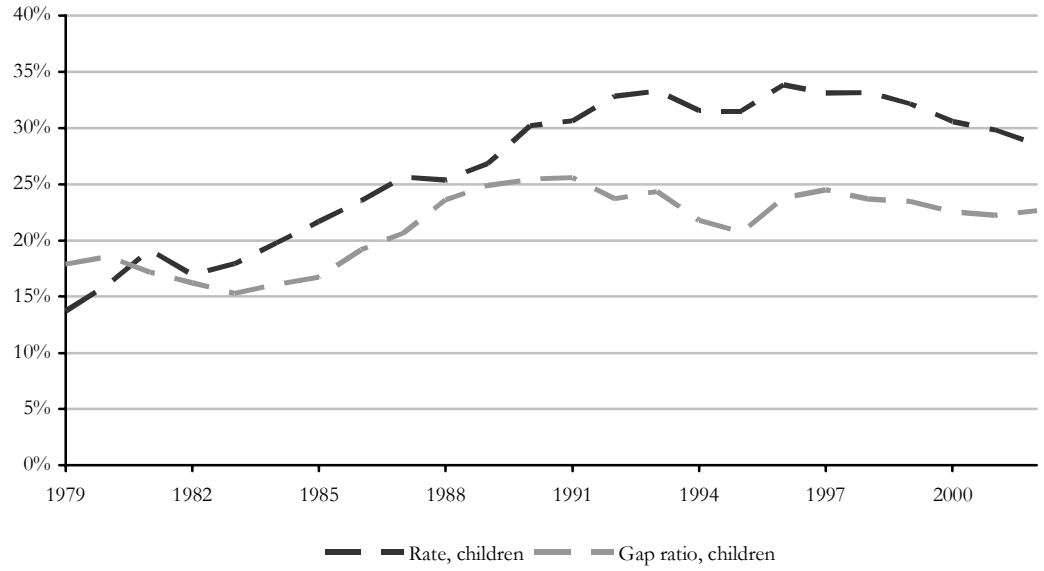
[47] Table 2 in Brewer, Clark and Goodman (2003) showed that the median poverty gap amongst children rose between 1996/97 and 2000/01. Measured in pounds per week, the poverty gap has continued to rise since 2000/01, but less quickly than has median income, and so the median poverty gap ratio is declining.

Figure 3.7. Poverty rates and poverty gaps, AHC: whole population



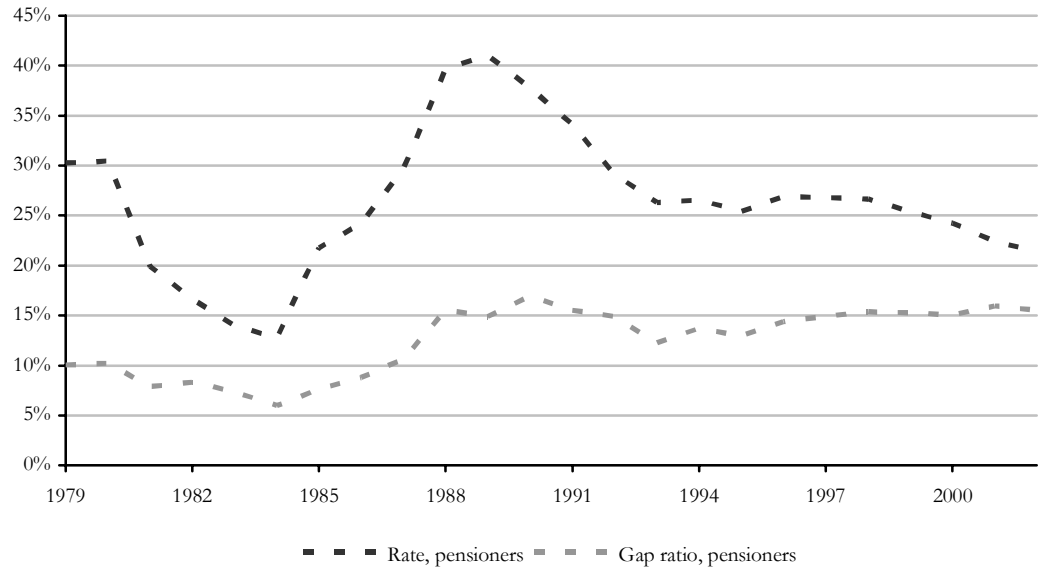
Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

Figure 3.8. Poverty rates and poverty gaps, AHC: children



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

Figure 3.9. Poverty rates and poverty gaps, AHC: pensioners



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

These patterns suggest that, although the number of people living in poverty has fallen, the seriousness of the poverty problem amongst those remaining poor has worsened. Although we cannot say this for sure – because the surveys analysed here do not measure the same people's incomes in each year – this suggests that recent falls in poverty were concentrated on those individuals who were in the richest half of the poor. This would be consistent with the detailed picture of income growth shown in Chapter 2.

3.4 Conclusions

- In 2002/03, 12.4 million individuals lived in households with incomes below 60 per cent of the median, measuring incomes after housing costs, down from 13.9 million in 1996/97. Generally, relative poverty has been on a downward trend since 1996/97, following a large increase during the 1980s and a flat or slightly falling trend during the early 1990s.

- The government has a target to reduce the number of children in relative poverty by a quarter between 1998/99 and 2004/05 using a poverty line of 60 per cent of median income, from 4.2 million to less than 3.2 million (after housing costs, AHC) and from 3.1 million to 2.3 million (before housing costs, BHC). In 2002/03, child poverty stood at 3.6 million (AHC) and 2.6 million (BHC), so the government has reduced child poverty by around 60 per cent of the required amount in 66 per cent of the available time. But the introduction of the child tax credit in 2003/04 and the extra spending announced for 2004/05, neither of which is reflected in the most recent data, suggest that the government is on course to meet its target.

- The proportion of pensioners below 60 per cent of median income measured AHC has fallen particularly sharply since 1996/97. This reflects the fact that many pensioners receiving the means-tested minimum income guarantee and its predecessors have moved from just below this poverty line to just above it, as entitlement to these benefits has become more generous. However, since Labour came to power, pensioner poverty rates have shown almost no change BHC. This difference may partly reflect the fact that people reaching pension age in recent years are more likely to have owned their own home, and therefore have relatively low housing costs, than in the past. Pensioners are also continuing to become richer relative to the rest of the population. For the first time in almost 20 years, a pensioner drawn at random from the population is less likely to be in poverty than a non-pensioner, measuring incomes AHC.

- The government has focused its financial support through the tax and benefit system on pensioners and families with children. Poverty rates among the population who are of working age and without children – almost 40 per cent of individuals – are slightly higher in 2002/03 than when Labour came to power, and at their highest levels since at least 1961. But poverty rates for this group are still lower than those for pensioners and families with children.

- Poverty rates do not tell us how far people fall below the poverty line. We should be more concerned about the welfare of people who fall a long way below the poverty line, and the policy response required to help them may be different. There is tentative evidence that, while the number of people living in poverty has fallen under the current government, the seriousness of the poverty problem for many of those remaining poor has not improved.

4. The government's new child poverty measure

In December 2003, the government announced a new child poverty measure for monitoring future trends (Department for Work and Pensions, 2003b). This chapter explains what the new measure is, and how it affects our impression of which children the government considers to be in poverty. Our main focus is on the relative poverty indicator and identifying the groups that would have been thought of as poor under the poverty measures currently targeted by government (analysed in Chapter 3), but are now no longer considered poor under the new measure.

In the next chapter, we turn to what any new targets might look like using this measure and what the government might have to do to meet them.

4.1 What is the new poverty measure?

The government's new measure consists of three separate indicators:

- *'Absolute low income' indicator:* the number of children living in families whose household income is below a fixed income threshold, uprated in line with inflation each year. The threshold has been set at 60 per cent of the median income in 1998/99, which was £149 per week for a single person with one child under 14 and

£207 per week for a couple with one child under 14, in 2002/03 prices (see Box 4.1 for the thresholds for other family sizes).

- *'Relative low income' indicator:* the number of children living in families whose household income is below 60 per cent of contemporary median household income. The threshold in 2002/03 was £169 per week for a single person with a child under 14 and £234 per week for a couple with a child under 14 (see Box 4.1).

- *'Material deprivation and low income combined' indicator:* the number of children living in households that are both 'materially deprived' and have an income below 70 per cent of contemporary median household income. This latter threshold in 2002/03 was £197 per week for a single person with one child under 14 and £273 per week for a couple with one child under 14 (see Box 4.1).

The government's new definition of poverty cannot say how many children are poor: each indicator will give a somewhat different picture of which, and how many, children are poor. Instead, the measure has been designed as a means of tracking progress over time.[48] Specifically, the Department for Work and Pensions (2003b) states that '[child] poverty is falling when all three indicators are moving in the right direction'.

Of the three indicators, it is the relative low-income measure that is likely to prove the most challenging to reduce. By including this indicator, the government has maintained its emphasis on relative poverty. But two important changes in its approach to measuring poverty stand out:

[48] The implications of this for the setting of poverty targets are discussed in Chapter 5.

Box 4.1. Income thresholds for the three new indicators of child poverty

The table below sets out the income thresholds (poverty lines) for each of the three new child poverty indicators. The thresholds differ by family size and composition because incomes are equivalised to make different households comparable, using the Modified OECD equivalence scale.

Family containing:	'Absolute low income' indicator	'Relative low income' indicator	'Material deprivation' indicator[a]
Lone parent:			
With one child (aged under 14)	£149	£169	£197
With two children (aged under 14)	£184	£208	£243
Couple:			
With one child (aged under 14)	£207	£234	£273
With two children (aged under 14)	£241	£273	£319
Each additional child under 14	*£34*	*£39*	*£46*
Each additional adult, or child 14+	*£57*	*£65*	*£76*

[a] This threshold refers just to the relative low-income part of the material deprivation indicator. In order for someone to be poor on this measure, they must both have income below this threshold and be 'materially deprived'. An exact definition of the latter is yet to be determined.

Source: Authors' calculations using Family Resources Survey, 1998/99 and 2002/03.

- The definition of income on which all three poverty indicators are based has been changed. This has the effect of cutting the headline number of children who are in relative income poverty, from 28.5 per cent of all children to 22.9 per cent.[49] As a result, the cost of meeting the government's child poverty targets may be reduced since there will be fewer children who need to be lifted from poverty. The composition of the target group will also change.

- For the first time, a measure of 'material deprivation' has been added alongside the pure income measures of poverty previously targeted. This may broaden the definition of what it means to be poor compared with considering income measures alone, but may make tracking changes over time less transparent.

We explain these changes in more detail in the next section, before analysing what each indicator says about the extent and nature of child poverty.

4.2 How does the new poverty measure differ from the way the government measured poverty before?

The new child poverty measure marks a significant departure from the way the government has chosen to measure child poverty up until now (see Chapter 3). The two main changes are that a new definition of income is being used in all three indicators and

[49] In 2002/03, 28.5 per cent of children had incomes below 60 per cent of the median AHC using the McClements scale and 22.9 per cent had incomes below 60 per cent of the median BHC using the Modified OECD equivalence scale.

that one of the indicators includes a measure of material deprivation. We discuss these in turn below.

4.2.1 A new definition of income

There have been two major changes to the definition of income on which all the indicators are based:

- Incomes will now be measured on a before-housing-costs (BHC) basis for all indicators.
- A new equivalence scale will be used to adjust incomes for household size and composition.

A measure based on BHC income

The most controversial aspect of the new way that the low-income indicators are measured is the switch away from measuring incomes on *both* a before-housing-costs (BHC) and an after-housing-costs (AHC) basis, to measuring incomes only before housing costs. The change means that the new measure of poverty will not directly take into account the effect of housing costs, either on the living standards of the poorest families with children or on the living standards of middle-income families whose income is used as a benchmark.

The government has not provided clear reasons for making this choice. Historically, official low-income statistics have been published on both a BHC and an AHC basis, without making a judgement as to which is the better measure of living standards.[50] The current PSA target for 2004/05 follows this tradition by targeting both definitions of income. Until recently, Ministers' statements have tended, if anything, to emphasise the AHC measure as the government's preferred measure of income for the purposes of measuring poverty.[51]

The lack of clearly stated rationale for preferring to use only the BHC measure of income in its new poverty measure is a matter of some concern,[52] particularly since, as we point out in Section 4.3, significantly fewer children are poor under BHC poverty measures. This may reduce the cost to the government of meeting its child poverty targets because a given percentage fall in poverty will require a smaller number of children to move out of poverty. In addition, in certain years, the biggest proportional falls in relative child poverty have been on the targeted BHC measure, whilst the biggest proportional increases in poverty over the 1980s were on the AHC measure.

[50] See Department for Work and Pensions (2003c), for example. We discussed the advantages and disadvantages of measuring income before housing costs and after housing costs in Section 1.1.

[51] For example, see HM Treasury (2003 and 2001, p. 87, box 5.3) and Department for Work and Pensions (2000, pp. 4, 26 and 37).

[52] Ensuring comparability with other EU countries' poverty measures (see Department for Work and Pensions (2003b, p. 10)) requires only that a BHC measure is included, but does not require that an AHC measure is excluded.

A new equivalence scale

As described in Chapter 1, income is equivalised to take account of household size and composition. The new poverty measure will use the Modified OECD equivalence scale to do this rather than the McClements scale which is employed in HBAI and elsewhere in this Commentary. This switch reflects a widespread view that McClements does not give sufficient weight to the costs of very young children relative to the costs of older children.[53] The Modified OECD scale, in contrast to the McClements scale, weights all children under 14 equally, and weights children 14 and over the same as additional other adults in the household (see Table 4.1).

Table 4.1. The McClements and Modified OECD equivalence scales compared

Equivalence scale (BHC)	Modified OECD rescaled to couple without children = 1	McClements (couple without children = 1)
First adult (head)	0.67	0.61
Spouse of head	0.33	0.39
Other second adult	0.33	0.46
Third adult	0.33	0.42
Subsequent adults (each)	0.33	0.36
Each dependant aged:		
0–1	0.20	0.09
2–4	0.20	0.18
5–7	0.20	0.21
8–10	0.20	0.23
11–12	0.20	0.25
13	0.20	0.27
14–15	0.33	0.27
16+	0.33	0.36

Note: There is a different McClements scale when incomes are measured after housing costs. For details on this, see Department for Work and Pensions (2004, appendix 2).

The main effect of the change is that for a given level of income, households containing children under 5 or aged 14 or 15 will appear worse off, and those with children between 5 and 13 will appear better off. Single individuals and individuals in lone-parent households will also appear worse off under the new scale, because, in the McClements scale, a single person needs 61 per cent of the income of a childless couple to achieve the same standard of living as the couple, compared with 67 per cent under the Modified OECD scale.[54] For example, the McClements scale implies that a lone parent with a baby requires 70 per cent of the resources of a couple without children to be as well off; the Modified OECD scale suggests that 87 per cent would be required.

The effects of this change on the number and the composition of those who are poor are shown in Section 4.3.

[53] See, for example, Gordon et al. (2000).

[54] Those with more adults than just the head or head and spouse will appear better off.

4.2.2 A material deprivation measure

Perhaps the biggest change introduced in the new poverty measure is the addition of an indicator of 'material deprivation' to supplement the more traditional 'pure' income measures of poverty. It has not yet been set out exactly how this indicator will be constructed, but the underlying principle will be to count children as poor under this indicator if they live in households that are both low-income (as defined by less than 70 per cent of the median) *and* lacking some critical number of 'commonly perceived' necessities (both goods and services). This follows the approach taken in Ireland, where such a measure has been officially adopted.[55]

Material deprivation indicators are supposed to address a number of shortcomings of pure income measures. By focusing more directly on what could be thought of as an outcome of being poor, they avoid problems relating to what a given income will buy (for example, if there are wide differences in prices across regions not reflected in price indices, or differences in needs across families not reflected in the equivalence scale). Material deprivation indicators may suffer less from measurement error than income measures, and since goods tend to be acquired over a period of time, they can capture the persistence of poverty more adequately. The public may also more easily identify with a material deprivation indicator than measures based on arbitrary fractions of the average income. They are, however, not without their own problems:

- These measures are difficult to track over time or compare internationally (Department for Work and Pensions, 2003b, p. 15). Given that the new poverty measure has been designed to track progress in child poverty over time, it will be important to design the new indicator so that it can capture such changes in a meaningful and transparent way. In particular, it will be important to scrutinise how the set of necessities is updated over time.

- Material deprivation indicators depend on choosing a fixed number of 'necessities' that families must lack in order to be counted as poor. The resulting picture of poverty can be very sensitive to which list of necessities families are asked about, and the exact number of items a family must lack to be deemed poor. This can make such measures as arbitrary as the pure income measures based on fractions of the median.

- In practice, many such measures depend on self-reported inability to afford a particular item, which is a very subjective concept for determining whether or not an individual is poor, and may vary as much by type of individual as by material circumstances. In contrast, income is an objective concept even if it is difficult to measure accurately.

- People who lack necessities often own many non-necessities (see McKay (forthcoming)). This suggests that whether or not a family lacks certain items is determined by the preferences of the family as well as by their budget constraints. It is therefore not clear what an 'enforced' lack of such items is really picking up.

[55] See Nolan (2003).

In general, economists would point to measures of consumption as providing a more complete and accurate view of material circumstances than any deprivation measure. This is because overall consumption gives a much fuller measure of material intake than the lack of specific items, and avoids the need to pick a list of necessities that are inevitably preferred and valued differently by different people.[56] If on the other hand, one is interested in broader definitions of poverty, then income, consumption and deprivation measures alike provide only a very partial view, and may only be weakly related to outcomes of genuine importance; these could include measures of well-being such as health, emotional well-being and future potential well-being as captured in educational attainment.

4.3 Who is poor under the new measure?

As we said before, it is difficult to use the new poverty measure to determine how many children are poor at a given point in time, since each of its three indicators gives a different answer. By looking at each indicator separately, however, we can see that the adoption of the new measure has some important implications for the number of children who will be considered in poverty and for the composition of those who are poor.

4.3.1 The new relative poverty indicator

In Great Britain, 2.9 million children, or 22.9 per cent of all children, are counted as poor under the new relative low-income indicator in 2002/03. This is set out in Table 4.2, which also describes the characteristics of children who are poor on this indicator. The first column of figures gives a breakdown of poor children showing the percentage with different characteristics (for example, 43.6 per cent of poor children belong to lone-parent families). The column of poverty rates takes an alternative perspective, giving the proportion of children with given characteristics who are poor (for example, 40.2 per cent of children in lone-parent families are poor). This allows us to see which types of children are over- and under-represented relative to the population as a whole. If no types are over- or under-represented, all poverty rates will equal the poverty rate for the child population as a whole (22.9 per cent). The last column gives the size of each group as a percentage of the child population as a whole.

From the table, it can be seen that poor children tend to belong to larger families, families in which no one works and families living in socially rented accommodation. Particularly striking (though not surprising) is that 54.6 per cent of poor children belong to workless families – this is almost two-thirds of all the children in workless families. The proportion of poor children living in lone-parent families is 43.6 per cent, a high proportion given that more than three times as many children live in couple families as in lone-parent families (and this is reflected by the 40.2 per cent poverty rate for children from lone-parent families). Families where the youngest child is aged 1 or under are also over-represented (the poverty rate is 28.3 per cent), and the poverty rate declines as the age band of the youngest child rises.

[56] Although different preferences for savings are embodied in consumption measures.

Table 4.2. Child poverty by family characteristics under the new relative poverty indicator, 2002/03

	Composition of 'poor' children	Poverty rates	Composition of all children
Total number of 'poor' children		2.9m (22.9%)	
Type of family:			
Lone-parent families	43.6%	40.2%	24.8%
Couple families	56.4%	17.1%	75.2%
Families where no one works	54.6%	63.8%	19.6%
Families where one person works	34.9%	22.2%	35.9%
Families where two people work	10.5%	5.4%	44.5%
Homeowner	39.6%	13.3%	68.0%
Private renter	3.3%	28.6%	2.6%
Social renter	51.5%	48.5%	24.2%
Other/unknown	5.7%	25.3%	5.1%
One child	18.2%	18.4%	22.7%
Two children	36.1%	18.4%	44.8%
Three or more children	45.6%	32.1%	32.5%
Youngest child aged 0–1	21.3%	28.3%	17.2%
Youngest child aged 2–7	43.1%	23.8%	41.5%
Youngest child aged 8–13	25.7%	19.8%	29.7%
Youngest child aged 14+	9.8%	19.4%	11.6%

Source: Authors' calculations using Family Resources Survey, 2002/03.

The number of children in relative poverty compared with the old PSA targets

Progress towards the government's objective to reduce child poverty by a quarter by 2004/05 is assessed using the before- and after-housing-costs measures set down in the Public Service Agreement (PSA), described in Section 3.1.2. Objectives for 2010 and 2020, however, will be judged against the new child poverty measure (see Chapter 5). How does the number of poor children under the new relative low-income indicator compare with numbers under the old PSA AHC and BHC measures? Significantly fewer children are poor under the new relative low-income indicator than under the previously favoured PSA AHC measure, but more children are now poor than under the PSA BHC measure. Table 4.3 presents the figures.

The main reason for this drop in the number of poor children compared with the PSA target measure is the abandonment of the AHC income definition. In Chapter 3, we saw

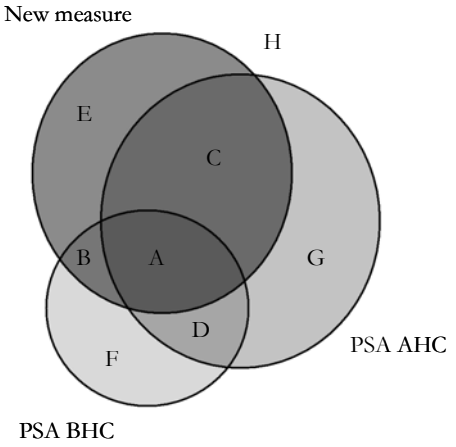
Table 4.3. Child poverty rates under new and old relative poverty indicators

Poverty measure	Number of 'poor' children	Poverty rate
New relative low-income indicator	2.9m	22.9%
Old PSA AHC measure	3.6m	28.5%
Old PSA BHC measure	2.6m	20.7%

that, for most groups, poverty measured after housing costs is greater than poverty before housing costs, though the notable exception is pensioners, where we have seen relative poverty rates before and after housing costs converge in recent years (see Table 3.4). The change to the Modified OECD equivalence scale, by contrast, has the effect of increasing the number of children who are in poverty, although it is important to remember that this is not a necessary result of the change of equivalence scale but occurs because of the concentration of households of different size and composition in different parts of the income distribution (both the middle and bottom of the scale).

Figure 4.1 illustrates the degree of overlap between the three relative poverty measures. The Venn diagram is not drawn to scale, but precise figures are set out in the table alongside. 29.9 per cent of children (3.8 million children) are poor by at least one of the three measures (all shaded areas on the Venn diagram), and 19.3 per cent (2.4 million children) are poor by all three (area A). Very few children (0.1 million, or 0.6 per cent) are counted as poor by the new relative measure but not by either of the old measures (area E). In contrast, many more children (0.9 million, or 6.9 per cent) are counted as poor by the PSA AHC measure but not by the new measure (D + G).

Figure 4.1. Overlap between new and old relative poverty measures



	Poor according to:	Number of children	Percentage of children
A	All measures	2.4m	19.3
B	New and PSA BHC only	0.1m	0.6
C	New and PSA AHC only	0.3m	2.4
D	Both PSA measures only	0.1m	0.8
E	New only	0.1m	0.6
F	PSA BHC only	<0.1m	0.1
G	PSA AHC only	0.8m	6.1
H	Not poor by any measure	8.9m	70.1
	Total	12.7m	100.0

Note: Venn diagram has not been drawn to scale.
Source: Authors' calculations using Family Resources Survey, 2002/03.

Which children are no longer poor, and which are the newly poor?

Who are the missing 900,000 children – those who were counted as poor under the headline PSA AHC measure but who will no longer be counted as poor under the new official measure (areas D and G on the Venn diagram in Figure 4.1)?[57] Children who are no longer counted as poor tend, not surprisingly, to be in households with large housing costs relative to their income (see Table 4.4). Although the income coming into the household (shown by unequivalised BHC income) is relatively high, housing costs are also much higher, averaging £106 for children who are no longer counted as poor

[57] These represent around one-quarter of all children who were poor under the PSA AHC measure (areas D and G compared with D, G, A and C on the Venn diagram).

compared with £57 for those who are still poor. These households are disproportionately in the south and east of England, are less likely to be in social housing (particularly local authority rented) and less likely to be in workless households, but are more likely to be in lone-parent families compared with those who are poor under both measures.

Table 4.4. Who are the 900,000 children 'no longer poor'?

	Poor AHC *and* Poor new measure (A + C)	Poor AHC, *not* Poor new measure (D + G)
Total number of children	2.7m	0.9m
BHC income (unequivalised)	£223	£303
Housing costs (unequivalised)	£57	£106
Housing costs (% of BHC income)	25.6%	35.0%
Number of rooms	5.47	5.39
Housing costs per room	£10.48	£19.62
Percentage in southern England[a]	37.0%	59.7%
Percentage in social housing	52.6%	45.1%
Percentage in workless households	55.8%	44.4%
Percentage in lone-parent households	43.8%	50.3%
Number of children in household	2.6	2.3
Average age of children in household	8.71	8.16

[a] This includes London, the South-East, East Anglia and the South-West.

Source: Authors' calculations using Family Resources Survey, 2002/03.

One important question, which we cannot fully address with our data, is whether the higher housing costs amongst this group reflect a choice made by these families so that they can enjoy a higher standard of living, or whether they represent an unavoidable call on resources. Table 4.4 shows that the 900,000 children who are no longer poor tend to live in houses with fewer rooms, though of course there are many more dimensions to housing quality than this.

A much smaller group of children who were poor under the PSA BHC measure will no longer be counted as poor (around 100,000 children, areas D and F), and, again, very few children will be poor under the new measure but not under either of the old measures (also around 100,000 children, area E). These changes are driven simply by the change in the equivalence scale.

To conclude, in order to understand what these differences in measurement mean for government policy, Table C.1 in Appendix C sets out the composition of children counted as being poor under the new relative poverty indicator, and how this compares with the composition under the PSA target measures. Table C.2 compares poverty rates across various family types according to the old and new measures. These tables show that the group of children who will be the subject of future policy targets – who are in poverty under the new official relative poverty indicator – will now be slightly more concentrated amongst workless households, in areas of Britain outside of the south and east of England, and less predominantly in private rented housing than under the previous headline AHC-based measure. Relative to the PSA BHC measure, the new

measure includes more children in lone-parent families, more children in social rented accommodation and more young children.

4.3.2 The number of poor children under the absolute low-income and material deprivation indicators

The government's justification for introducing material deprivation and absolute low-income indicators is that they capture important dimensions of poverty that are obscured by the relative low-income indicator alone. With this in mind, it is interesting to compare the size and composition of the groups of children counted as poor by each new indicator.

Taking the absolute poverty indicator first, 13.9 per cent of children, or around 1 in 7 (1.8 million), are poor according to the absolute low-income indicator, compared with 22.9 per cent (2.9 million children) under the relative low-income indicator. This group – the absolutely poor – is in fact just a subset of the group of children who are poor on the relative indicator, and represents roughly the poorest three-fifths of the relatively poor.[58]

We do not yet know how many children are poor on the material deprivation indicator, since the government has not yet spelled out how it will be constructed. At most, 33.9 per cent (4.3 million children) are poor under the material deprivation indicator, since this is the number of children living in households below 70 per cent of median equivalised income. But this is a substantial overestimate, since only a proportion of this group will be materially deprived. We do not know of any published figures that give an estimate for the number of children who are *both* materially deprived and have incomes below 70 per cent of median BHC income. However, a number of estimates do exist for the number of children who are both materially deprived and have income below 60 per cent of the median. For example, Gordon et al. (2000) find that in 1999 around 55 per cent of children living in households below 60 per cent of the median income[59] were lacking *one* or more items considered to be necessities because their parents could not afford them, and that around 35 per cent were lacking *two* or more items. If the same proportions of the children below 70 per cent of the median (i.e. 55 per cent and 35 per cent) are also materially deprived today, then this would mean that around 19 per cent of all children are poor on the combined material deprivation and low-income indicator, where material deprivation is defined as enforced lack of one item or more, and around 12 per cent would be poor on this indicator if material deprivation is defined as a lack of two or more items. In reality, a lower proportion of those on incomes below 70 per cent of the median may be materially deprived compared with those below 60 per cent, and levels of deprivation may also have fallen since 1999 – in which case poverty rates would be lower. The definitions of material deprivation might also differ substantially, in which case these ballpark estimates may also not be very accurate.

[58] This is because the only difference between the two measures is the level of the poverty line; as we saw in Box 4.1, the absolute line in 2002/03 was approximately £20 per week lower than the relative line for a lone parent with one child (this amount varies by family size and type). Another way of looking at the same information is that the absolute poverty threshold in 2002/03 stood at approximately 53 per cent of the contemporary median, and so the number of children below the absolute threshold is also the number of children with incomes below 53 per cent of the 2002/03 median.

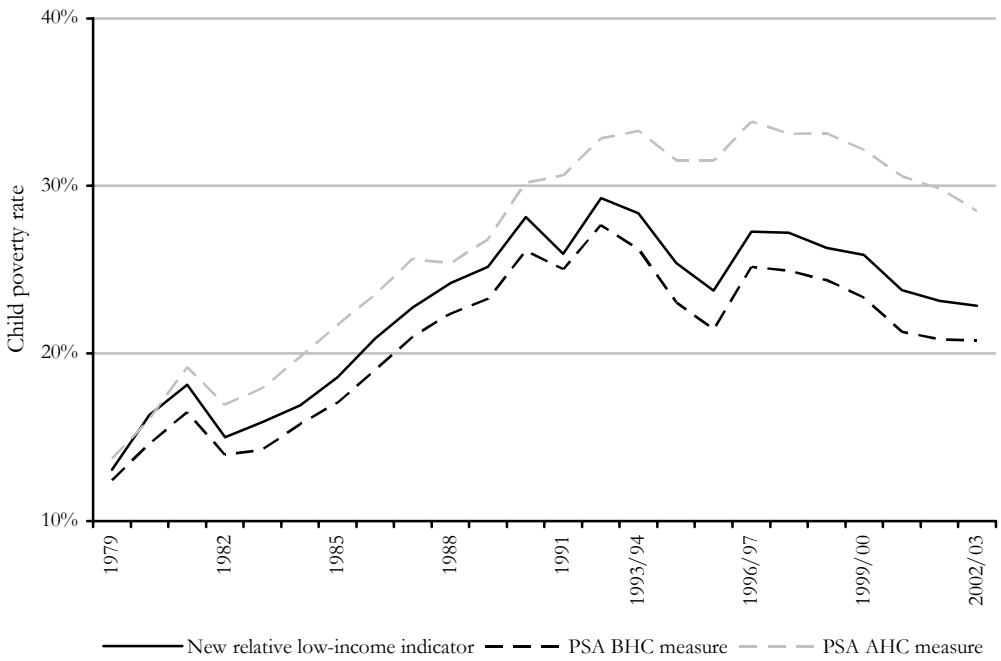
[59] Where income is equivalised and measured before housing costs.

4.4 What are the trends in poverty under the new measure?

4.4.1 Trends in the new relative low-income indicator

Although the change to the new relative poverty indicator will have the effect of reducing the headline number of children who are poor, the trends over time in the measure are reasonably similar to those of the old target measures (see Figure 4.2). One important difference is that the rise in relative poverty over the 1980s is not as pronounced on the new measure as on the former headline AHC measure, whilst the fall in the early 1990s is bigger on the new measure. The fall in poverty since 1996/97, though, has been similar in percentage terms across all three measures (perhaps slightly greater for the BHC measure), implying that by choosing the new measure, the government is not already closer to halving relative child poverty by 2010 (relative to 1998/99 or 2000/01) or eliminating it by 2020. That said, given a smaller number of children are poor under the new measure than under the old PSA AHC measure, fewer children have to be moved out of poverty for the government's targets to be met (see Chapter 5). This may make achieving the targets less expensive.

Figure 4.2. Trends in child poverty under alternative income measures



Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

4.4.2 Trends in absolute low-income and material deprivation indicators

Since 1979, child poverty under the new absolute low-income indicator has more than halved. This is not surprising since absolute poverty falls so long as the incomes of children just below the poverty line are rising faster than the rate of inflation. Only during the recessions of the early 1980s and early 1990s has absolute poverty risen. Absolute poverty measures do not generally provide a good indication of changes in poverty over long periods of time. This is illustrated by the fact that 70 per cent of the

child population were poor in the early 1960s according to the new absolute measure. Unless the measure is rebased, absolute poverty will almost certainly have fallen to such a low level by 2010 that measuring year-on-year changes will be statistically unreliable (particularly since there is concern about the accuracy with which incomes at the bottom of the distribution are measured). Nevertheless, over the short term, it may be useful to monitor trends in both relative and absolute poverty because they can behave quite differently over the economic cycle, particularly during recessions, when absolute poverty can rise while relative poverty falls.[60]

Without knowing how the material deprivation measure will be constructed, it is difficult to be certain about its path over time. That said, in the shorter term (if the group of commonly perceived necessities is not updated annually), its behaviour is likely to be similar to that of the absolute measure. This is because we would expect some of any rise in real income (which would cause absolute poverty to fall) to be spent on the commonly perceived necessities, causing material deprivation to fall. This is certainly the experience in Ireland, where a combined material deprivation and low-income indicator was adopted as part of the National Anti-Poverty Strategy, introduced in 1997. By 2000, the proportion of the Irish population (not just children) poor under this measure had fallen to less than a fifth of its 1994 level, and to such a low level that concerns have been raised about its reliability as a measure of poverty.[61] In the longer term, it seems likely that the group of necessities will be updated in some way. The behaviour of the indicator will depend very heavily on how this is done.

4.5 Conclusions

- Moving to a new measure of poverty will not provide us with a definitive number of children who are poor, but will give us a new framework for assessing how child poverty is changing over time.

- The new relative poverty indicator shows almost 1 million fewer children in poverty than the previously targeted after-housing-costs measure. This may make achieving future targets less expensive. It may also move the government's poverty reduction efforts away from families with large housing costs relative to their income, and more towards workless families, families in social housing and families living outside of the south and east of England.

- Children who are poor under the new absolute poverty indicator are a subset – the poorest two-thirds – of those who are relatively poor. Over the longer term, achieving reductions in absolute poverty will tend to prove far less challenging than reducing relative poverty, as the poverty line remains fixed in real terms over time. However, during deep recessions, absolute poverty may rise even when relative poverty is falling.

[60] Over the last 40 years, this has occurred three times – namely, between 1963 and 1964, 1974 and 1975, and 1981 and 1982 – when median income has fallen faster than the falls in income at the lower end of the distribution of income.

[61] See, for example, Nolan (2003) and Whelan et al. (2003).

- The new material deprivation measure accords well with popular perceptions of poverty and may address some shortcomings of pure income measures. However, its focus is still a fairly narrow one, based solely on material circumstances, and its measurement over time can be problematic.

5. Poverty targets

5.1 What will future child poverty targets look like and what needs to be done to meet them?

The government has long spoken of its aim to halve child poverty by 2010, as it moves towards abolishing it by 2020. In 2002, the consultation document on the new measure of child poverty opened by saying that

> In March 1999, the Prime Minister announced the Government's commitment to eradicate child poverty within a generation. As we move towards this goal we want to be sure that we are measuring poverty in a way that helps us to target effective policies and enables the Government to be held to account for progress.[62]

This strongly suggested that the new measure of child poverty would be used to assess progress towards halving and then abolishing child poverty. However, the final document that set out the new measure of child poverty has still not provided an explicit explanation of how the government will be assessing progress towards its long-term aims, although it did say that

> The detail of the PSA [Public Service Agreements] that will achieve this [halving child poverty by 2010 on the way to eradication in 2020] will be set as part of successive Spending Reviews. This will include publication of technical details of any new targets.[63]

A further complication is that the government's new measure of child poverty has three indicators. The government has said that it will consider that 'poverty is falling when all three indicators are moving in the right direction';[64] but, just as it is impossible to use three indicators to say unambiguously what the level of child poverty is, it is equally difficult conceptually to halve child poverty using this measure. However, the same document that announced the new measure of child poverty at the end of 2003 contained enough hints for us to be able to suggest what future child poverty targets might look like.

A child poverty target for 2020

The government's long-term aim is very clear: there should be no children in poverty in Britain by 2020. More than four years after that aim was set out, the government has finally suggested how we might know when we have achieved it. It has said that achieving a zero rate of child poverty using the current HBAI methodology is impossible, because surveys 'always classify as poor some with high living standards but transitory low incomes'.[65] We agree with this: although it might sound like a

[62] Department for Work and Pensions, 2002, p. 5.

[63] Department for Work and Pensions, 2003b, para. 72. The first of these spending reviews is later this year, although data to measure the material deprivation indicator will not be available until the 2006 Spending Review, should Labour still be in government then.

[64] Department for Work and Pensions, 2003b.

[65] Department for Work and Pensions, 2003b, para. 70.

contradiction, it is plausible to say that child poverty has been abolished even if the HBAI survey were recording some children to be in households below a relative-income poverty line.

The government has also said that

> success in eradicating child poverty could, then, be interpreted as having a material deprivation child poverty rate that approached zero and being amongst the best in Europe on relative low incomes.[66]

This is clearly a matter of opinion and political judgement. In 2001, three countries in Europe (Denmark, Finland and Sweden) had relative child poverty rates of 10 per cent or less.[67] It could be argued that achieving a child poverty rate of between 5 and 10 per cent in the UK falls some way short of abolishing child poverty: it is not clear, for example, whether Denmark, Finland and Sweden consider that they have abolished child poverty (see Box 5.1). On the other hand, reducing child poverty in Britain to these levels would be a remarkable achievement judged by both current international standards and past British evidence. So a reasonable guess is that the target for 2020 could be:

1. To reduce the relative low-income measure of child poverty below 10 per cent, ideally to 5 per cent, from its current level of 22.9 per cent. There are currently 12.7 million children in Britain, so a rate of 10 per cent would imply 1,270,000 children were in poverty, if the number of children were to remain unchanged.[68]

2. To reduce the material deprivation child poverty rate to a number close to zero, at least below 5 per cent. The current rate is not known, because the data required to estimate it have not yet been collected. The first estimate of the material deprivation child poverty rate will be available in 2006, and will use data collected in 2004/05.

There are some problems with such an approach:

- It is not clear whether the government intends Britain to have child poverty rates in 2020 that are amongst the current best in Europe (i.e. between 5 and 10 per cent) or that are amongst the best in Europe in 2020. It would seem a little odd if the government's aspiration for child poverty rates in Britain were to become less demanding because of a change in political preferences in other European countries that led them to have higher child poverty rates.

- As Chapter 4 points out, the usefulness of the material deprivation indicator will depend upon how and how often the group of necessities is updated.

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[66] Department for Work and Pensions, 2003b, para. 71. The document does not say precisely how we would assess whether Britain was 'amongst the best in Europe', although it gives suggestions.

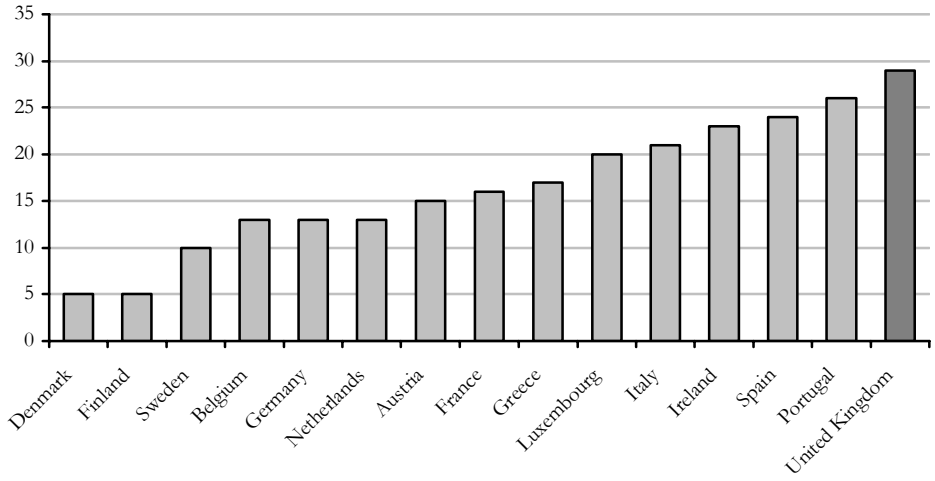
[67] Measured by the first of the government's new child poverty indicators – the proportion of children in households with less than 60 per cent of median income measured BHC using the Modified OECD equivalence scale. Figures come from Department for Work and Pensions (2003b, p. 11).

[68] To ensure that progress towards the target is not obscured by changes in the underlying population, it would be more sensible if such a long-term target were expressed in terms of the rate of poverty, rather than the number of children in poverty.

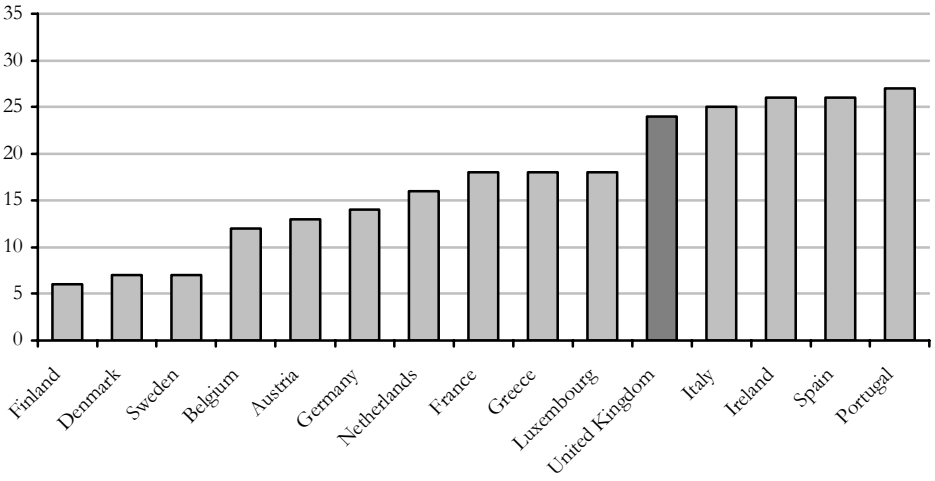
Box 5.1. European comparisons of child poverty

The graphs below show rates of child poverty in the EU. They show the percentage of children aged 0–15 who live in households whose BHC income is below 60 per cent of the median. The large reduction in relative child poverty in the UK since 1998 is well reflected in its ranking amongst the EU15 countries. In 1998, it was ranked worst, with almost 30 per cent of children in poverty on this measure, compared with just 5 per cent in Denmark and Finland. By 2001, the proportion of children in poverty in the UK fell by five percentage points, with the UK now ranked fifth-worst amongst the EU15 countries. However, it should be noted that as of 2001, there are only very small differences between the five countries that are ranked worst on child poverty. Furthermore, the difference between the fifth-worst (the UK) and sixth-worst (Luxembourg) is large (six percentage points).

European child poverty compared, 1998



European child poverty compared, 2001



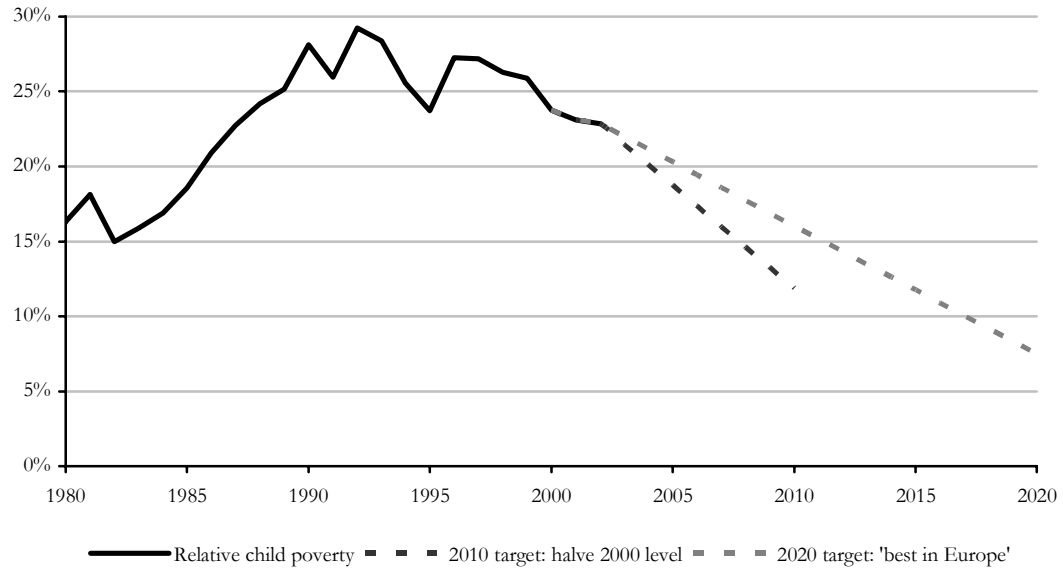
Source: European Community Household Panel.

A child poverty target for 2010

Having decided in 1999 that it sought to abolish child poverty by 2020, in 2000 the government set a goal of halving child poverty by 2010. There are a couple of ways that this could be interpreted:[69]

- The government could set a target for 2010 where each of its three new indicators of child poverty was no greater than half its 2000 level by 2010.[70] This would imply a relative child poverty rate of 11.9 per cent and an absolute child poverty rate of 9.6 per cent. The material deprivation child poverty rate will not be available until 2004/05, and the government might consider that halving that measure within six years is too taxing; a reduction of a third might be appropriate.
- Alternatively, the government could set a target for 2010 where it aims to halve the distance between where it was in 2000 and where it would like to be in 2020. This is less demanding on relative child poverty: it would imply a relative child poverty target of 16 per cent in 2010. Given that the government's long-term aim is to have a material deprivation rate of zero, a reduction of a third in the material deprivation rate estimated for 2004/05 would also be appropriate for this formulation of the 2010 target. It is not clear what this formulation would imply for the absolute child poverty measure, although, as we argued earlier, counting the number of children

Figure 5.1. Possible paths of relative child poverty to future targets



Note: Data from 1993 onwards are for financial years, i.e. 1993/94 etc.

[69] These guesses are supported by Budget 2004, which said that 'Applying the new measure, the Government will continue to judge progress towards halving child poverty by 2010 against relative low income alongside the new measures on material deprivation and absolute low income' (HM Treasury, 2004, para. 5.9).

[70] An alternative choice for the baseline year is 1998/99, which is the base year from which the existing PSA targets are measured. We have, instead, chosen 2000 as the illustrative base year, because the first mention of the desire to halve child poverty was in late 1999, and said that 'the Government's long-term economic ambition is to halve child poverty by the end of the next decade as the Government moves forward with its commitment to end child poverty in Britain within the next twenty years' (HM Treasury, 1999, para. 5.5).

Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

below the 1998/99 poverty line in 2010 is unlikely to be a useful exercise, unless there is very low income growth over the next six years.

Figure 5.1 shows what these various formulations might imply for the government's desired future rates of relative child poverty, assuming a linear path of child poverty between 2002 and the two target dates. Achieving the target for 2020 would require the number of children in poverty to continue to fall as fast as it has over the past few years, but achieving the more taxing 2010 target (i.e. to halve the 2000 rate by 2010) would require child poverty to fall by more each year than it has in the past few years.

What would be needed to hit these targets?

Forecasting the impact of policy changes on child poverty over the medium to long run is very difficult. This is primarily because the measure of relative child poverty depends upon not just the income levels of low-income families with children, but also the income of the median individual in society. Forecasting the impact of policy changes on future rates of child poverty therefore requires forecasting not only the impact of policy reforms on the incomes of low-income families with children, but also the impact of policy on the income distribution, and, indeed, what the income distribution would have looked like if the reform had not taken place.

Existing research[71] includes examples where researchers have been prepared to forecast the income distribution up to three years (or so) into the future, by assuming that demographics and patterns of work and benefit/tax credit take-up are unchanged, but that incomes and rents grow in line with past trends. But these assumptions become less and less plausible over the medium to long term. Any forecast of the level of child poverty in 2010 will be extremely sensitive to what is assumed about the future shape of the entire income distribution, and the level of uncertainty is likely to be substantial.

Perhaps the only robust approach is to think about what sort of impact future policies would need to have to reduce child poverty further. To maintain child poverty at its current level, for example, the total disposable income (i.e. earnings after income and council tax and National Insurance, plus benefits, plus tax credits) of the parents of those children just above the poverty line would need to rise in line with median income BHC. To reduce child poverty further, not only would the incomes of those parents need to rise in line with median income BHC, but the incomes of the parents of children just below the poverty line would need to rise faster than median income BHC. This is not going to be achieved automatically by the government's policy of increasing the per-child element of the child tax credit in line with growth in average earnings (which is usually similar to growth in median income BHC), because the per-child element of the child tax credit is only a proportion of the disposable incomes of families around the poverty line. Reducing child poverty further requires, therefore, either above-average increases in the earnings of low-income parents, or substantial year-on-year increases in the total state support to low-income families, including child benefit, the family element of the child tax credit, the working tax credit and income support, all of which in real terms have either been fixed historically (income support, child benefit) or been in

[71] See, for example, Brewer (2004) and Sutherland, Sefton and Piachaud (2003).

decline since 2003 (working tax credit, family element of the child tax credit). In addition, some of the future parents in 2020 are still children now, and so education and other non-financial interventions may also play a role.

5.2 A target for pensioner poverty?

The government often speaks of its desire to reduce pensioner poverty and to ensure that pensioners share in the nation's prosperity. Although reductions in pensioner poverty have been high on the government policy agenda, no specific target for pensioner poverty, as exists for children, has yet been set. Such a target, though, is a possibility for the 2004 Spending Review.

The experience of past child poverty targets suggests that the government may set a target to reduce pensioner poverty by some amount, using the same definitions and methodology as for children. Just as with children, it would be possible to measure pensioner poverty in relative terms, in absolute terms (i.e. with an unchanging poverty line) or as a combination of relative low income and material deprivation, and much of our discussion of these measures in Chapter 4 is also applicable to pensioners. However, there are some issues particular to pensioners that should be considered when thinking about using relative income measures to define targets for pensioner poverty:

- Pensioner incomes are relatively immune to fluctuations in the economic cycle compared with the incomes of working-age adults. This means that pensioner poverty, measured relative to the incomes of the population as a whole, often goes up during periods of economic growth and down during recessions. The recent period of economic growth is a notable exception (see Goodman, Myck and Shephard (2003)).

- Because of the higher rates for pensioners in income support and its successors such as the pension credit, pensioner poverty, where it exists, has tended to be relatively shallow but persistent.

- Because pensioners have relatively low housing costs, which are falling relative to those of non-pensioners, there has been a marked difference between trends in pensioner poverty measured AHC and BHC in the past decade which does not exist for other groups.

- The equivalence scale used in HBAI makes no allowance for the fact that old age or bad health may increase a household's needs.[72] For example, if a pensioner household experiences a decline in health and thereby becomes eligible to attendance allowance to help them pay for someone to help care for them, then the current HBAI methodology will consider them to have become better off.

None of these is a reason not to set a target for pensioner poverty in terms of relative low incomes, but they all suggest that it is not necessarily appropriate to set the same sort of poverty targets for pensioners as for children.

[72] This is also true of the Modified OECD scale.

However, it could be argued that the government does not need to have a target for pensioner poverty defined in terms of relative low income. One reason for this is that it already has targets for the number of pensioners who should be receiving the pension credit in 2006 (which is effectively a take-up-rate target[73]) and a commitment to increase the pension credit in line with average earnings until the end of this parliament. Because pensioners have limited opportunities to increase their own incomes, and because they are entitled to generous levels of state support (compared with non-pensioners), the amount of pensioner poverty depends to a very large extent on the generosity of the safety-net benefits for pensioners and on whether pensioners actually claim them.[74] So if the pension credit were to continue to increase every year in line with average earnings (not just for the rest of this parliament), and if the take-up rate of the pension credit were to rise gradually each year, then pensioner poverty measured in terms of relative low incomes should remain stable or even decline; a separate target for pensioner poverty may be unnecessary.

Another fact that is relevant when considering whether a pensioner poverty target is needed is that, on the AHC measure of poverty at least, the poverty rate for pensioners has been falling for several years and is now lower than that for non-pensioners. This is a completely different position from the one that existed for child poverty in the late 1990s, when children were much more likely to be poor than adults and child poverty had been on a long upward trend since the 1970s. This suggests that, unless the government has strong reasons for wanting poverty amongst pensioners to be a lot lower than, say, poverty amongst the over-50s, any pensioner poverty target might be for only a small decline.

[73] The current target for 2006, for example, implies a take-up rate of 72 per cent: see House of Commons (2003).

[74] Over the longer term, the level of pensioner poverty also depends on how much people save for retirement.

6. Conclusions

This Commentary has shown that since the mid-1990s, Britain has experienced an unusual combination of slightly rising income inequality and falling relative poverty. This combination has arisen because of two trends: over the majority of the income distribution, growth in income has been slightly stronger amongst poorer individuals than for those located further up the income scale; but in the richest and poorest decile groups, the pattern is reversed, thereby increasing inequality. We have shown that this pattern of change is quite different from that of the 1980s, when incomes widened across the whole population and relative poverty rates grew rapidly.

The government has played an important role in making this unusual combination come about. Our analysis has shown that tax and benefit policy has kept the lid on what would otherwise have been a much bigger growth in inequality. Most notably, increases in means-tested benefits and tax credits directed towards low-income pensioners and families with children mean that some of the largest gains in income have been seen in the third decile of the distribution, which includes many individuals around the poverty line. Increases in employment rates amongst parents have also contributed to this.

Such redistribution, together with employment growth, has put child poverty rates on a firm downward path. It now looks as if the government is on course to meet its existing target to cut relative child poverty by one-quarter by 2004/05. Pensioners have also seen their relative position continue to improve and, as a group, they are no longer any more likely to be poor than non-pensioners, measuring incomes after housing costs.

But not everyone has gained to the same extent. Across the whole population, the incomes of the bottom 15 per cent of the population have, on average, risen more slowly than those of the rest of the population. Perhaps as a result of this, the poverty gap, which measures the depth of poverty amongst those who remain poor, has not become any smaller as poverty rates have declined. The declines in poverty are also limited to the government's favoured groups: relative poverty rates amongst those under pension age who are not parents – a group that includes almost two-fifths of the population – have not decreased, although they remain lower than poverty rates for children.

How much will be achieved by the next set of government poverty targets? Of the three new indicators identified by the government in its new child poverty measure, it is the relative low-income indicator that will prove the most challenging to reduce. But the government will have made life easier for itself by focusing on a measure of relative poverty that classifies fewer children as poor than its previous headline measure.

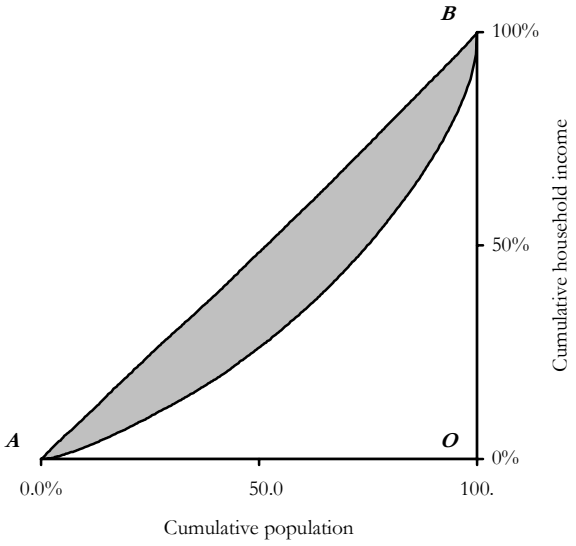
Even under the new definition, achieving further big relative poverty reductions through tax and benefit changes remains a formidable and probably very expensive task, especially if the underlying distribution of incomes continues to become more unequal. Government policy could also try to make this underlying distribution less unequal – for example, through investments in education and other policies aimed at improving the life chances of people from low-income backgrounds. But this too is likely to be expensive and may take a long time to have a measurable impact.

Appendix A. The Gini coefficient

A widely used measure of income inequality is the Gini coefficient. The Gini coefficient benefits from an intuitive geometric interpretation in the form of the Lorenz curve. In Figure A.1, the horizontal axis corresponds to the cumulative percentage of individuals in the population, while the vertical axis gives the cumulative percentage of income. The Lorenz curve then shows the relationship between the percentage of income recipients and the percentage of income actually received. Assume that individuals are placed in ascending order on the basis of their household income, so that the Lorenz curve is below the 45-degree line. Figure A.1 shows the Lorenz curve drawn using actual data from 2002/03. If income were equally distributed across households, then 10 per cent of the population would have exactly 10 per cent of total income, 20 per cent of the population would have 20 per cent of total income, and so on. The line of perfect equality is therefore given by the 45-degree line, AB. Note that the further is the Lorenz curve from the line of perfect equality, the greater is the degree of inequality.

The Gini coefficient is obtained by taking the ratio of the shaded area to the area ABO. When there is perfect equality, the shaded area will have zero measure so that the Gini coefficient will be zero. Conversely, when there is complete inequality (a single household having command over the entire income of the economy), the shaded area will coincide with ABO so that the Gini coefficient will equal 1.

Figure A.1. The Lorenz curve and Gini coefficient, 2002/03



Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey, 2002/03.

Appendix B. Estimating the total cost of tax and benefit changes affecting families with children and pensioners

Table B.1 gives a detailed breakdown of government policies affecting the incomes of pensioners and of families with children. It is produced by adding up the government's estimates of the costs of the various tax and benefit changes; these estimates are all made in advance of the policies being introduced. All of the costs are equivalent full-year costs for the first year that the policy took effect. The table considers only the changes that are limited to families with children or to pensioners; measures that affected the whole population are not included.

The table will not reflect the fact that the real cost of a policy reform may change over time, perhaps because of economic or demographic changes. It is possible to add up the numbers in the table, but this will implicitly assume that the real cost of a policy reform is the same in all future years.

Table B.1. Government policies affecting the incomes of pensioners and of families with children

Effective from:	Policies specific to pensioners (£ million)	Policies specific to families with children (£ million)
April 1998 – March 1999	—	1,391[A]
April 1999 – March 2000	730[a] + 110[b] + 231[c]	1,428[B]
April 2000 – March 2001	231[c] + 892[a]	268[C] + 1,361[D] + 37[E]
April 2001 – March 2002	378[d] + 152[e] + 2,580[f] + 220[g]	2,060[F] + 100[B] + 330[B] + 604[G]
April 2002 – March 2003	175[h] + 65[g] + 55[b]	250[G] + 355[E] + 220[F] + 30[B]
April 2003 – March 2004	230[b] + 2,060[i] + 230[h] + 180[a]	75[E] + 2,400[H] + 350[I]
April 2004 – March 2005	690[j]	851[H]

[a] Winter allowance.

[b] Income-tax-related policies.

[c] Introduction and uprating of MIG.

[d] TV licence subsidy.

[e] MIG (capital limits).

[f] Pensioners' package.

[g] Disability-related policies.

[h] Basic state pension.

[i] Pension credit.

[j] Uprating of the pension credit with earnings (estimate).

[A] Child support package.

[B] Working families' tax credit.

[C] Child benefit.

[D] Increases in working families' tax credit and income support.

[E] Maternity and Sure Start maternity-related payments.

[F] Children's tax credit.

[G] Income support.

[H] Child tax credit.

[I] Child Trust Fund.

Source: HM Treasury, *Financial Statement and Budget Report*, various years; values presented in 2003/04 prices, uprated by the GDP deflator.

Appendix C. New and old child poverty measures compared

Table C.1. The composition of 'poor' children by family type

	'Relative low income'			'Absolute low income'
	New measure	PSA target measure BHC	PSA target measure AHC	New measure
Total number of 'poor' children	2.9m	2.6m	3.6m	1.8m
Percentage of children who are 'poor'	22.9%	20.7%	28.5%	13.9%
Composition by family type:				
Lone-parent families	43.6%	39.0%	45.3%	38.9%
Couple families	56.4%	61.0%	54.7%	61.1%
Families where no one works	54.6%	51.6%	53.0%	55.1%
Families where one person works	34.9%	36.2%	34.9%	34.7%
Families where two people work	10.5%	12.1%	12.1%	10.2%
Homeowner	39.6%	42.9%	35.6%	45.5%
Private renter	3.3%	3.5%	5.8%	3.7%
Social renter	51.5%	48.2%	50.8%	44.8%
Other/unknown	5.7%	5.4%	7.9%	6.0%
One child	18.2%	16.6%	19.9%	20.2%
Two children	36.1%	35.0%	37.7%	35.9%
Three or more children	45.6%	48.4%	42.4%	43.9%
Youngest child aged 0–1	21.3%	21.4%	15.7%	21.3%
Youngest child aged 2–7	43.1%	44.5%	44.8%	40.4%
Youngest child aged 8–13	25.7%	25.1%	29.4%	26.5%
Youngest child aged 14+	9.8%	9.0%	10.2%	11.9%
Northern England[a]	29.8%	29.6%	27.4%	30.1%
Midlands[b]	18.3%	18.2%	17.1%	19.0%
Southern England[c]	36.4%	37.1%	42.5%	35.7%
Wales	6.2%	5.9%	5.2%	5.5%
Scotland	9.2%	9.1%	7.8%	9.7%

[a] Comprises the standard regions North, North-West and Yorkshire.

[b] East Midlands and West Midlands.

[c] London, South-East, East Anglia and South-West.

Table C.2. Child poverty rates by family type

	'Relative low income'			'Absolute low income'
	New measure	PSA target measure BHC	PSA target measure AHC	New measure
Total number of 'poor' children	2.9m	2.6m	3.6m	1.8m
Percentage of children who are 'poor'	22.9%	20.7%	28.5%	13.9%
Composition by family type:				
Lone-parent families	40.2%	32.7%	52.1%	21.8%
Couple families	17.1%	16.8%	20.7%	11.3%
Families where no one works	63.8%	54.7%	77.2%	39.1%
Families where one person works	22.2%	20.9%	27.7%	13.4%
Families where two people work	5.4%	5.7%	7.7%	3.2%
Homeowner	13.3%	13.1%	14.9%	9.3%
Private renter	28.6%	27.7%	63.3%	19.4%
Social renter	48.5%	41.2%	59.7%	25.7%
Other/unknown	25.3%	21.9%	43.6%	16.3%
One child	18.4%	15.2%	25.0%	12.3%
Two children	18.4%	16.2%	24.0%	11.1%
Three or more children	32.1%	30.9%	37.2%	18.8%
Youngest child aged 0–1	28.3%	18.9%	29.5%	17.2%
Youngest child aged 2–7	23.8%	22.4%	32.2%	13.5%
Youngest child aged 8–13	19.8%	20.5%	25.3%	12.4%
Youngest child aged 14+	19.4%	18.2%	21.9%	14.2%
Northern England	26.9%	24.3%	30.9%	16.5%
Midlands	24.8%	22.3%	28.8%	15.6%
Southern England	18.7%	17.3%	27.2%	11.1%
Wales	28.7%	24.6%	29.9%	15.3%
Scotland	25.2%	22.8%	26.6%	16.2%

Note: See notes to Table C.1 for details of which regions fall into each of the broad categories.

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