

# Poverty and Inequality in UK: 2010

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## Preface

The Joseph Rowntree Foundation has supported this project as part of its programme of research and innovative development projects, which it hopes will be of value to policymakers, practitioners and service users. The facts presented and views expressed in this Commentary are, however, those of the authors and not necessarily those of the Foundation. Neither are the views expressed necessarily those of the other individuals or institutions mentioned here, including the Institute for Fiscal Studies, which has no corporate view. Co-funding from the ESRC-funded Centre for the Microeconomic Analysis of Public Policy at IFS (grant number RES-589-28-0001) is also very gratefully acknowledged. Data from the Family Resources Survey were made available by the Department for Work and Pensions, which bears no responsibility for the interpretation of the data in this Commentary. The authors wish to thank their colleague Mike Brewer, whose comments and insight greatly improved this Commentary. Any errors and all views expressed are those of the authors.



# Contents

	<b>Executive summary</b>	<b>1</b>
<b>1.</b>	<b>Introduction</b>	<b>3</b>
<b>2.</b>	<b>Living standards</b>	<b>4</b>
	2.1 The UK income distribution	5
	2.2 Changes in mean and median income	7
	2.3 Family type and economic status	17
	2.4 Regional variation in living standards	18
	2.5 Conclusion	19
<b>3.</b>	<b>Inequality</b>	<b>21</b>
	3.1 Income changes by quintile group	21
	3.2 Income changes by percentile	24
	3.3 Top-income growth and financial markets	28
	3.4 Summary measures of inequality	29
	3.5 Conclusion	32
<b>4.</b>	<b>Poverty</b>	<b>33</b>
	4.1 Poverty in the whole population	35
	4.2 Relative poverty amongst different groups	38
	4.3 Regional trends in poverty	56
	4.4 Absolute poverty	60
	4.5 Conclusion	62
<b>5.</b>	<b>Conclusion</b>	<b>64</b>
	<b>Appendices</b>	
	Appendix A. The Households Below Average Income (HBAI) methodology	66
	Appendix B. Growth in benefits income: comparing HBAI and administrative data	70
	<b>References</b>	<b>71</b>



# Executive summary

## Living standards

- The latest year of HBAI data cover 2008–09, the first full financial year of the recent recession. Despite the significant drop in national income and employment seen during 2008–09, average take-home incomes as measured in HBAI grew slightly in 2008–09, in part due to tax cuts and more generous tax credits. Mean equivalised income in Great Britain grew by about 1.1% in real terms (from £504 to £509) and median income grew by about 0.7% in real terms (from £406 to £409).
- Taking the period from 1996–97 to 2008–09 as a whole, living standards in Great Britain have risen on average by the equivalent of 2.0% per year at the mean and 1.6% at the median. But growth has slowed over that period. Mean incomes grew fastest during Labour’s first term, at 3.1% a year on average, before slowing to 1.7% per year during Labour’s second term and to 1.1% per year over Labour’s third term up to 2008–09. In fact, 2008–09 is the seventh consecutive year of weak growth in average take-home income.
- Employment trends in HBAI largely match the falls observed in official employment statistics, and this alone would have caused mean take-home income to fall. However, the earnings growth recorded in HBAI more than cancels out this effect and leads to positive growth in mean income. The growth in gross earnings seen in HBAI does not match the real-terms fall observed in official gross earnings statistics over this same period.
- HBAI is based on a survey of 25,000 households and is thus subject to uncertainty and sampling error from year to year. One should not put too much emphasis on one year’s worth of data. Future years may show a different pattern for mean incomes, and the positive growth in real income might be a result of mean income being underestimated in the previous year of data.

## Inequality

- Despite the recession, we saw relatively even (albeit modest) growth in incomes across the distribution between 2007–08 and 2008–09, leaving income inequality largely unchanged on most measures.
- However, there is evidence that income growth at the very top of the distribution was low or negative. Given the turmoil in the financial markets in 2008–09, and the historical correlation between top incomes and the performance of the financial sector, this decline in top incomes is perhaps unsurprising.
- Taking the period 1996–97 to 2008–09 as a whole, incomes have grown relatively evenly across the bulk of the income distribution. Considering each of Labour’s three terms individually, however, we see a more complicated picture – with income growth relatively even in Labour’s first term, unambiguously inequality-reducing in Labour’s second term and very much inequality-increasing in Labour’s third term up to 2008–09.
- The Gini coefficient, a commonly-used measure of inequality, has fallen very slightly since 2007–08 but remains near its highest point since our consistent time series began in 1961.



- While we might expect top incomes to begin to recover, tracking the recovery in financial markets that began in 2009, individuals with high incomes will also be affected by changes to the tax and benefit system (including a new, higher top rate of income tax) coming into effect from 2010 onwards.

## Poverty

- Relative poverty was 100,000 lower in 2008–09 than in 2007–08 measured before housing costs (BHC) and it was unchanged measured after housing costs (AHC). Neither change is statistically significant, but the small fall (BHC) is the first fall since 2004–05 and follows three years in a row that relative poverty rose. However, poverty remains statistically significantly higher than in 2004–05.
- In the latest year of data, child poverty fell 100,000 measuring incomes both BHC and AHC. Between 2008–09 and 2010–11, child poverty needs to fall by 1.1 million to meet the previous government's 2010 target of halving child poverty. Documents accompanying the March 2010 Budget confirmed that the previous government had as good as conceded that its child poverty target for 2010 would not be met, a conclusion supported by previous IFS analysis.
- The Child Poverty Act 2010 makes meeting the 2020 target of 'eradicating' child poverty legally binding. Progress will be assessed using four measures, the most-watched of which is likely to be the relative poverty target (a rate of less than 10%, measuring incomes BHC). The new coalition government has yet to set out its strategy, and the policies put forward by the parties before the election were vague and unlikely to be enough to meet the targets. The Act requires that the government of the day publishes its first strategy by 25 March 2011.
- In 2008–09, pensioner poverty fell 200,000 measuring incomes both BHC and AHC. About 30,000 to 40,000 of this fall can be attributed to increases in the rates of the winter fuel payment. Pensioner poverty is now at its lowest level since 1985 (BHC) or 1984 (AHC). Measured AHC, the rate of poverty amongst pensioners is now lower than the rate for any other population group.
- Poverty amongst working-age adults without dependent children is at its highest level since the start of our comparable series in 1961, with rises of 200,000 both AHC and BHC in the latest year of data. This rise was driven largely by an increase in the fraction of such people living in families where no-one works.
- After adjusting for regional differences in the cost of living, relative poverty (using incomes measured BHC) is highest in London and lowest in Scotland. Poverty has fallen the most since the three-year period beginning in 1996–97 in the North East of England and it has risen the most in the West Midlands.
- Looking to future years of HBAI data, falling levels of inflation meant that benefits and tax credits grew in real terms during 2009–10. This would normally act to reduce relative poverty, depending on the relative growth in average incomes and the poverty line. At least part of this real rise is likely to be undone in 2010–11 (even though 1.5% of the expected increase in 2011–12 has been brought forward for a number of benefits), as inflation has started to pick up.

# 1. Introduction

In this Commentary, we assess the changes to average incomes, inequality and poverty that have occurred since 1979, with a particular focus on the changes that have occurred in the latest year of data (2008–09) and since 1996–97. This analysis is based upon the latest figures from the DWP’s Households Below Average Income (HBAI) series, published on 20 May 2010 (Department for Work and Pensions, 2010). The HBAI series takes household income as its measure of living standards, and is derived from the Family Resources Survey, a survey of around 25,000 households in the United Kingdom that asks detailed questions about income from a range of sources. Further details on the methodology of HBAI can be found in Appendix A, but a few key points are worth summarising here:

- It uses a household measure of income, summed across all members living in the same household. A household is not the same as a family; for instance, young adults living together are in the same household but not the same family, which we define here as a single adult or couple and their dependent children.
- Income is rescaled (‘equivalised’) to take into account the fact that households of different sizes and compositions have different needs.
- Income is measured after income tax, employee and self-employed National Insurance contributions, and council tax.
- Income is measured both before housing costs have been deducted (BHC) and after they have been deducted (AHC).

Chapter 2 details the levels and trends in average living standards, while Chapter 3 looks in some detail at the trends in income inequality. Chapter 4 contains our analysis of the trends in the rate of poverty, and focuses in particular on the rates of child and pensioner poverty. Chapter 5 concludes.

## 2. Living standards

### Key findings

- The latest year of HBAI data cover 2008–09, the first full financial year of the recent recession. Despite the significant drop in national income and employment seen during 2008–09, average take-home incomes as measured in HBAI grew slightly in 2008–09, in part due to tax cuts and more generous tax credits. Mean equivalised income in Great Britain grew by about 1.1% in real terms (from £504 to £509) and median income grew by about 0.7% in real terms (from £406 to £409).
- Taking the period from 1996–97 to 2008–09 as a whole, living standards in Great Britain have risen on average by the equivalent of 2.0% per year at the mean and 1.6% at the median. But growth has slowed over that period. Mean incomes grew fastest during Labour’s first term, at 3.1% a year on average, before slowing to 1.7% per year during Labour’s second term and to 1.1% per year over Labour’s third term up to 2008–09. In fact, 2008–09 is the seventh consecutive year of weak growth in average take-home income.
- Employment trends in HBAI largely match the falls observed in official employment statistics, and this alone would have caused mean take-home income to fall. However, the earnings growth recorded in HBAI more than cancels out this effect and leads to positive growth in mean income. The growth in gross earnings seen in HBAI does not match the real-terms fall observed in official gross earnings statistics over this same period.
- HBAI is based on a survey of 25,000 households and is thus subject to uncertainty and sampling error from year to year. One should not put too much emphasis on one year’s worth of data. Future years may show a different pattern for mean incomes, and the positive growth in real income might be a result of mean income being underestimated in the previous year of data.

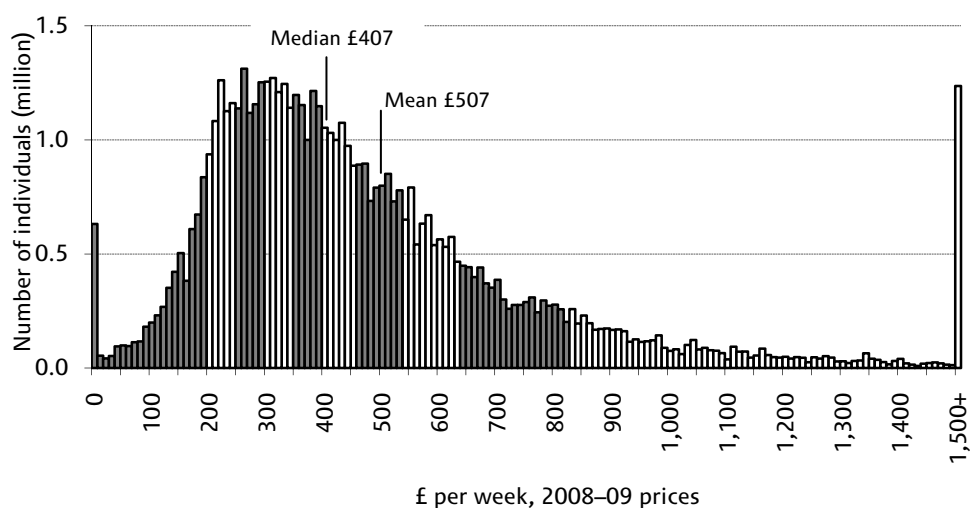
The UK has recently emerged from probably its deepest recession since the 1930s, with national income falling by about 6% in real terms from its peak in the first quarter of 2008 to its low point in the third quarter of 2009. In this chapter, we discuss how average incomes have changed in the latest year of HBAI data, 2008–09, the first full financial year of the recent recession. We also discuss how average incomes have evolved in the recent past, paying particular attention to changes since 1996–97.

All monetary values in this chapter are expressed in average 2008–09 prices, and so all the differences we refer to are unaffected by inflation. Since all incomes have been ‘equivalised’ (see Appendix A), all income amounts are expressed as the equivalent income for a couple with no children. Most of the analysis is presented on a GB basis, to allow consistent comparisons over long periods of time. The only income figures presented on a UK basis in this chapter and the one that follows are those surrounding Figure 2.1, which presents some facts about the UK income distribution in 2008–09. This chapter and Chapter 3 focus on income before housing costs have been deducted.

## 2.1 The UK income distribution

Figure 2.1 shows the UK income distribution in 2008–09. The graph shows the number of people living in households with different income levels, grouped into £10 income bands. The height of the bars represents the number of people in each income band. Mean income in the UK in 2008–09 was £507 per week (equivalised to the level for a couple with no children), and median income was £100 lower at £407. As can be seen, the distribution is highly skewed, with 65% of individuals having household incomes below the national average. Furthermore, the final bar of the graph shows that more than 1.2 million individuals, out of a private household population of approximately 60 million individuals, have incomes above £1,500 a week. The graph also shows that there are more than 600,000 individuals whose income is between zero and £10 a week (in the HBAI data, negative incomes are set to zero). These zero or negative incomes could be due to factors such as large self-employment losses or because of various outgoings (such as council tax, student loan repayments or maintenance payments) that are deducted when calculating net income.<sup>1</sup>

Figure 2.1. The income distribution in 2008–09 (UK)



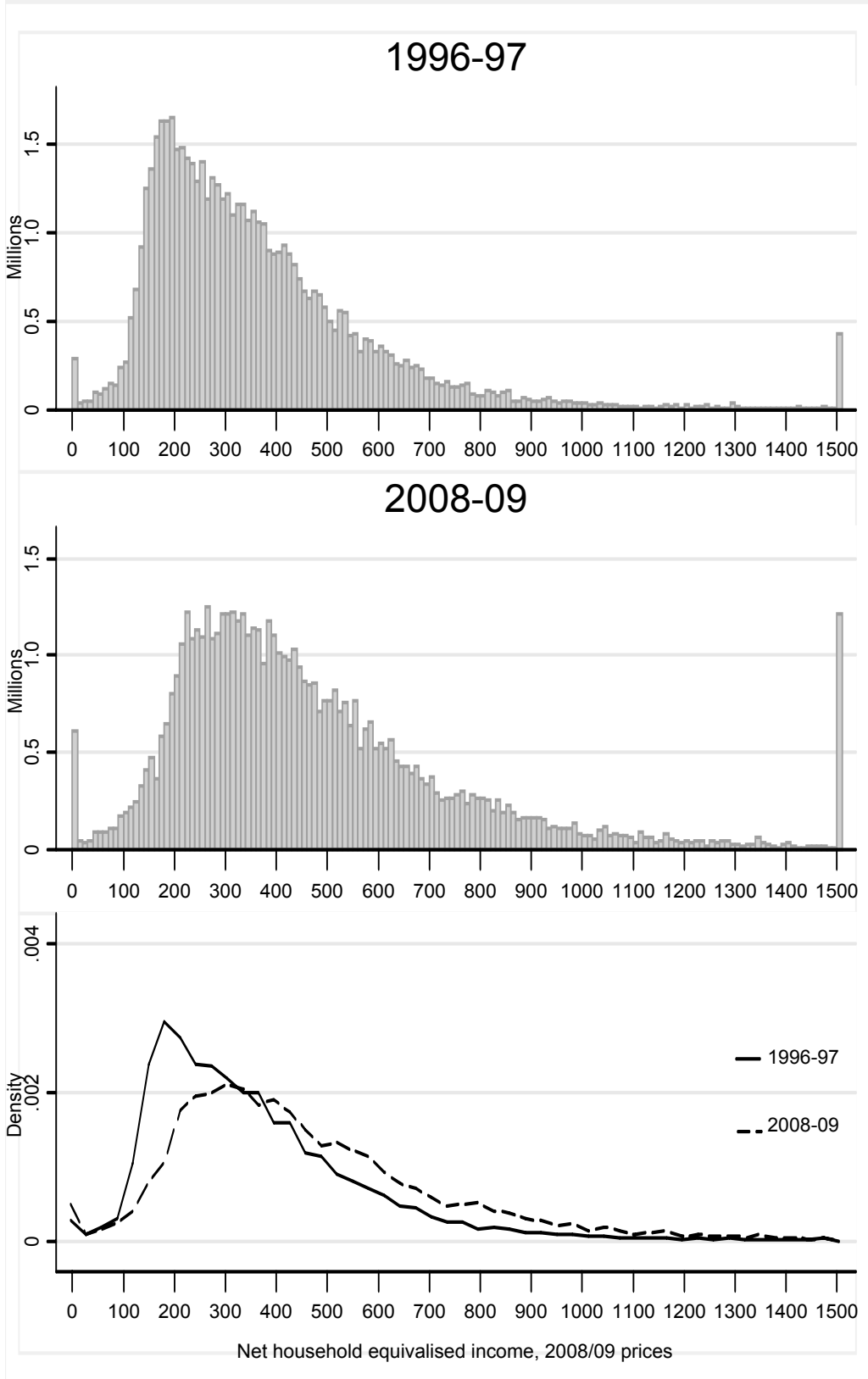
Notes: Incomes have been measured before housing costs have been deducted. The right-most bar represents incomes of over £1,500. The differently-shaded bars refer to decile groups.

Source: Authors' calculations using the Family Resources Survey, 2008–09.

Figure 2.1 also divides the population into 10 equally-sized groups, called decile groups. The first decile group contains the poorest 10% of the population, the second decile group contains the next poorest 10%, and so on. In the graph, 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 incomes in decile groups 2 to 6. 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 (by far the widest in the graph) is much wider than is shown in Figure 2.1, because those with incomes greater than £1,500 are shown together rather than in £10 bands.

<sup>1</sup> See Brewer, Phillips and Sibieta (2010) for further details.

Figure 2.2. The income distributions in 1996–97 and 2008–09 (GB)



Notes: Incomes have been measured before housing costs have been deducted. The right-most bar in the top two panels represents incomes of over £1,500. Incomes above £1,500 have been excluded from the kernel densities in the final panel.

Source: Authors' calculations using Family Resources Survey, 1996–97 and 2008–09.

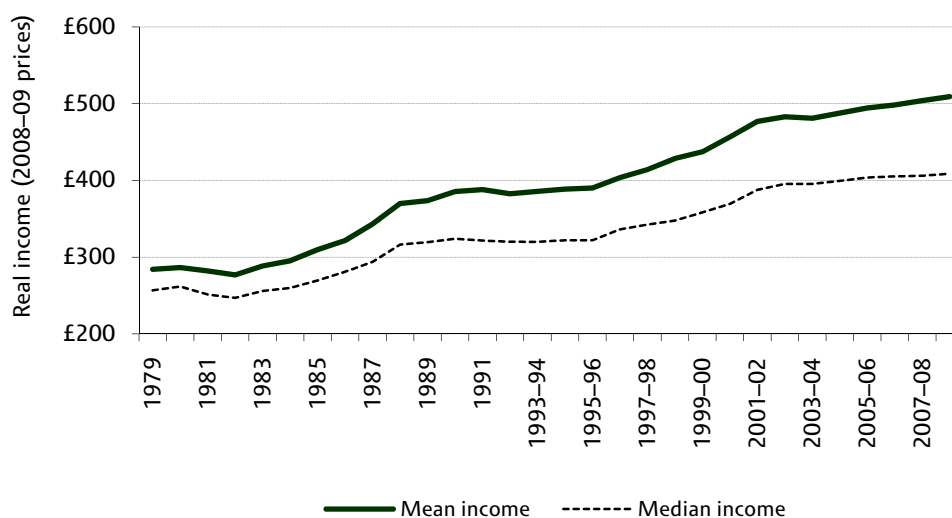
Figure 2.2 shows how the income distribution has changed between 1996–97 and 2008–09. (From now on, the focus will be on Great Britain rather than the United Kingdom, in order to allow us to make consistent comparisons of income distributions over time.) The first two panels of Figure 2.2 repeat the type of presentation used in Figure 2.1, showing the number of people in various income bands in each year. The third panel allows us to see more clearly how the shape of the income distribution has changed over time, by comparing ‘kernel density’ estimates of the shapes of the distributions. The units for these kernel density estimates are such that the total area under each plotted line is 1 rather than the size of the total population.

Looking at this lowest panel, which compares 1996–97 with 2008–09, the shape of the GB income distribution appears to have changed. First, there has been a rightward shift as a result of general growth in households’ real incomes. Second, the peak of the income distribution has become less distinct. Whereas in 1996–97 there was a pronounced spike at the modal income,<sup>2</sup> by 2008–09 there was a broader peak in the distribution between about £200 and £350. Looking at the top two panels, it can be seen that about three times as many individuals fall into the highest income band in 2008–09 as in 1996–97.

## 2.2 Changes in mean and median income

Trends in average (mean and median) incomes since 1979 are shown in Figure 2.3. The graph shows that over this period, average incomes have tended to rise. However, real income growth has not been uniform over time – it has tended to come in ‘s spurts’, such as in the mid-1980s and late 1990s, followed by periods of relative stagnation, such as the early 1990s. Income growth in recent years (since 2001–02 in particular) has also been slow relative to growth in the late 1990s.

Figure 2.3. Average real incomes since 1979 (GB)



Note: Incomes have been measured before housing costs have been deducted.

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

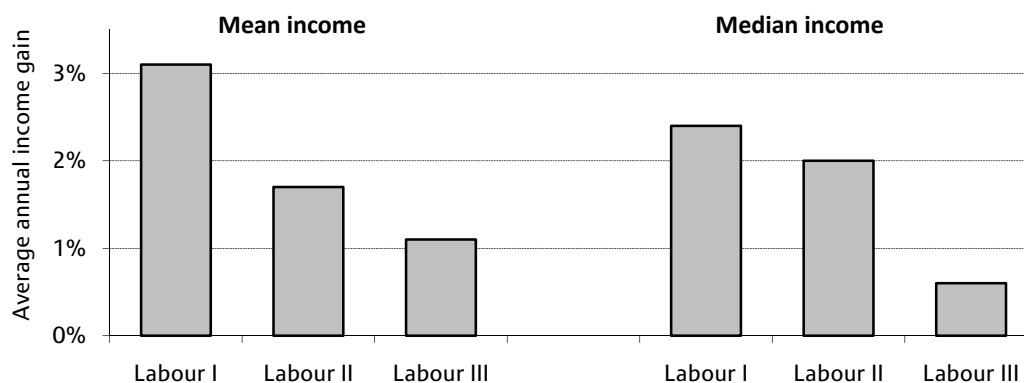
<sup>2</sup> Modal income refers to the income level possessed by the greatest proportion of the population.

The latest year of HBAI covers the first full financial year of the recent recession, which is probably the deepest since the 1930s. The significant drop in national income and employment seen over this period would naturally lead us to expect disposable incomes to also have dropped over this period. In fact, average take-home incomes as measured in HBAI grew in 2008–09, though at a fairly slow rate. Mean equivalised income in Great Britain grew by about 1.1% in real terms (from £504 to £509) and median income grew by about 0.7% in real terms (from £406 to £409).

Over the period since 1996–97 as a whole, mean weekly BHC income in Great Britain has increased from £404 in 1996–97 to £509 in 2008–09. This corresponds to a real rise of about 26%, or 2% per year on average. Similarly, median income has increased by 22% (1.6% when annualised), from £336 to £409.<sup>3</sup>

Figure 2.4 shows average annual real income growth in each of Labour’s three terms of office since 1997 (as elsewhere in this Commentary, please note that Labour’s third term only covers the period up to 2008–09). We observe rapid income growth in Labour’s first term (more than 3% per year at the mean and nearly 2.5% per year at the median), but each subsequent term has seen slower annual income growth than the one before. In making these comparisons, it is important to realise that these periods cover different stages of various economic cycles, and income growth rates are very sensitive to this. The latest household income data (from 2008–09) cover the first full financial year after the recession began in the first quarter of 2008. However, income growth was sluggish during Labour’s third term *before* the UK had entered recession. In fact, income growth at the mean and median between 2007–08 and 2008–09 was at a very similar level to the growth seen over Labour’s third term up to 2008–09, and 2008–09 was the seventh consecutive year of slow growth in average take-home incomes.

Figure 2.4. Average annual real income growth in Labour’s three terms (GB)



Notes: Incomes have been measured before housing costs have been deducted. Labour III covers the period up to 2008–09.

Source: Authors’ calculations using Family Resources Survey, 1996–97 to 2008–09.

<sup>3</sup> The growth of income is rather stronger when measured AHC rather than BHC: mean and median AHC incomes increased by 34% and 28% respectively between 1996–97 and 2008–09.

How do these growth rates compare with those in previous administrations? Table 2.1 shows that annualised real income growth under the period of Labour government as a whole up to 2008–09 was very similar to growth under the Conservative governments between 1979 and 1996–97 (though somewhat stronger than it was under Major and slightly slower than that experienced under Thatcher). Looking at each Labour term individually, we note that Labour’s first term (from 1996–97 to 2000–01) saw exceptionally strong average income growth – faster at both the mean and the median than under Thatcher or Major. Labour’s second term (from 2000–01 to 2004–05) saw slightly weaker average income growth than under Thatcher, though growth was still stronger than it was under Major. In contrast, Labour’s third term (from 2004–05 to the latest year of data, 2008–09) saw average incomes growing at less than half the rate under Thatcher – rates similar to those experienced under Major.

Table 2.1. Annualised real average income growth (GB)

	Mean	Median
<b>Conservatives (1979 to 1996–97)</b>	<b>2.1%</b>	<b>1.6%</b>
<i>Of which:</i>		
Thatcher (1979 to 1990)	2.8%	2.1%
Major (1990 to 1996–97)	0.8%	0.6%
<b>Labour (1996–97 to 2008–09)</b>	<b>2.0%</b>	<b>1.6%</b>
<i>Of which:</i>		
Labour I (1996–97 to 2000–01)	3.1%	2.4%
Labour II (2000–01 to 2004–05)	1.7%	2.0%
Labour III (2004–05 to 2008–09)	1.1%	0.6%

Note: Incomes have been measured before housing costs have been deducted.

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

Table 2.2. Real income growth and 95% confidence intervals (GB)

	<i>Mean income</i>			<i>Median income</i>		
	Lower	Point	Upper	Lower	Point	Upper
1997–98	0.9%	2.6%	4.0%	0.3%	1.8%	3.1%
1998–99	1.5%	3.5%	5.5%	0.3%	1.5%	3.1%
1999–00	–0.2%	2.1%	4.3%	1.7%	3.1%	4.6%
2000–01	2.4%	4.4%	6.6%	1.6%	3.1%	4.5%
2001–02	2.2%	4.4%	6.6%	3.6%	4.9%	6.2%
2002–03	–0.9%	1.3%	3.4%	0.8%	2.0%	3.4%
2003–04	–2.4%	–0.4%	1.8%	–1.1%	0.0%	1.2%
2004–05	–0.5%	1.4%	3.1%	–0.2%	1.0%	2.1%
2005–06	–0.8%	1.4%	3.4%	–0.2%	1.1%	2.3%
2006–07	–1.4%	0.8%	3.2%	–0.9%	0.4%	1.7%
2007–08	–1.6%	1.1%	3.4%	–1.3%	0.2%	1.6%
2008–09	–1.4%	1.1%	3.7%	–0.8%	0.7%	2.4%

Note: Incomes have been measured before housing costs have been deducted.

Source: Authors’ calculations using Family Resources Survey, various years. Confidence intervals were calculated by bootstrapping the changes using 500 iterations. 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).



The 'turning point' for income growth was not 2004–05, however. As Table 2.2 shows, average income growth appears to have started slowing between 2001–02 and 2002–03. The table shows real percentage changes in mean and median incomes in each year since 1996–97, together with the 95% confidence intervals for these changes.<sup>4</sup> In the latest year of data (shown in the bottom row), we see that mean income rose by 1.1% in real terms (or the equivalent of around £5 per week for a couple with no children), while median income rose in real terms by 0.7% (about £3 per week). Neither of these changes is statistically significantly different from zero.

During the period of strong income growth between 1996–97 and 2001–02, mean income growth was never less than 2% and median income growth never below 1.5%. After 2002–03, mean income growth has been less than 1.5% every year and median income growth has never been above 1.1%.

The level of mean income is not statistically significantly greater than it was in 2006–07, and the level of median income is not statistically significantly greater than as far back as 2005–06.

## **HBAI income compared with other measures of average income**

HBAI income is not the only measure of average income; it is therefore informative to compare the HBAI estimates of changes in average income with estimates from other sources. Figure 2.5 compares average (BHC) income in the HBAI series with two alternative estimates of average income derived from the National Accounts: real gross domestic product (GDP) per head and 'real household disposable income per head' (HDI). Real GDP per head is a widely-used measure of economic well-being, showing the estimated market value of all final goods and services produced in the UK economy, divided by the total number of people in the UK. Real household disposable income, as the name implies, focuses on the household sector,<sup>5</sup> and so excludes the incomes of companies and the government. However, unlike our HBAI income measure, HDI is an AHC measure of income. These National Accounts measures are for the whole United Kingdom, not just Great Britain, but the trends should still be broadly comparable.

The National Accounts have the advantage that they do not rely to the same extent on data gathered from samples, and so they are not subject to the same degree of statistical uncertainty as the HBAI data. However, they are quite limited in their use in analysing living standards, since they are only able to provide estimates of the mean; they do not allow us to assess the median or any other information about the distribution of income.

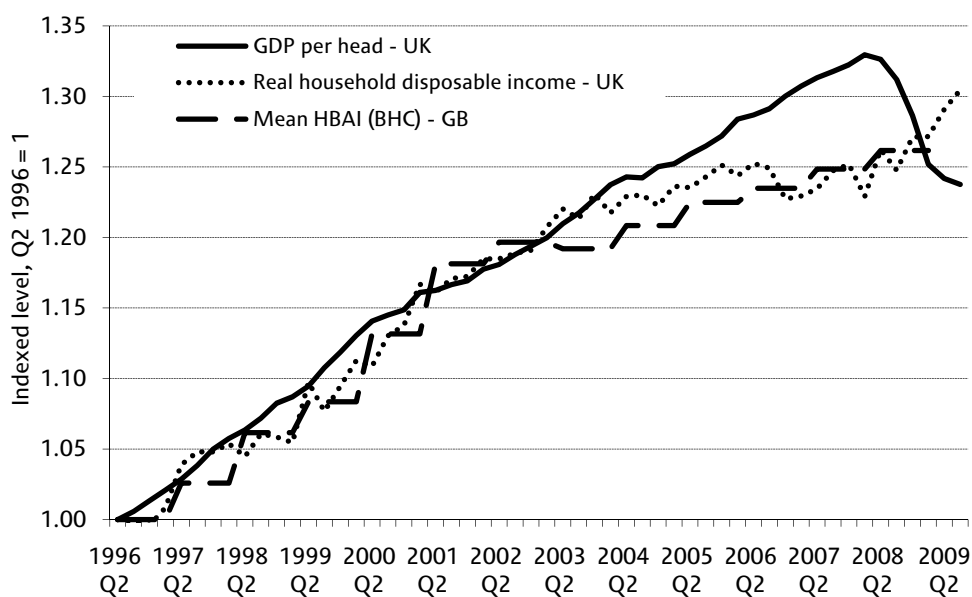
We can see from Figure 2.5 that the three series moved together for most of the late 1990s, so that by 2002 all series had grown by very similar amounts since 1996. After 2002, however, the series began to diverge, with HBAI mean income and household disposable income both lagging significantly behind GDP per head. This trend was dramatically reversed after the start of the recession in 2008. Whilst GDP per head was falling rapidly, mean HBAI income and household disposable income continued to rise. This now means that GDP per head has seen the slowest average growth rate of the three measures since 1996. The latest HBAI data are for 2008–09, but Figure 2.5 shows that the divergence between GDP per head and real household disposable income per head

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<sup>4</sup> For information on confidence intervals, see Source to Table 2.2.

<sup>5</sup> Though the household sector used for this measure also includes charities and universities.

Figure 2.5. Mean HBAI income compared with other measures



Note: Incomes have been measured before housing costs have been deducted.

Source: Authors' calculations using the UK National Accounts and Family Resources Survey, various years.

continued to widen up to the third quarter of 2009 (the last data point for these two National Accounts measures).

Taking the period since 2002 as a whole, both the HBAI and household disposable income measures suggest that household living standards have fluctuated less than the size of the economy: robust economic growth between 2002 and 2008 did not always translate into increased household disposable incomes, and the recession from early 2008 does not seem to have translated into the dramatic reductions in household living standards that one might expect.

The higher growth in GDP per head between 2002 and 2008 might reflect the slight rise in the tax burden seen over this period.<sup>6</sup> To the extent that the increase in the tax burden was used to fund increased spending on public services of value to households, the measures of disposable incomes may underestimate the growth in living standards observed over this period.<sup>7</sup>

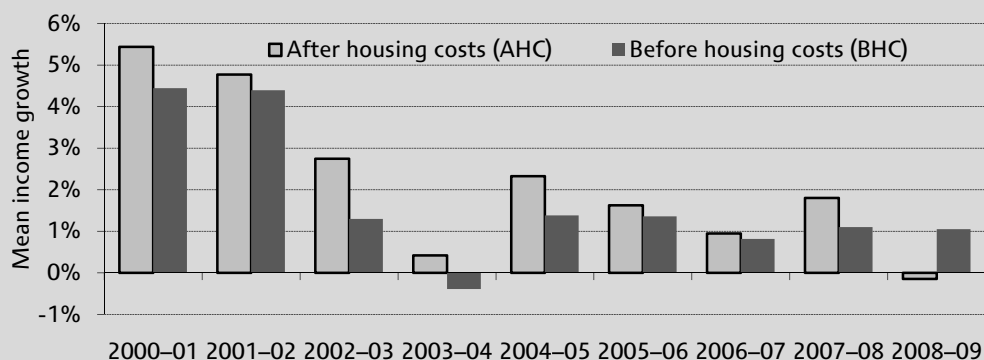
Part of the discrepancy during the recent recession between household disposable income and GDP per head is the result of falling mortgage rates, which translated into higher disposable incomes, even as GDP fell. However, this cannot account for the growth in the HBAI income measure shown in Figure 2.5, since it measures incomes before housing costs are deducted (BHC). Since housing costs were falling during this period, we might expect the after-housing-costs (AHC) HBAI income measure to have grown even more strongly than BHC income. In fact, this was not the case – the AHC measure of mean income actually fell by 0.2% between 2007–08 and 2008–09. This anomaly is discussed in Box 2.1.

<sup>6</sup> See Chote, Crawford, Emmerson and Tetlow (2010) for details of the rising tax burden.

<sup>7</sup> One important advantage of using GDP per head to measure living standards is that it also captures expenditure on public services and thus will not fall one-for-one with any tax increases used to pay for more public services. In contrast, household income measures will fall with such tax increases, with no account taken of the extra spending on public services or its impact on living standards.

### Box 2.1. Income growth before and after housing costs

The growth rates of the two HBAI income measures (AHC and BHC) between 2007–08 and 2008–09 present us with something of a puzzle. We know that housing costs declined as the UK entered recession (as the Bank of England repeatedly cut interest rates, leading to lower mortgage rates), and that this fall in housing costs is cited as one reason for growth in real household disposable income per head during 2008–09 (see Figure 2.5) even as GDP per head fell.<sup>a</sup> We might therefore expect to see a similar divergence in the two HBAI income measures, with the before-housing-costs measure declining by more than the after-housing-costs measure. In fact, as the figure below makes clear, we see the opposite pattern – in 2008–09, mean BHC income grew by 1.1%, while mean AHC income declined by 0.2%.



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

This pattern of growth is certainly anomalous. It means that the measure of housing costs used in HBAI grew (by 2.9% at the mean and 4.6% at the median, in cash terms), even as the measure of housing costs in the RPI fell (by 1.2%). We should be wary of reading too much into a single year of housing costs data, just as we should not place too much emphasis on a single year of income growth (since neither the AHC nor the BHC income change is statistically significant), but we will monitor these trends in future. If housing costs in the Family Resources Survey continue to show different trends from other (likely more accurate) data sources, this could prove a cause for concern.

a. See Davies, Fender and Williams (2010) for more details on changes in household disposable income.

### Examining different sources of income

In order to further understand trends in household income growth, it is helpful to break household income down into its component sources. To this end, Table 2.3 shows what happened to the mean values of household income's various sources, both in the last year and over the entire period since 1996–97.

The first row of the table shows how large each component is as a share of total income. The largest source of household income, on average, is income from earnings (two-thirds of all income), followed by income from state benefits and tax credits, income from savings, investments and private pensions, and self-employment income.

The second row shows how these income sources grew under Labour up to 2008–09; and the next two rows break Labour's period of government into two periods – the rapid income growth of 1996–97 to 2001–02 and the slower growth of 2001–02 to 2008–09. Household earnings, which grew by 4.4% during the former period and just 0.8% during

Table 2.3. Income sources: real year-on-year income growth and share of total income (GB)

	<i>Source of income</i>					Deductions from income (including council tax)	Total	Total HBAI income
	Earnings	Benefits and tax credits	Self-employment	Savings, investments and private pensions	Other income			
<b>Share of total income:</b> 2008–09	66%	19%	9%	11%	3%	–7%	100%	n/a
<b>Annual change under Labour:</b> 1996–97 to 2008–09	2.3%	1.5%	0.3%	1.8%	3.4%	5.0%	1.7%	2.0%
<i>Of which:</i> 1996–97 to 2001–02	4.4%	1.2%	2.0%	1.6%	4.6%	7.8%	3.1%	3.4%
2001–02 to 2008–09	0.8%	1.7%	–0.9%	2.0%	2.5%	3.0%	0.8%	0.9%
<b>Change in latest year:</b> 2007–08 to 2008–09	0.9%	4.7%	–10.4%	–0.2%	2.6%	2.1%	0.4%	1.1%

Notes: All incomes have been equivalised and are measured at the household level and before housing costs have been deducted. Shares in 2008–09 do not sum to 100% due to rounding. The sum of all income sources is not exactly equal to household income under the HBAI definition, for two reasons. First, the incomes of the very richest households are adjusted within the HBAI definition to take into account potential undersampling or inaccurate reporting of income at the very top of the income distribution (the so-called ‘SPI adjustment’; see Appendix A). No such SPI adjustment is attempted on the individual sources of income. Second, negative household incomes are set to zero within the HBAI definition of income, but the component income sources have not been adjusted in this way. The final two columns of this table show how the year-on-year change in mean income on the HBAI definition (‘Total HBAI income’) compares with the change in the mean of the total of all income sources (‘Total’).

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

the latter period, can explain much of the slowdown in household income growth after 2001–02.

Focusing on the most recent year of HBAI data, for 2008–09, the final row of Table 2.3 shows that the two largest components of household income – net earnings, and benefits and tax credits – both grew year-on-year in real terms. Discretionary changes to income tax rates and allowances (a net income tax cut of about £3.4 billion) and discretionary changes to tax credits and benefits (increasing their generosity by about £2.2 billion) will have acted to increase net earnings, and benefits and tax credits income, respectively. Box 2.2 discusses these changes in more detail.

Since earnings represent about two-thirds of total income, trends in earnings have very strong implications for overall trends in HBAI mean income. We discuss what happened to earnings in more detail in the next subsection. The real growth in benefits and tax credits in 2008–09 was particularly strong, at 4.7%. (Appendix B shows that this growth is matched by growth in benefits payments in DWP and HMRC administrative data.) As well as changes to the tax credit system (see Box 2.2), there are two explanations for this. First, due to falling inflation, uprating procedures for benefits and tax credits meant that most grew in real terms in 2008–09 (see Chapter 4). Second, the fall in employment between 2007–08 and 2008–09 (see next subsection) increased the number of people eligible for various means-tested benefits and tax credits.

Table 2.3 also shows that income from self-employment fell sharply in 2008–09, as one might have expected during a recession (though this tends to be a volatile series). Average household self-employment income in 2008–09 was lower than in 2001–02.

### Box 2.2. Income tax, National Insurance and tax credit changes in 2008–09

In Budget 2007,<sup>a</sup> then Chancellor Gordon Brown announced a significant simplification of the income tax and National Insurance (NI) system, together with an increase in the generosity of the child and working tax credits. The reforms as initially planned were:<sup>b</sup>

Abolition of starting rate of income tax on non-savings income	(raising £7.4 billion)
Cut in basic rate of income tax from 22% to 20%	(costing £8.4 billion)
Increase over-65s' personal allowance by £1,180 and to £10,000 for over-75s	(costing £0.8 billion)
An increase in the NI upper earnings limit of £75 per week	(raising £1.1 billion)
Increase child element of child tax credit by £175	(costing £1.1 billion)
Increase threshold of working tax credit by £1,200	(costing £1.0 billion)
Increase tax credit taper rate by 2 ppts to 39%	(raising £0.4 billion)

The fact that the abolition of the 10% starting rate of income tax would create a fairly significant number of losers (not all of whom would be compensated by the increased generosity of tax credits) caused significant political controversy, and, in May 2008, the government increased the income tax personal allowance by £600 (with an offsetting adjustment to the higher-rate threshold to prevent higher-rate taxpayers from gaining from this) to 'compensate' most of the remaining losers, at a cost of £2.7 billion. This increase was implemented from September 2008 onwards, with a one-off 'rebate' in people's September pay packets to account for the extra tax paid between April and August. Because income tax is operated as an annual system, this means that, considering the 2008–09 tax year as a whole, people were taxed as if the personal allowance had been increased by £600 a year for the entire year. But because FRS survey respondents are typically asked their earnings for the last month (or week), the net earnings reported may be affected by this timing issue.

All-in-all, including the 'compensation package', changes in income tax and NI represented a tax cut (and therefore an increase in net earnings) of £3.4 billion, and changes to tax credits and benefits (including winter fuel payment increases at a cost of £0.6 billion, announced in Budget 2008<sup>c</sup>) increased their generosity by £2.2 billion. The biggest winners were low- and middle-income households with children, individuals or couples earning moderate to middle incomes, and pensioners aged 65 and over. A number of losers remained: individuals with low incomes (not necessarily living in low-income households) who lost more from the abolition of the starting rate of income tax than they gained from the higher personal allowance or the lower basic rate and who were not entitled to tax credits. These would consist of, primarily, working-age adults without dependent children.

a. HM Treasury, 2007b.

b. All amounts reported are from chapter A of Budget 2008 (HM Treasury, 2008a) or annex B of Pre-Budget Report 2008 (HM Treasury, 2008b).

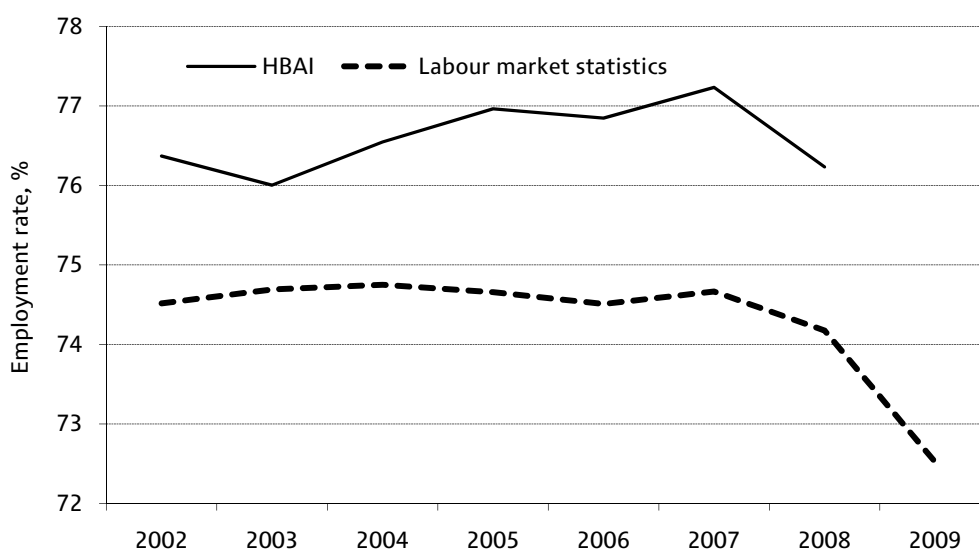
c. HM Treasury, 2008a.

## Employment and earnings

Earnings from employment form by far the largest single source of household incomes, on average. From early 2008, the UK employment rate started to fall, and in last year's poverty and inequality Commentary we expressed concern about the consequences of the deteriorating labour market conditions for income growth in the near future.<sup>8</sup>

Figure 2.6 shows the employment rate in the UK since 2002–03, according to both the HBAI data and labour market statistics from the Office for National Statistics (ONS), based on the Labour Force Survey (LFS). We focus on employment rather than unemployment, because economically inactive people are not counted as unemployed and yet the consequences of economic inactivity and unemployment for household income are quite similar.

Figure 2.6. Employment, 2002–03 to December 2009 (UK)



Notes: Figures are annual averages. Years refer to financial years. The labour market statistics employment rate for 2009–10 is a seasonally adjusted average for the fiscal year up to December 2009.

Sources: Office for National Statistics, series MGSU; authors' calculations using Family Resources Survey, various years. Denominator is the working-age population.

As shown in Figure 2.6, the employment rate in the HBAI data has consistently been about 2 percentage points higher than the employment rate recorded in the LFS. However, the changes in employment rates over time in the two series are generally quite similar (an exception is 2003–04, when the employment rate fell according to HBAI but rose slightly according to labour market statistics). The most recent year of HBAI data, for 2008–09, accord with the LFS in showing a year-on-year decline in the employment rate (the fall according to HBAI was actually slightly larger, at 1 percentage point compared with 0.5 percentage points in labour market statistics).

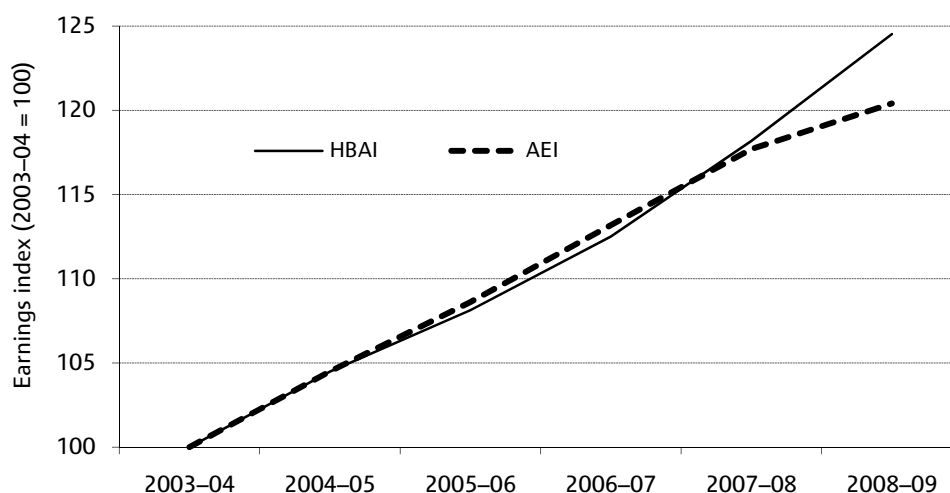
Looking ahead, the LFS shows a further sharp fall in the employment rate over the first three quarters of 2009–10. There is thus good reason to be pessimistic about the prospects for income growth over 2009–10, assuming that falling employment translates into falling household incomes.

<sup>8</sup> Brewer, Muriel, Phillips and Sibieta, 2009, p. 12.

Despite the reduction in employment observed between 2007–08 and 2008–09 in both HBAI and labour market statistics, we saw in the previous subsection that average household earnings grew in real terms over this period. This implies that average real earnings *amongst employed individuals* in the HBAI data increased, and that this more than offset the reduction in the *number* of employed individuals. Does this real-terms growth in earnings amongst workers observed in HBAI match the trends observed in the average earnings index (AEI), Great Britain’s key indicator of earnings growth?

Up to now, we have been examining real-terms growth in individual earnings after tax. However, the AEI records individual earnings before taxes. We have therefore constructed a comparable measure from HBAI (which is thus not comparable to the measure of HBAI net earnings presented in Table 2.3). Figure 2.7 presents the level of earnings before tax as measured by HBAI and the AEI in cash terms (the AEI is a cash-terms index) and relative to their level in 2003–04, such that they are equal to 100 in 2003–04.

Figure 2.7. HBAI versus average earnings index, before tax, cash-terms index, 2003–04 = 100 (GB)



Note: The HBAI and AEI earnings measures both include bonus payments.

Sources: Office for National Statistics; authors’ calculations using Family Resources Survey, various years.

The figure shows that earnings growth in HBAI and the AEI have tracked each other very closely in recent years until 2008–09, the latest year of HBAI data, when HBAI recorded noticeably higher earnings growth than the AEI. According to HBAI, there was a 2.4% real (or 5.4% cash-terms) rise in average earnings for employees between 2007–08 and 2008–09. In contrast, the slower growth in the AEI (which is a cash-terms index) implies a real *fall* in average earnings over this period (or a 2.3% cash-terms rise).

The rate of real earnings growth for employees will be crucial to the evolution of average incomes in the near future. The relatively robust growth of real earnings in the HBAI data in 2008–09 is a key reason why income growth in the HBAI data was no slower than in recent years, despite the falling employment rate and the sluggish performance of other income sources. The evolution of real earnings in the near future is highly uncertain. First, macroeconomic conditions are fragile, and employers’ responses to those conditions are difficult to predict. Second, as discussed, a disparity has emerged between HBAI and the AEI, and it will be interesting to see whether this persists in future years.

## 2.3 Family type and economic status

In order to further understand changes in average incomes between 2007–08 and 2008–09, it is also informative to consider average income growth for different family types.

In Table 2.4, we split families into 12 different types according to whether or not they have children, the number of adults, the number in paid work and whether or not they are pensioners. The first column of numbers shows the real-terms growth in mean incomes for these 12 family types between 2007–08 and 2008–09. As can be seen, there is quite a wide variation in average income growth across different family types. However, it should be noted that these one-year growth figures are subject to considerable sampling uncertainty. Noting this concern, average income growth in 2008–09 was highest amongst working lone parents and single pensioners. Couples with two workers also experienced relatively robust income growth, which was slightly higher for those with children. Income growth was negative for single non-working adults without children and for single-earner couples with children.

Taking this further, we can decompose overall mean income growth (1.1%) amongst the whole population into *growth effects* amongst individual family types and *composition effects* to reflect the changing composition of family types across the population – for example, a shift from two-worker couples towards workless couples would tend to reduce total income growth, other things being equal, as the latter have lower incomes, on average.

Table 2.4. Decomposition of the rise in mean incomes (BHC), 2007–08 to 2008–09, by family type and work status

	<i>Income growth</i> 2007–08 to 2008–09	<i>Percentage of population</i> 2007–08 2008–09		<i>Growth effect</i>	<i>Composition effect</i>
<b><i>Working-age families with children</i></b>					
Lone parent, working	7.4%	4.2%	4.4%	0.2 ppts	0.1 ppts
Lone parent, not working	1.5%	4.0%	4.0%	0.0 ppts	0.0 ppts
Couple with kids, two workers	3.5%	21.8%	21.4%	0.9 ppts	–0.5 ppts
Couple with kids, one worker	–4.1%	10.1%	10.8%	–0.4 ppts	0.6 ppts
Couple with kids, no workers	0.1%	2.7%	2.3%	0.0 ppts	–0.2 ppts
<b><i>Working-age families without children</i></b>					
Single, working	0.7%	12.1%	11.4%	0.1 ppts	–0.7 ppts
Single, not working	–2.8%	5.6%	6.2%	–0.1 ppts	0.4 ppts
Couple, no kids, two workers	2.2%	14.7%	14.3%	0.5 ppts	–0.6 ppts
Couple, no kids, one worker	1.3%	5.1%	5.1%	0.1 ppts	0.1 ppts
Couple, no kids, no workers	0.6%	2.4%	2.5%	0.0 ppts	0.1 ppts
<b><i>Pensioners</i></b>					
Pensioner, single	5.2%	7.6%	7.8%	0.3 ppts	0.1 ppts
Pensioner couple	0.4%	9.7%	9.8%	0.0 ppts	0.0 ppts
<b><i>Great Britain total</i></b>	1.1%	100%	100%	1.6 ppts	–0.5 ppts

Source: Authors' calculations based on Family Resources Survey, 2007–08 and 2008–09.



We begin by focusing on the growth effects amongst individual family types, which are detailed in Table 2.4. These growth effects can be interpreted as the number of percentage points by which total mean income growth would rise purely as a result of income growth amongst each individual family type, all else being equal and given the proportion of the population made up by this family type. The bottom row shows the sum of all these growth effects (1.6 percentage points), which was almost entirely driven by income growth amongst two-worker couples with and without children.

Given that overall mean income growth was actually 1.1%, this must mean that the changing composition of the population by family type acted to reduce mean income growth. These composition effects are shown in the final column, and sum to -0.5 percentage points across family types. This is the result of a shift away from family types where all the adults in the family are in work.

From this analysis, we learn that the reduction in employment across the population would have led mean income growth to be negative, all else being equal. However, all else was not equal, and growth amongst individual family types – particularly amongst two-earner couples – more than cancelled out these composition effects, leading overall mean income growth to be positive.

## 2.4 Regional variation in living standards

In this section, we examine the regional variation in levels of median income and in the growth rates of median income under Labour.

Table 2.5. Median income by region and country in 2006–07 to 2008–09 and growth since 1996–97 to 1998–99 (GB)

Region or country	Median income in 2006–07 to 2008–09 (national median = 100), assuming uniform national prices	Median income in 2006–07 to 2008–09 (national median = 100), using regional price relativities	Average annual median income growth since 1996–97 to 1998–99
South East	116.1	109.6	1.5%
London	110.5	100.2	2.0%
East of England	106.5	104.8	1.5%
South West	101.3	99.5	2.1%
Scotland	99.2	104.4	1.8%
North West	93.3	98.5	2.0%
East Midlands	93.2	95.1	1.4%
West Midlands	93.2	94.7	1.3%
Yorkshire and Humber	92.8	95.2	1.7%
Wales	91.2	97.4	1.6%
North East	89.9	94.9	2.2%
<b>Great Britain median</b>	<b>£407</b>	<b>£407</b>	<b>1.7%</b>

Notes: Incomes have been measured before housing costs have been deducted. Regions are defined as Government Office Regions. Income growth (shown in the final column) is the same whether regional or national prices are used, since we only have regional price indices available for a single year.

Source: Authors' calculations using Family Resources Survey, various years, and ONS regional price indices for 2004–05 (see Wingfield, Fenwick and Smith (2005)).

Table 2.5 shows median household income by region and country of Great Britain, averaged over the three years 2006–07 to 2008–09 (three-year averages are used to ensure adequate sample sizes), relative to the median for Great Britain as a whole.

The government presents regional income statistics in its annual HBAI publication, but makes no adjustment for variation in living costs across the country. This is, perhaps, because the ONS produces no regular regional price indices. However, it did produce regional price indices for 2003–04 and 2004–05 on an experimental basis, and these showed considerable regional price variation. Although regional price relativities are unlikely to be constant over time, it is highly likely that using the most recent available relativities yields a much better approximation of regional living standards than assuming that prices are the same throughout Great Britain. Hence, in the second column of Table 2.5, we adjust median income in each region and country to take account of regional price variation, using the 2004–05 regional price indices.

The following facts hold true whether we use regional or national prices:

- In the years 2006–07 to 2008–09, median household income was highest in the South East of England.
- Comparing the three-year period of 1996–97 to 1998–99 with 2006–07 to 2008–09, the North East experienced the fastest growth in median income, with average annual growth of 2.2%. The Midlands saw the slowest median income growth over this period, with average annual growth of 1.4% and 1.3% in the East and West Midlands respectively.

The second column of Table 2.5 shows how important it is to account for regional price variation when measuring regional living standards:

- Median incomes in the South East and London are substantially lower, relative to the national median, when we account for the relatively high price levels in those regions. The South East still ranks first, but London drops from having an average income level 10% above the national median to an income level about equal to the national median after taking account of regional price variation.
- In contrast, median incomes in Wales and Scotland, relative to the national median, rise by 6 and 5 percentage points respectively, relative to the national median, when we account for the relatively low prices in those countries. Wales rises from tenth to seventh in the rankings; Scotland rises from fifth to third, with a median income above the national median. Median incomes in the North East and the North West rise by similar amounts relative to the national median after taking account of regional price differences.

## **2.5 Conclusion**

The latest year of HBAI data cover 2008–09, the first full financial year of the recent recession. The significant drop in national income and employment seen during 2008–09 would naturally lead us to expect disposable incomes to have dropped as well over this period. In fact, average take-home incomes as measured in HBAI grew in 2008–09, though at a fairly slow rate.

The year 2008–09 was the seventh consecutive year of slow growth in average take-home incomes. These years of sluggish real income growth stand in stark contrast to

Labour's first term in office (1997–2001), when mean incomes grew by an average of 3.1% a year.

Looking at trends in HBAI in 2008–09 in more detail, we observe that trends in employment largely match the falls observed in official labour market statistics. Furthermore, we could expect that, taken alone, lower levels of employment as seen in HBAI would have led to a fall in mean take-home incomes, had all other factors remained equal. However, real-terms growth in incomes amongst those in employment, as measured by HBAI, more than cancels out this effect and leads to positive growth in mean incomes. The real-terms growth in earnings seen in HBAI does not match the slowdown in earnings observed in other national statistics over this period.

HBAI is based on a survey of 25,000 households and is thus subject to uncertainty and sampling error from year to year. One should not put too much emphasis on one year's worth of data. Future years may show a different pattern for mean incomes, which could well have been underestimated in previous years.

## 3. Inequality

### Key findings

- Despite the recession, we saw relatively even (albeit modest) growth in incomes across the distribution between 2007–08 and 2008–09, leaving income inequality largely unchanged on most measures.
- However, there is evidence that income growth at the very top of the distribution was low or negative. Given the turmoil in the financial markets in 2008–09, and the historical correlation between top incomes and the performance of the financial sector, this decline in top incomes is perhaps unsurprising.
- Taking the period 1996–97 to 2008–09 as a whole, incomes have grown relatively evenly across the bulk of the income distribution. Considering each of Labour’s three terms individually, however, we see a more complicated picture – with income growth relatively even in Labour’s first term, unambiguously inequality-reducing in Labour’s second term and very much inequality-increasing in Labour’s third term up to 2008–09.
- The Gini coefficient, a commonly-used measure of inequality, has fallen very slightly since 2007–08 but remains near its highest point since our consistent time series began in 1961.
- While we might expect top incomes to begin to recover, tracking the recovery in financial markets that began in 2009, individuals with high incomes will also be affected by changes to the tax and benefit system (including a new, higher top rate of income tax) coming into effect from 2010 onwards.

Chapter 2 considered changes in average incomes, without considering how evenly (or otherwise) these changes were distributed. In this chapter, we look at how income growth has varied across the income distribution, and how the degree of income inequality has changed, particularly over the latest year of data (2008–09) and since 1996–97.

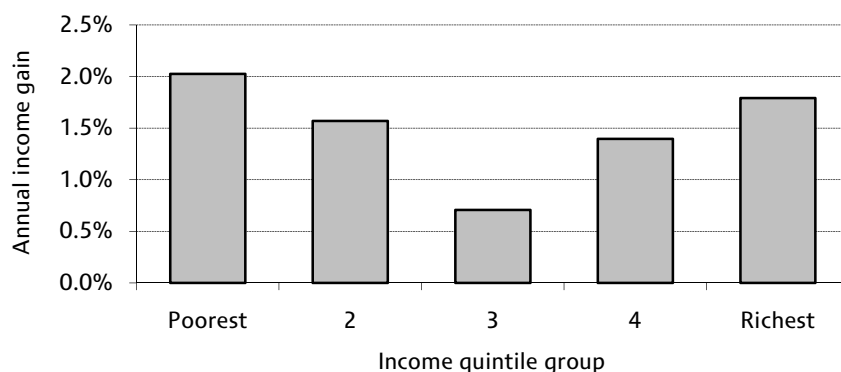
In our discussions of inequality, we will be adopting a relative notion of inequality. This means that should all incomes increase or decrease by the same proportional amount, we would conclude that income inequality had remained unchanged.

### 3.1 Income changes by quintile group

One common way to show how inequality has changed across the population is to consider average real income growth by quintile group (each quintile group contains 20% of the population, or around 12 million individuals).

As discussed in Section 2.2, between 2007–08 and 2008–09 mean and median income grew in real terms by 1.1% and 0.7% respectively. Figure 3.1 shows the underlying pattern of this income growth by quintile group. The figure shows a U-shaped distribution of income growth, with the lowest growth (0.7%) in the middle income quintile but brisker growth above and below it. However, in Section 3.2, we show that this pattern is an artefact of the five points chosen for the comparison, and that income growth was actually largely flat when we consider the income distribution in more detail.

Figure 3.1. Real income growth by quintile group, 2007–08 to 2008–09 (GB)



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

Source: Authors' calculations using Family Resources Survey, 2007–08 and 2008–09.

Figure 3.2 looks at the changes over time as defined by political eras, showing how changes under the Labour government up to 2008–09 compare with what happened under the Conservatives between 1979 and 1996–97. It is important to remember that the pattern of income growth is strongly influenced by booms and recessions, and that our comparisons across periods of government cover different stages of various economic cycles and will be affected by this.

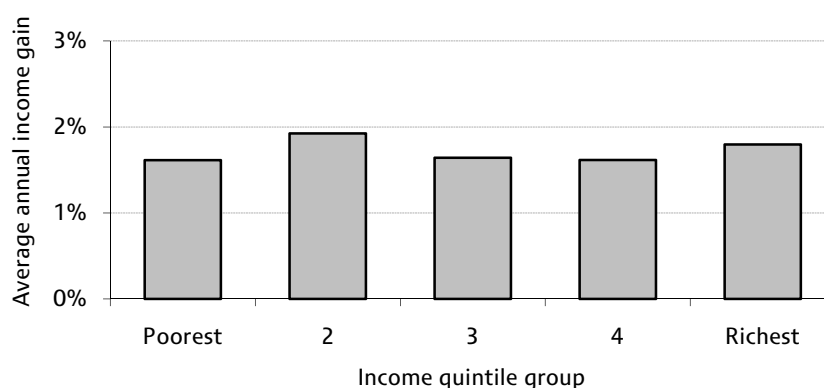
Taking the period 1996–97 to 2008–09 as a whole, all quintile groups have experienced income growth in the region of 1.6–2.0% on an annualised basis. The second quintile group fared best, with annual income growth of 1.9%, but there is relatively little difference across quintile groups. This pattern taken alone would suggest little change in income inequality over Labour's time in government up to 2008–09, a point to which we will return in Section 3.4. This is very different from the experience under the previous period of Conservative government, when income growth was stronger the richer the quintile group, a pattern consistent with strongly rising inequality.

Table 3.1 gives income growth by quintile group separately for each of Labour's terms in office and also divides the previous Conservative era into the premierships of Thatcher and Major. It shows that during Labour's first term, robust annualised income growth of 2.4% or more per year was experienced across the distribution. In contrast, during Labour's second term, income grew faster for poorer quintiles than for richer ones: income for the poorest quintile grew by 2.6% annualised, compared with 1.4% for the richest quintile.

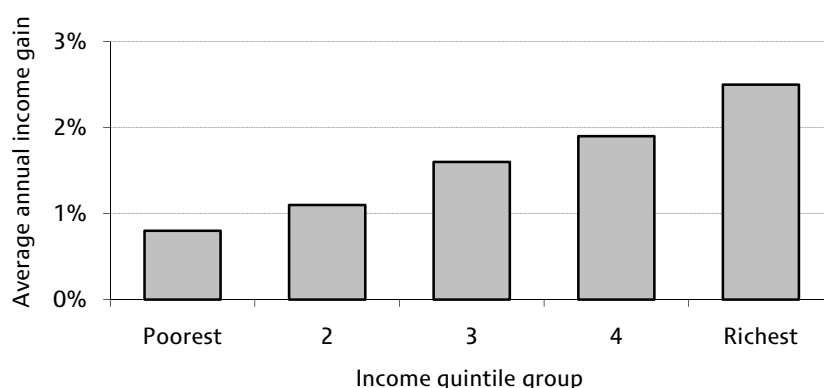
In Labour's third term up to 2008–09, income growth was lower for every quintile than in the previous two terms, and negative for the bottom quintile. Growth between 2004–05 and 2008–09 was strongest among the top quintiles, with only the richest group experiencing income growth of more than 1% per year.

Figure 3.2. Real income growth by quintile group (GB)

Labour: 1996–97 to 2008–09



Conservatives: 1979 to 1996–97



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

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

Table 3.1. Real income growth by quintile group, across parliaments and between 2004–05 and 2008–09 (GB)

	<i>Income quintile group</i>					<b>Mean</b>
	<b>Poorest</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>Richest</b>	
<b>Conservatives (1979 to 1996–97)</b>	<b>0.8%</b>	<b>1.1%</b>	<b>1.6%</b>	<b>1.9%</b>	<b>2.5%</b>	<b>2.1%</b>
<i>Of which:</i>						
Thatcher (1979 to 1990)	0.4%	1.2%	2.1%	2.7%	3.6%	2.8%
Major (1990 to 1996–97)	1.7%	0.9%	0.6%	0.5%	0.7%	0.8%
<b>Labour (1996–97 to 2008–09)</b>	<b>1.6%</b>	<b>1.9%</b>	<b>1.6%</b>	<b>1.6%</b>	<b>1.8%</b>	<b>2.0%</b>
<i>Of which:</i>						
Labour I (1996–97 to 2000–01)	2.4%	2.7%	2.4%	2.5%	2.7%	3.1%
Labour II (2000–01 to 2004–05)	2.6%	2.5%	2.0%	1.6%	1.4%	1.7%
Labour III (2004–05 to 2008–09)	–0.2%	0.6%	0.6%	0.8%	1.3%	1.1%

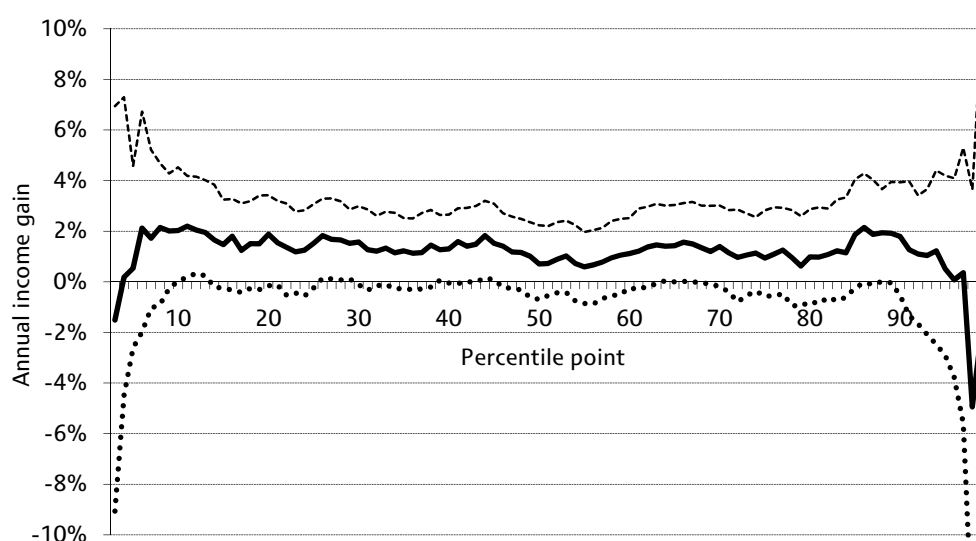
Notes: The averages in each quintile group correspond to the midpoints, i.e. the 10<sup>th</sup>, 30<sup>th</sup>, 50<sup>th</sup>, 70<sup>th</sup> and 90<sup>th</sup> percentile points of the income distribution. Incomes have been measured before housing costs have been deducted.

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

## 3.2 Income changes by percentile

While Figures 3.1 and 3.2 give us a reasonable summary of how incomes have been changing across the distribution, they do mask the changes within each quintile and at the extremes. In Figure 3.3, we show how incomes in Great Britain have changed between 2007–08 and 2008–09 right across the distribution, including those individuals at the 99<sup>th</sup> percentile point. This graph is similar to the ‘quintile’ chart in Figure 3.1, except that rather than presenting how incomes have changed in different quintile groups, we instead consider income growth at 99 percentile points in the income distribution. We also show 95% confidence intervals (the dotted and the dashed lines) for our estimates of income growth, to give us an idea of whether the estimated growth is statistically significantly different from zero.

Figure 3.3. Real income growth by percentile point, 2007–08 to 2008–09 (GB)



Notes: The changes in income at the 1<sup>st</sup> and 2<sup>nd</sup> percentiles are not shown on this graph. Incomes have been measured before housing costs have been deducted.

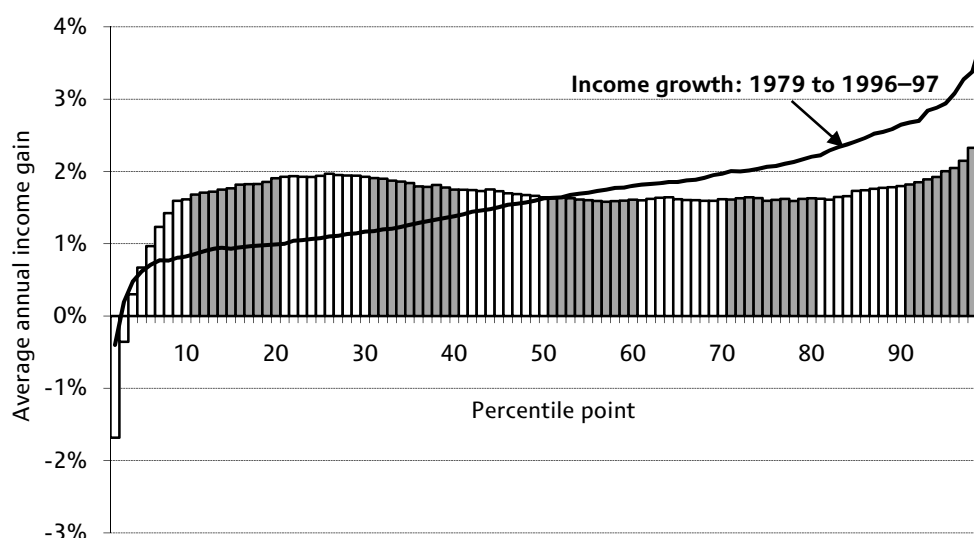
Source: Authors' calculations using Family Resources Survey, 2007–08 and 2008–09.

The figure shows a reasonably ‘flat’ profile of income growth, with growth between 1% and 2% for the bulk of the income distribution. Figure 3.1 showed a pattern of U-shaped income growth, with the fastest growth in the top and bottom income quintiles, and the lowest growth in the middle of the distribution, but Figure 3.3 reveals that this pattern was something of a quirk of the points chosen for comparison. Growth does indeed appear to be slow towards the middle of the distribution (closer to 1%), but the overall pattern is of flat growth across the distribution, rather than a consistent U-shaped pattern. Almost nowhere in the income distribution is growth statistically significant.

Figure 3.3 also shows incomes falling at the very top of the distribution – though these declines are also not statistically significant. Growth in incomes at the top of the distribution has been an important driver of increased inequality in recent years, and we consider the issue of top-income growth in greater detail in Section 3.3.

Figure 3.4 shows how incomes have changed across the distribution over the period of the Labour government up to 2008–09 as a whole. To place the changes in a historical

Figure 3.4. Real income growth by percentile point, 1996–97 to 2008–09 (GB)



Notes: The change in income at the 1<sup>st</sup> percentile is not shown on this graph. Incomes have been measured before housing costs have been deducted. The differently-shaded bars refer to decile groups.  
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

context, we also show how this income growth compares with what was observed between 1979 and 1996–97 under the Conservative governments of the time, as illustrated by the superimposed line.

For the middle 50% of the income distribution (between the 25<sup>th</sup> percentile point and the 75<sup>th</sup> percentile point), it is the lower parts of the distribution that have gained most over the period 1996–97 to 2008–09. By itself, this would be consistent with falling inequality. However, for the bottom 25% and top 25% of the distribution, the lower the income percentile, the lower the growth experienced.

The superimposed line in Figure 3.4, showing income growth under the previous period of Conservative government, makes clear that over the period 1979 to 1996–97, income growth was increasing in the level of income. The graph also shows that compared with the period of Conservative government as a whole, the lower half of the income distribution saw stronger annual average income growth under Labour up to 2008–09, whilst income growth was slightly lower in the top half of the income distribution.

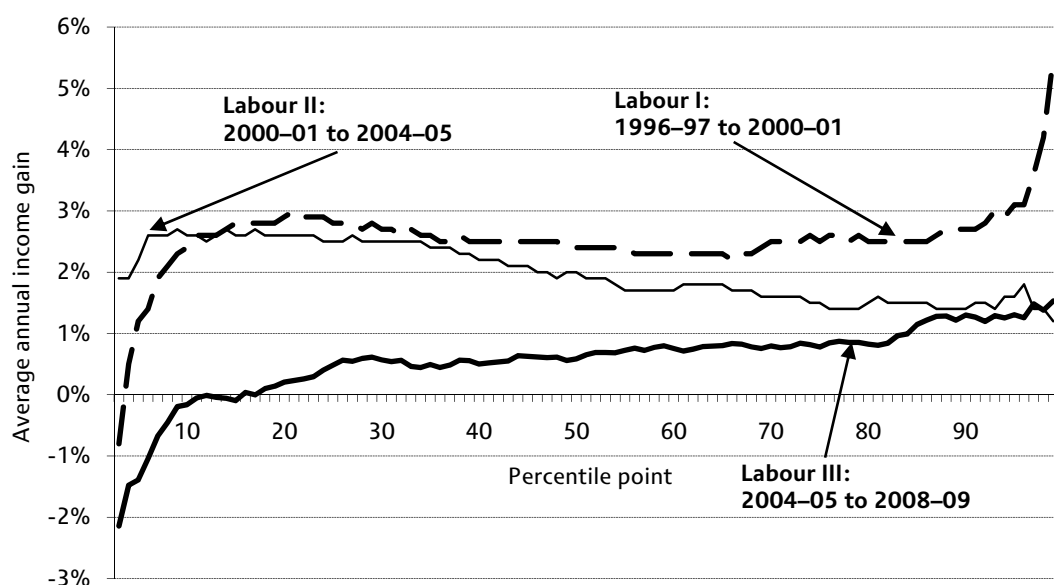
Figure 3.4 shows income growth under Labour's period of government up to 2008–09, taken as a whole, while Figure 3.5 gives more detail by showing income growth separately for the three Labour parliaments between 1996–97 and 2008–09. This makes clear that Figure 3.4 masks significant variation in income growth across the distribution in the different periods.

For the bulk of the income distribution, income growth was fastest in Labour's first term in office, between 1996–97 and 2000–01. Growth over this period is also inequality-reducing across most of the distribution, with the highest growth around the 20<sup>th</sup> percentile. However, the tails of the distribution are a different matter, with very fast growth for the top 5% and lower growth for the bottom 10%.

The period between 2000–01 and 2004–05 – Labour's second term in office – saw income growth that was unambiguously inequality-reducing. The highest income growth is seen



Figure 3.5. Percentile-point real income growth by parliament, 1996–97 to 2008–09 (GB)



Notes: The changes in income at the 1<sup>st</sup> and 2<sup>nd</sup> percentiles are not shown on this graph. Incomes have been measured before housing costs have been deducted.

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

at the very bottom of the income distribution, with lower growth the higher we move up the income distribution. For most points of the income distribution, growth is lower than in the previous four years, but still positive (and above 1%) everywhere in the distribution.

In stark contrast to this, income growth from 2004–05 to 2008–09 was lower than in previous parliaments for most of the income distribution (all bar the top 3%) and also almost uniformly inequality-increasing. That is, for most points of the income distribution since 2004–05, the higher up the income distribution we go, the higher the annual growth in incomes. Income growth has been negative for the bottom 15% or so of the income distribution over this period, and below 1% everywhere except in the top 15%.

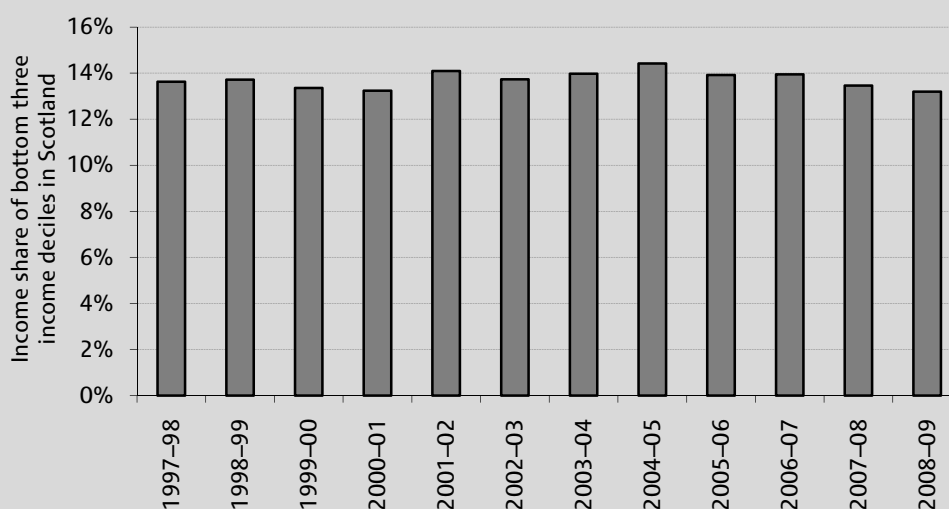
While the UK government has never explicitly targeted the income levels, or income shares, of different sections of the income distribution, in 2007 the Scottish government announced a 'solidarity target' which does both. Box 3.1 discusses the Scottish target in more detail.

**Box 3.1. Targeting inequality: the Scottish government's 'solidarity target'**

While targets for reducing child poverty have become a prominent feature of UK social policy, we have not hitherto seen national targets relating to income inequality. In 2007, however, the Scottish government published an Economic Strategy which included a 'solidarity target' relating specifically to income inequality: 'to increase overall income and the proportion of income earned by the three lowest income deciles as a group by 2017'.<sup>a</sup>

The first part of this target – the commitment to increase overall income among the three lowest deciles – should be the easier commitment to meet. While we have seen decade-long periods in which the average income of the poorest 30% of people in Scotland has failed to grow in real terms (such as the period 1978 to 1988), real income growth among the bottom three deciles has been reasonably robust from the late 1980s onwards, averaging around 2% per year in real terms.

The second commitment – to increase the proportion of income earned by the three lowest income deciles – could be substantially more challenging to meet. The figure below shows the share of income enjoyed by the three lowest income deciles in Scotland since 1997–98, using the same definition of ‘income share’ as the solidarity target. We see that this income share has fluctuated around 14% of total income in all years, and has if anything been declining in recent years. Meeting the solidarity target would require a reversal in this trend.



Note: Incomes have been measured before housing costs have been deducted

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

It is worth noting that the concept of the ‘income proportion’ used to evaluate this target does not correspond to what we might intuitively think of as a share of Scotland’s national income. The measure of ‘total income’ used for the target is the sum of all Scottish households’ equivalised household income – which means that households with multiple members have their equivalised income counted multiple times, giving a total that bears little relation to Scotland’s true net household income. The Scottish government website notes that this methodology is ‘currently under review’.<sup>b</sup>

The solidarity target also creates a ‘cliff edge’ in policy incentives: giving extra income to a household in the 31<sup>st</sup> percentile of the income distribution would move the government further away from its target, while giving income to a household in the 29<sup>th</sup> percentile of the distribution would move it closer to meeting the target, despite the fact that the two households may differ little in the degree of hardship they face. This is a criticism that also applies to poverty targets (with the ‘cliff edge’ arising either side of the poverty line), but with slightly less force. The number of individuals living below the poverty line can be reduced, but the number of individuals living in the bottom three income deciles is purely a function of Scotland’s population size.

We may also question whether, under the current division of powers between Westminster and Holyrood, the Scottish government has sufficient power over policy levers to affect the income distribution in the manner envisaged by the target. It currently has limited control over taxation (the power to change the basic rate of income tax by up to 3 pence in the pound and to change the form of local taxation) and no control over the rates of state benefits and pensions, which significantly limits its ability to redistribute income directly. The new Conservative–Liberal-Democrat coalition government has committed itself<sup>c</sup> to implementing the recommendations of the Calman Commission,<sup>d</sup> which would significantly increase the Scottish government’s tax-setting powers but would not give control over the rates of state benefits or pensions.

a. Scottish Government (2007), *The Government Economic Strategy* (<http://www.scotland.gov.uk/Resource/Doc/202993/0054092.pdf>).

b. <http://www.scotland.gov.uk/About/scotPerforms/purposes/solidarity>. Also note that the Scottish government is due to publish *Poverty and Income Inequality in Scotland 2008–09* on 20 May 2010 (<http://www.scotland.gov.uk/Topics/Statistics/Browse/Social-Welfare/IncomePoverty/Publications>).

c. See the coalition agreement, section 6, available at <http://www.conservatives.com/~media/Files/Downloadable%20Files/agreement.ashx?dl=true>.

d. Commission on Scottish Devolution, 2009.

### 3.3 Top-income growth and financial markets

Brewer, Sibieta and Wren-Lewis (2008) note that growth in incomes at the very top of the income distribution tends to be correlated with growth (and contraction) in financial markets. This is not surprising, given that individuals in this group earn a larger fraction of their income from savings and investments than individuals further down the income distribution, and that a significant fraction of top earners work in the financial sector.<sup>9</sup> With 2008–09 seeing the continued unfolding of the worst financial crisis since the Great Depression, it is perhaps unsurprising that top incomes appear to have fallen between 2007–08 and 2008–09. The HBAI data used in this analysis are not the best source for investigating the evolution of top incomes (for reasons discussed by Brewer et al.), but the latest year of data do nonetheless show a decline in the average incomes of the top two percentiles, for the first time since 1994–95.

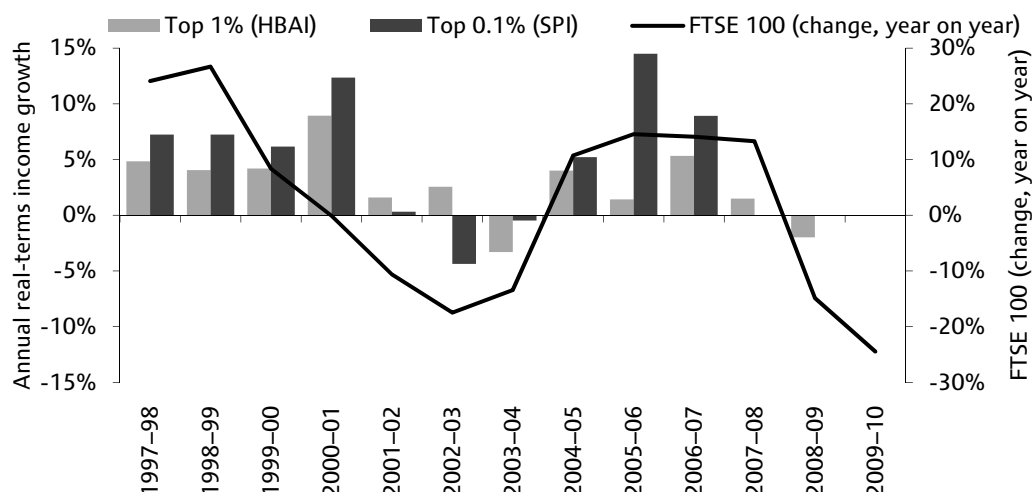
In Figure 3.6, we show the yearly growth in the real income levels of the top 1% and the top 0.1% (the very highest incomes) compared with the year-on-year change in the FTSE 100 index.<sup>10</sup>

The FTSE 100 index is by far the most volatile of the three series, rising dramatically in the late 1990s, and again from 2003 to 2007, before ‘crashing’ again in both cases. Following the crash in 2000, top incomes (both the top 1% and the top 0.1%) did not fall by anything like the same extent as the stock market: they fell a little, or at least grew much more slowly, between 2000 and 2003. With the incomes of the top 1% falling in 2008–09, it appears something similar happened during the recent financial crisis. This downward pressure on top incomes will act to reduce income inequality, all else being equal.

<sup>9</sup> Brewer, Sibieta and Wren-Lewis (2008) show that at the very top of the earnings distribution (the top 0.1%), 30% of individuals work in ‘financial intermediation’.

<sup>10</sup> The series for the top 0.1% was created by Brewer, Sibieta and Wren-Lewis (2008) using the Survey of Personal Incomes. It was updated for years up to 2006–07 (the latest year for which such data are available) in Muriel, Phillips and Sibieta (2010).

Figure 3.6. Top incomes and the FTSE 100 index



Notes: Incomes have been measured before housing costs have been deducted. Top incomes figures relate to Great Britain only. Methodological improvements to the Survey of Personal Incomes are likely to have overstated growth over this period, particularly in 2005-06.

Sources: Google Finance; authors' calculations using Family Resources Survey and Survey of Personal Incomes, various years.

### 3.4 Summary measures of inequality

While Figures 3.3 to 3.5 give a very detailed impression of how incomes have changed between specific years, it can also prove useful to construct some summary measures of how inequality has evolved over time. This section discusses trends in various inequality measures.

#### The Gini coefficient

The Gini coefficient is a popular measure of income inequality that condenses the entire income distribution into a single number between 0 and 1: the higher the number, the greater the degree of income inequality. A value of 0 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 1 corresponds to inequality in its most extreme form, with a single individual having command over the entire income in the economy.<sup>11</sup>

Figure 3.7 shows the evolution of the Gini coefficient since 1979. Inequality rose dramatically over the 1980s, with the Gini rising from a value of around 0.25 in 1979 and reaching a peak in the early 1990s of around 0.34. The scale of this rise in inequality has been shown elsewhere to be unparalleled both historically and compared with the changes taking place at the same time in most other developed countries.<sup>12</sup>

Since the early 1990s, the changes in income inequality have been less dramatic. After falling slightly over the early to mid-1990s, inequality rose again during Labour's first term, with the Gini coefficient reaching a new peak of 0.35 in 2000-01. During Labour's second term, however, the Gini fell, with the level of inequality in 2003-04 returning to

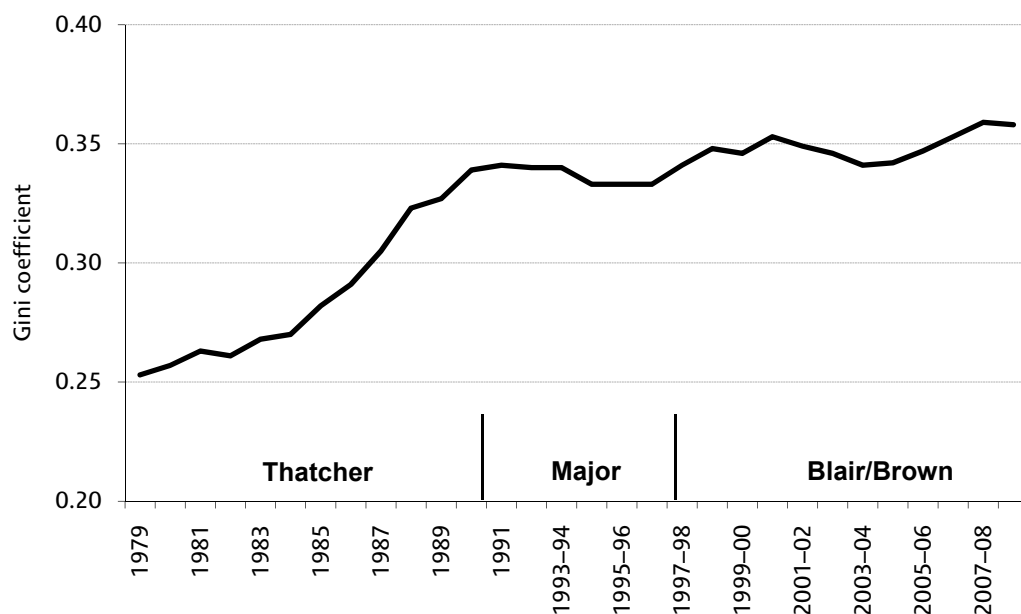
<sup>11</sup> See appendix C of Brewer, Goodman, Shaw and Sibieta (2006) for more information.

<sup>12</sup> See Goodman, Johnson and Webb (1997), Gottschalk and Smeeding (1997) and Atkinson (1999).

that last seen in 1997–98. Over the first two terms of the Labour government, the net effect of these changes was to leave income inequality effectively unchanged and at historically high levels.

Income inequality (as measured by the Gini coefficient) rose in each of the first three years of Labour's third term. This left the Gini coefficient in 2007–08 at 0.36, its highest level since our comparable time series began in 1961. Though the Gini has fallen very slightly in 2008–09, it remains at 0.36 when rounded to two decimal places, leaving it just below its historic high. The increases in the Gini since Labour came to power in 1996–97 and since the recent low in 2003–04 are both statistically significant.

Figure 3.7. The Gini coefficient, 1979 to 2008–09 (GB)

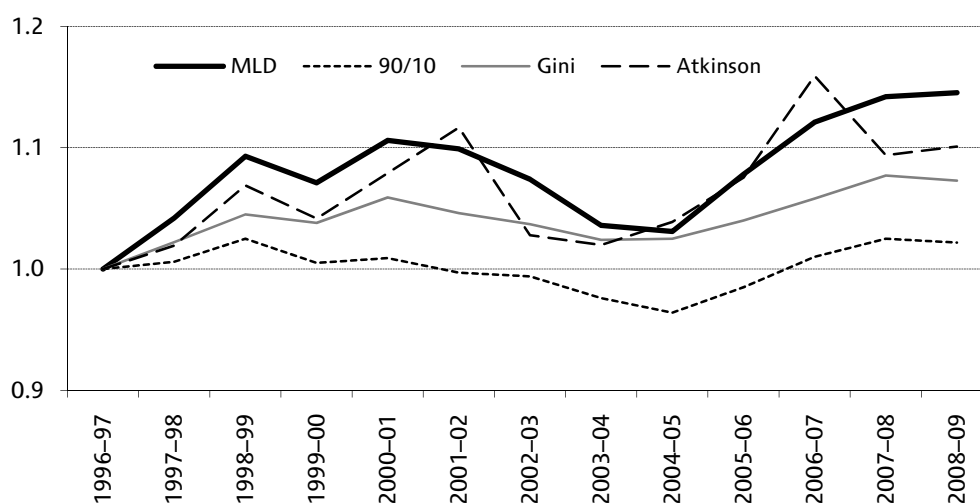


Note: The Gini coefficient has been calculated using incomes before housing costs have been deducted.  
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

## Other summary measures of inequality

There are a wide range of other measures available to summarise income inequality, based on different definitions of income inequality. Figure 3.8 shows the path of a selection of inequality measures, indexed so as to equal 1 in 1996–97. The 90:10 ratio is the simplest of these measures: it is the ratio of the income of the household at the 90<sup>th</sup> percentile point to that of the household at the 10<sup>th</sup> percentile point. Mean log deviation (MLD) measures (roughly) the expected percentage difference between the income of a randomly-selected individual and overall mean income. The Atkinson measure allows one to choose a value for society's aversion to inequality, defining the amount that society considers it necessary to give to a 'poor' person, having taken a given amount of income from a 'rich' person, in order to keep overall social welfare the same. The value we have chosen for this parameter reflects a society that considers it necessary to give £33 to a 'poor' person, having taken £100 from a 'rich' person, in order to keep overall social welfare the same (this is a relatively inequality-averse society). This measure was discussed in more detail in appendix C of Brewer, Goodman, Shaw and Sibieta (2006).

Figure 3.8. Summary measures of income inequality, 1996–97 to 2008–09 (GB)



Notes: Measures have been calculated using incomes before housing costs have been deducted. The Atkinson inequality measure is shown for an inequality aversion parameter,  $\epsilon$ , of 1.5. This implies that society considers it necessary to give £33 to a 'poor' person, having taken £100 from a 'rich' person, in order to keep overall social welfare the same.

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

While the precise pattern of inequality changes varies between these different measures, all measures agree in certain key respects. They all show inequality rising for the first few years after 1996–97, but then falling back to a low point between 2003–04 and 2004–05; and all measures show inequality rising after 2004–05, leaving inequality higher in 2008–09 than it was in 1996–97. With Figure 3.3 showing relatively even growth in incomes across the bulk of the distribution between 2007–08 and 2008–09, it is perhaps unsurprising that our summary measures of inequality have changed little in the latest year. The MLD and Atkinson measures have risen very slightly, while the Gini and 90:10 have fallen slightly, but none of these changes is statistically significant.<sup>13</sup> Across a range of measures, therefore, income inequality is broadly unchanged from its level in 2007–08.

## Prospects for inequality

Muriel and Sibieta (2009) illustrate how inequality evolved during previous UK recessions, and make clear that there is no 'rule' for the behaviour of inequality during a downturn. Inequality fell during the recession of the mid-1970s, rose during the recession of the early 1980s and was more or less unchanged during the recession of the early 1990s. Clearly, history offers little guide as to what we can expect to happen to inequality during recessions. While our first full year of data for the current recession show income inequality to be largely unchanged, this need not remain the case in subsequent years. We can, however, point to several forces that look likely to affect income inequality in the immediate future.

<sup>13</sup> Standard errors for these inequality measures were calculated using the bootstrap methodology. See Source to Table 2.2 for more detail.

To the extent that inequality can be changed by government tax and benefit policy, some measures targeted at low-income families that have already been announced might serve to reduce inequality very slightly. These measures include increases in the child element of the child tax credit between 2009 and 2010 (over and above earnings indexation, which is the default rate of increase), and a commitment to increase the pension credit in line with earnings indefinitely.<sup>14</sup> However, the fact that reducing the fiscal deficit appears to be the priority of all politicians would seem to limit government's scope to employ further discretionary measures aimed at low-income families in 2011–12 and beyond.

Turning to the top of the income distribution, we have already seen that top incomes appear to be correlated with the performance of financial markets. Over the course of 2009, financial markets began to claw back some of their losses during the financial crisis – a process that has broadly continued in 2010. We might therefore suspect that the declines in top incomes seen in 2008–09 (which tended to reduce inequality) will not continue for long.

However, a number of planned tax policy changes will also particularly affect those on higher incomes. These policies include the introduction of a new higher tax rate of 50% on incomes above £150,000, the withdrawal of the personal allowance on incomes above £100,000, and the reduction in the tax relief on pensions contributions for individuals with incomes over £130,000 whose income, plus the estimated value of any employer pension contributions, exceeds £150,000. The government also levied a one-off 'bonus tax' on banks in 2009–10, at a rate of 50% on bonuses above £25,000. These changes look likely to act to reduce income inequality, all else being equal.

### **3.5 Conclusion**

Given the deep decline in GDP over the course of 2008–09, it is perhaps surprising that we see so little evidence of declining net incomes, except at the very top of the income distribution. Inequality, across a range of measures, remains broadly unchanged from 2007–08, and therefore stays just below its highest level since our comparable time series begins in 1961.

The overall change in the income distribution since 1996–97 is little altered by one more year of data: broadly, the income distribution became more equal between around the 25<sup>th</sup> and 75<sup>th</sup> percentiles, but it has grown more unequal at the top and the bottom of the distribution. A range of summary measures of inequality, including the widely-used Gini coefficient, show that inequality has risen significantly between 1996–97 and 2008–09. However, this increase in inequality is much smaller in magnitude than the rise in inequality that occurred during the 1980s.

The decline in incomes at the very top of the income distribution between 2007–08 and 2008–09 tracks the crash in financial markets over this period. Given that 2009–10 has seen a recovery in financial markets following the crisis, we may well not expect this decline to continue in future. However, several changes to the tax and benefit system look set to hit those on high incomes particularly hard in the coming years, which will tend to reduce income inequality, all else being equal.

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<sup>14</sup> Though the latter will only prevent the increase in inequality that would have resulted if, prior to the announcement, the government had planned to increase pension credit less generously.

## 4. Poverty

### Key findings

- Relative poverty was 100,000 lower in 2008–09 than in 2007–08 measured before housing costs (BHC) and it was unchanged measured after housing costs (AHC). Neither change is statistically significant, but the small fall (BHC) is the first fall since 2004–05 and follows three years in a row that relative poverty rose. However, poverty remains statistically significantly higher than in 2004–05.
- In the latest year of data, child poverty fell 100,000 measuring incomes both BHC and AHC. Between 2008–09 and 2010–11, child poverty needs to fall by 1.1 million to meet the previous government’s 2010 target of halving child poverty. Documents accompanying the March 2010 Budget confirmed that the previous government had as good as conceded that its child poverty target for 2010 would not be met, a conclusion supported by previous IFS analysis.
- The Child Poverty Act 2010 makes meeting the 2020 target of ‘eradicating’ child poverty legally binding. Progress will be assessed using four measures, the most-watched of which is likely to be the relative poverty target (a rate of less than 10%, measuring incomes BHC). The new coalition government has yet to set out its strategy, and the policies put forward by the parties before the election were vague and unlikely to be enough to meet the targets. The Act requires that the government of the day publishes its first strategy by 25 March 2011.
- In 2008–09, pensioner poverty fell 200,000 measuring incomes both BHC and AHC. About 30,000 to 40,000 of this fall can be attributed to increases in the rates of the winter fuel payment. Pensioner poverty is now at its lowest level since 1985 (BHC) or 1984 (AHC). Measured AHC, the rate of poverty amongst pensioners is now lower than the rate for any other population group.
- Poverty amongst working-age adults without dependent children is at its highest level since the start of our comparable series in 1961, with rises of 200,000 both AHC and BHC in the latest year of data. This rise was driven largely by an increase in the fraction of such people living in families where no-one works.
- After adjusting for regional differences in the cost of living, relative poverty (using incomes measured BHC) is highest in London and lowest in Scotland. Poverty has fallen the most since the three-year period beginning in 1996–97 in the North East of England and it has risen the most in the West Midlands.
- Looking to future years of HBAI data, falling levels of inflation meant that benefits and tax credits grew in real terms during 2009–10. This would normally act to reduce relative poverty, depending on the relative growth in average incomes and the poverty line. At least part of this real rise is likely to be undone in 2010–11 (even though 1.5% of the expected increase in 2011–12 has been brought forward for a number of benefits), as inflation has started to pick up.

Reducing poverty amongst families with children was made a key element of the Labour government’s agenda in 1999 following then Prime Minister Tony Blair’s pledge to ‘abolish child poverty within a generation’.<sup>15</sup> In addition, there has been considerable

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<sup>15</sup> Tony Blair, Beveridge Lecture, Toynbee Hall, London, 18 March 1999.



effort to raise the incomes of the poorest pensioners and tackle pensioner poverty. In this chapter, we summarise the trends since 1996–97 in some of the government’s main income-based poverty indicators, all derived from HBAI data.

In Section 4.1, we analyse recent changes in relative poverty for the population as a whole. Section 4.2 focuses on subgroups of the population, examining poverty first amongst children and pensioners, groups favoured by the previous government’s tax and benefit reforms, and then amongst working-age adults without dependent children, a group much less favoured by recent tax and benefit reforms. Section 4.3 discusses trends in poverty across the regions and nations of the UK, Section 4.4 discusses absolute poverty and Section 4.5 concludes.

#### **Box 4.1. Poverty definitions and the reporting of poverty**

Unless stated otherwise, we measure poverty by counting the number of individuals whose household income is below 60% of that of the median individual (the median individual is in the middle of the income distribution).<sup>a</sup> The indicator is a ‘relative’ measure of poverty because the poverty line moves with median income growth each year. This definition of poverty as a relative concept is in common with those used in most of the rest of Europe but contrasts with, for example, the official measure of poverty used by the United States Census Bureau, which was initially based on the income required to purchase a fixed basket of food items and has since been updated in line with price changes. Such measures are called ‘absolute’ measures of poverty – although this terminology is not intended to suggest that it measures a more severe state of poverty than relative poverty – and we also report the number of people living in households with income below 60% of the median individual’s income as fixed in 1996–97 (and 1998–99 for child poverty, representing the previous government’s official measure of absolute child poverty).

Poverty rates can be measured using incomes before housing costs (BHC) or after housing costs (AHC) (see Appendix A), and we present both, but it should be noted that the Child Poverty Act 2010 defines a measure of child poverty in terms of incomes measured BHC only. The government reports the number of individuals rounded to the nearest 100,000, and likewise rounds changes in the number to the nearest 100,000. For consistency and ease of comparison, we also use this convention. Sometimes, this can lead to numbers that can be difficult to interpret and confusing. For example, using the unrounded numbers, there were 13,472,027 people in poverty measured AHC in 2007–08 and 13,444,270 in 2008–09. Rounded to the nearest 100,000, these would be 13.5 million and 13.4 million respectively. Rounded to the nearest 100,000, the *change* in the number of people in poverty measured AHC between 2007–08 and 2008–09 (27,757) is zero, however. The level of poverty has fallen but the change in poverty was zero. To avoid confusion, we will point out other such examples as they arise in the main text.

The government reports poverty rates rounded to the nearest full percentage point. Here we depart from its methodology and round percentages to the nearest tenth (0.1) of a per cent. This allows us to be more precise and to report smaller changes in the proportion of people in poverty than the government.

a. In this chapter, most estimates of poverty are presented on a GB basis up to and including 2001–02 and on a UK basis in 2002–03 and subsequent years. The size of the discontinuity caused by the inclusion of Northern Ireland is small: using a UK-wide poverty line, the risk of poverty in Northern Ireland in 2008–09 was 21.3% measuring incomes BHC, slightly higher than that in the rest of the UK (18.1%) (the opposite is true when measuring incomes AHC – 21.0% in Northern Ireland compared with 22.3% in the rest of the UK); but only 2.9% of individuals in the UK live in Northern Ireland.

As noted in Appendix A, figures are presented on a GB basis up to and including 2001–02 and on a UK basis from 2002–03 (i.e. largely the same way as they are presented in HBAI).<sup>16</sup> Due to this break in the series, and because the size of populations can change over time, when looking at longer-run poverty trends we will focus on the *fraction* of individuals that poverty affects rather than the actual *number* of individuals. Nevertheless, most of the following tables present both the number of people who are poor and the percentage of the relevant population that this number represents. We also report estimates of whether changes in poverty are statistically significant.<sup>17</sup> Box 4.1 gives more details of how we measure and report poverty in this publication.

## 4.1 Poverty in the whole population

In the UK in 2008–09, there were 13.4 million individuals in relative poverty measuring incomes after housing costs (AHC) and 10.9 million measuring them before housing costs (BHC), using a poverty line equal to 60% of median income. On this indicator, between 1997–98 and 2004–05, Labour oversaw the longest decline in poverty since the start of our consistent time series in 1961. However, this decline in poverty came to an end in 2004–05, and poverty then rose for three consecutive years.

Between 2007–08 and 2008–09, poverty fell by 100,000 measuring incomes BHC (or by 0.3 percentage points) and was unchanged measuring incomes AHC (although as a proportion of the total population it fell by 0.2 percentage points). Following three years of consecutive rises, however, from its recent low in 2004–05, poverty is higher by 0.9 million or 1.0 percentage points (BHC) or 1.4 million or 1.8 percentage points (AHC). Despite falls in the most recent year of data, the increase since 2004–05 remains statistically significantly different from zero.

To give more perspective, Figure 4.1 shows relative poverty in Great Britain between 1979 and 2001–02 and in the UK from 2002–03 onwards, measuring incomes AHC (Figure 4.1a) and BHC (Figure 4.1b) and under a range of poverty lines. (Note that the rest of this chapter will focus mostly on poverty lines defined as 60% of median income.) One can see from these graphs that poverty rates measured AHC tend to be higher than those measured BHC, because those on low incomes tend to spend a greater proportion of their incomes on housing than those on higher incomes. In 2008–09, for instance, poverty measuring incomes AHC was 22.3%, whilst the rate was 18.1% for poverty measuring incomes BHC.

Poverty rates increased dramatically during the mid- to late 1980s, more slowly in the early 1990s, and then stabilised or fell from the mid-1990s onwards, about the same time that the Labour government came to power. To be more specific, in Labour's first term, overall poverty fell by 2.1 percentage points (AHC) and by 1.0 percentage points (BHC); it then fell slightly faster during the second term, falling by a further 2.6 percentage points (AHC) and 1.4 percentage points (BHC). All of these declines are statistically significant. The decline came to an end in 2004–05, with increases in 2005–06, 2006–07 and 2007–08 meaning a cumulative rise between 2004–05 and 2008–09 of 1.8 and 1.0 percentage points, AHC and BHC respectively. However, it is clear that the rise in relative poverty

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<sup>16</sup> Though it should be noted that headline indicators are presented on a UK basis in HBAI back to 1998–99, with data imputed for Northern Ireland between 1998–99 and 2001–02 inclusive.

<sup>17</sup> These were calculated by bootstrapping the changes using 500 iterations (see Source to Table 2.2).

since 2004–05 has not completely undone the progress on reducing poverty in Labour’s first two terms.

Looking at trends using other poverty lines (40%, 50% and 70% of the median income), we see that poverty rates also increased during the 1980s using these poverty lines. Poverty has fallen or stabilised since the mid-1990s using the 50% and 70% thresholds. However, when we consider the 40% poverty line, we see that this measure of poverty

Figure 4.1a. Relative poverty: percentage of individuals in households with incomes below various fractions of median income (AHC)

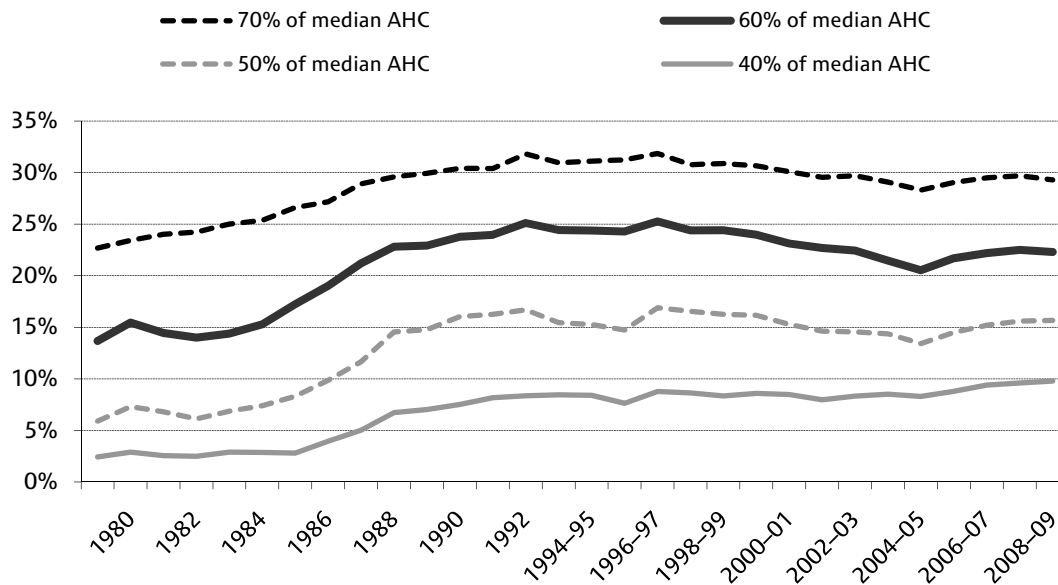
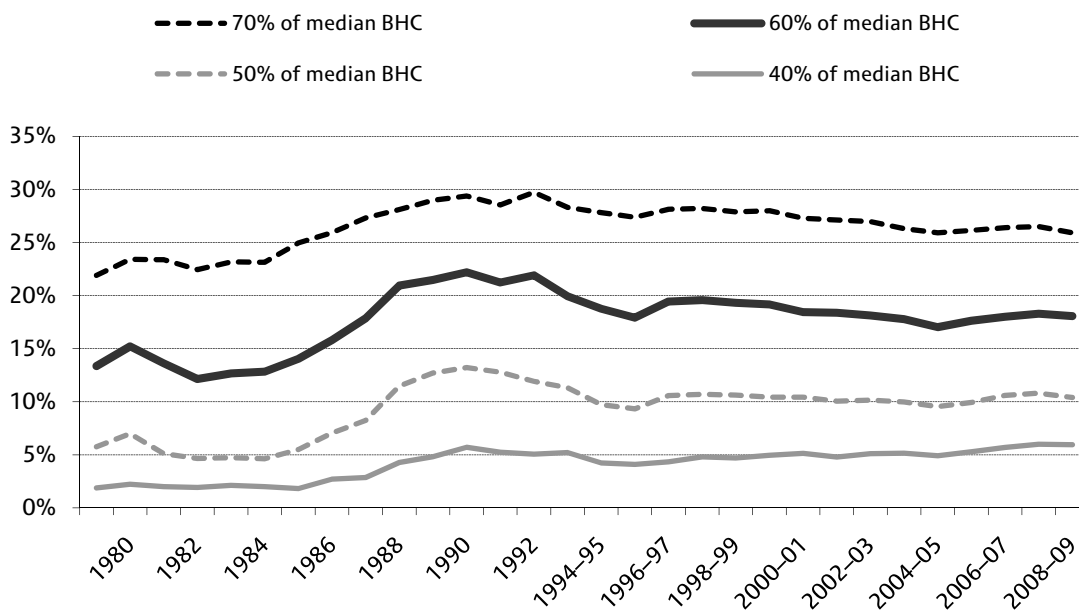


Figure 4.1b. Relative poverty: percentage of individuals in households with incomes below various fractions of median income (BHC)



Note: Figures are presented for GB up until 2001–02 and then for the whole of the UK from 2002–03 onwards. Source: Authors’ calculations based on Family Expenditure Survey and Family Resources Survey, various years.

has actually risen by 1.0 percentage points since 1996–97 measuring incomes AHC and by 1.6 percentage points measuring incomes BHC. These rises are both statistically significantly different from zero.

#### Box 4.2. What happened to ‘severe poverty’ under Labour?

Of the 3.6 million individuals with incomes less than 40% of the contemporary median (BHC), about 1 million have recorded incomes less than about £50 per week. At first glance, this would seem to indicate that ‘severe’ poverty really is ‘severe’. However, other research has suggested that people in this group have, on average, living standards equivalent to those with much higher incomes (where living standards are measured by expenditure/consumption and/or material deprivation).<sup>a</sup> It could be that such people have only temporarily low incomes (due to temporary unemployment or low self-employment income, for instance), and are able to use their savings or borrow to fund higher living standards until their incomes rise again. It could also be that these people have their incomes measured with error. Since this group represents a relatively large proportion of those with current incomes less than 40% of the contemporary median, we have previously argued that it is unhelpful to refer to those with incomes less than 40% of the contemporary median as living in ‘severe’ or ‘deep’ poverty. Brewer, Phillips and Sibieta (2010) show that there are at least two fundamental issues one should consider when trying to assess this claim and conclude that one cannot convincingly prove that severe poverty increased between 1996–97 and 2007–08 (the most recent year of data available to the authors at the time of writing).

First, for the period since 1996–97, there is significant disagreement between different possible severe poverty measures, with some showing falls and others increases. However, relative and absolute measures of very low income, and measures of severe material deprivation (for families with children), have all increased since 2004–05, mirroring an increase in the official measures of relative poverty (based on a poverty line equal to 60% of median income).

Second, there is evidence that the increase in the fraction of people with very low levels of relative income does not reflect a genuine increase in those with very low living standards. Importantly, the rise between 1996–97 and 2000–01 was accounted for largely by a rise in the proportion of the population living in households with either zero measured income or an income below 20% of the median, groups for which we have evidence (see note a) that living standards are not as low as their incomes would suggest. Furthermore, some of this increase seems to be the result of increased deductions from income, some of an unrealistic level, such as student loan contributions (which explain about one-third of the rise in the fraction of people with an income less than 40% of the median between 1996–97 and 2004–05). It is therefore difficult to support the idea that severe poverty rose between 1996–97 and 2004–05 in a meaningful sense. However, the rise in the proportion of people living in households with incomes below 40% of the median since 2004–05 was driven mainly by those with incomes between 20% and 40% of the median, for whom living standards are very low on average, and so this probably does reflect an increase in the fraction of people with very low living standards.

Claims that severe poverty has increased since 1996–97 are therefore difficult to sustain convincingly. However, there is considerably stronger evidence that severe poverty has risen since 2004–05, mirroring an increase in the previous government’s preferred measure of poverty.

a. See Attanasio, Battistin and Ichimura (2005), Brewer, Goodman and Leicester (2006) or Brewer, O’Dea, Paull and Sibieta (2009).

A number of commentators have expressed concern at this increase, referring to those with current incomes less than 40% of the contemporary median as living in ‘severe’ or ‘deep’ poverty.<sup>18</sup> However, those with the lowest incomes are not necessarily those with the lowest living standards, as noted in Box 4.2, which discusses the issues of severe poverty in more detail.<sup>19</sup> The key finding is that whilst we cannot be sure that ‘severe poverty’ has increased since 1996–97, there is more compelling evidence that the rise in the fraction of people with an income less than 40% of the median since 2004–05 does represent a genuine increase in the number of people in ‘severe poverty’.

## 4.2 Relative poverty amongst different groups

This section examines poverty amongst children and pensioners (the two groups targeted by tax and benefit reforms under the Labour government) and amongst working-age adults without dependent children (who have fared less well).<sup>20</sup>

Table 4.1. Relative poverty: percentage and number of individuals in households with incomes below 60% of median AHC income

	<i>Children</i>		<i>Pensioners</i>		<i>Working-age parents</i>		<i>Working-age non-parents</i>		<i>All</i>	
	%	Million	%	Million	%	Million	%	Million	%	Million
1996–97 (GB)	34.1	4.3	29.1	2.9	26.6	3.3	17.2	3.5	25.3	14.0
1997–98 (GB)	33.2	4.2	29.1	2.9	25.9	3.2	15.9	3.3	24.4	13.6
1998–99 (GB)	33.9	4.3	28.6	2.9	26.3	3.2	15.5	3.2	24.4	13.6
1999–00 (GB)	32.7	4.2	27.6	2.8	25.5	3.1	16.1	3.4	24.0	13.4
2000–01 (GB)	31.1	3.9	25.9	2.6	24.7	3.0	16.2	3.4	23.1	13.0
2001–02 (GB)	30.8	3.9	25.6	2.6	24.5	3.0	15.6	3.4	22.7	12.8
2002–03 (UK)	29.8	3.9	24.2	2.5	24.1	3.0	16.5	3.7	22.4	13.1
2003–04 (UK)	28.7	3.7	20.6	2.2	23.5	2.9	16.6	3.7	21.5	12.6
2004–05 (UK)	28.4	3.6	17.6	1.9	23.0	2.9	16.1	3.6	20.5	12.1
2005–06 (UK)	29.8	3.8	17.0	1.8	24.9	3.1	17.6	4.0	21.7	12.8
2006–07 (UK)	30.5	3.9	18.9	2.1	25.2	3.2	17.6	4.0	22.2	13.2
2007–08 (UK)	31.1	4.0	18.1	2.0	25.6	3.3	18.1	4.2	22.5	13.5
2008–09 (UK)	30.3	3.9	16.0	1.8	25.6	3.3	19.1	4.4	22.3	13.4
<b>Changes</b>										
1996–97 to 2000–01	–3.0		–3.2		–1.9		–1.0		–2.1	
2000–01 to 2004–05	–2.8		–8.3		–1.6		–0.1		–2.6	
2004–05 to 2008–09	1.9	0.2	(–1.6)	(–0.1)	2.6	0.4	3.1	0.8	1.8	1.4
2007–08 to 2008–09	(–0.8)	(–0.1)	–2.1	–0.2	(–0.0)	(0.1)	1.0	0.2	(–0.2)	(0.0)

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Changes in parentheses are not significantly different from zero at the 5% level. Because of the discontinuity in the series due to the inclusion of Northern Ireland from 2002–03, changes in the number of people in poverty since 1996–97 are not available. However, due to Northern Ireland’s small population and similar poverty rates, the changes in poverty rate reported should be accurate. All figures are presented using the modified OECD equivalence scale.

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

<sup>18</sup> See Conservative Party (2008) or Hunt and Clark (2007).

<sup>19</sup> This draws on Brewer, Phillips and Sibieta (2010).

<sup>20</sup> We use the shorthand ‘working-age adults without children’ or ‘working-age non-parents’ to refer to ‘working-age adults without dependent children’.

Table 4.2. Relative poverty: percentage and number of individuals in households with incomes below 60% of median BHC income

	<i>Children</i>		<i>Pensioners</i>		<i>Working-age parents</i>		<i>Working-age non-parents</i>		<i>All</i>	
	%	Million	%	Million	%	Million	%	Million	%	Million
1996–97 (GB)	26.7	3.4	24.6	2.4	20.2	2.5	12.0	2.5	19.4	10.8
1997–98 (GB)	26.9	3.4	25.3	2.5	20.4	2.5	11.9	2.5	19.6	10.9
1998–99 (GB)	26.0	3.3	26.8	2.7	19.6	2.4	11.5	2.4	19.3	10.8
1999–00 (GB)	25.6	3.3	25.1	2.5	19.8	2.4	12.1	2.6	19.2	10.7
2000–01 (GB)	23.3	3.0	24.8	2.5	18.1	2.2	12.8	2.7	18.4	10.4
2001–02 (GB)	23.1	2.9	25.1	2.5	18.3	2.2	12.5	2.7	18.4	10.4
2002–03 (UK)	22.6	2.9	24.4	2.5	18.0	2.2	12.7	2.8	18.1	10.6
2003–04 (UK)	22.1	2.9	22.9	2.4	17.9	2.2	12.8	2.9	17.8	10.4
2004–05 (UK)	21.3	2.7	21.3	2.3	16.9	2.1	12.6	2.9	17.0	10.0
2005–06 (UK)	22.0	2.8	20.8	2.2	18.2	2.3	13.4	3.1	17.6	10.4
2006–07 (UK)	22.3	2.9	23.2	2.5	17.9	2.3	13.2	3.0	18.0	10.7
2007–08 (UK)	22.5	2.9	22.7	2.5	18.1	2.3	14.0	3.2	18.3	11.0
2008–09 (UK)	21.8	2.8	20.4	2.3	18.2	2.4	14.7	3.4	18.1	10.9
<b>Changes</b>										
1996–97 to 2000–01	–3.4		0.1		–2.0		0.7		–1.0	
2000–01 to 2004–05	–2.0		–3.5		–1.2		–0.2		–1.4	
2004–05 to 2008–09	(0.5)	(0.1)	(–0.9)	(0.0)	1.3	0.2	2.1	0.5	1.0	0.9
2007–08 to 2008–09	(–0.7)	(–0.1)	–2.3	–0.2	(0.1)	(0.1)	(0.7)	(0.2)	(–0.3)	(–0.1)

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Changes in parentheses are not significantly different from zero at the 5% level. Because of the discontinuity in the series due to the inclusion of Northern Ireland from 2002–03, changes in the number of people in poverty since 1996–97 are not available. However, due to Northern Ireland's small population and similar poverty rates, the changes in poverty rate reported should be accurate. All figures are presented using the modified OECD equivalence scale.

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

Tables 4.1 and 4.2 contain more detailed information on relative poverty, using a 60% poverty line, since 1996–97 for the population as a whole (the last pair of columns) and for various subgroups (the other columns). Using rounded numbers, the overall picture of no change in poverty between 2007–08 and 2008–09 measuring incomes AHC comprises 200,000 additional working-age adults without children in poverty, an additional 100,000 adults with children in poverty, 100,000 fewer children in poverty and a fall in the number of pensioners in poverty of 200,000.<sup>21</sup> Measuring incomes BHC, the net fall in overall poverty of 100,000 comprises an additional 200,000 working-age adults without children, an additional 100,000 working-age adults with children, 100,000 fewer children and 200,000 fewer pensioners in poverty. It should be noted that in some of these instances, the levels reported in Tables 4.1 and 4.2 will not have changed (to the nearest 100,000) even though the change is not zero (rounded to the nearest 100,000) – see Box 4.1 for more details.

<sup>21</sup> Unusually, the rate of poverty amongst children and that amongst adults with dependent children (i.e. 'parents') move in different directions this year. This may reflect different trends in poverty amongst smaller and larger families.

These figures contrast with those observed last year, when poverty rose overall (but not for pensioners). Child poverty remains above its recent low in 2004–05. There were substantial falls in relative poverty amongst children between 1996–97 and 2004–05, measuring incomes both AHC and BHC. Despite the small fall this year, about one-tenth of the fall in child poverty using incomes measured BHC and about one-third of the fall using incomes measured AHC has been reversed as a result of the net rise in child poverty since 2004–05.

The fall in pensioner poverty in 2008–09 means that the rate of pensioner poverty is at its lowest since 1985 using income measured BHC or since 1984 using income measured AHC. Since comparable figures began, pensioner poverty has been lower than in 2008–09 in only four years measuring incomes BHC and in only two years measuring incomes AHC (all in the early 1980s). Measured AHC, pensioners now have a lower rate of poverty than all other groups in society. However, using incomes measured BHC, the rate of pensioner poverty exceeds that of working-age adults (although it is below that of children).

Whilst other groups have seen falls in poverty rates since 1996–97, there has been a rise in relative poverty amongst working-age adults without children, a group not favoured by tax and benefit reforms under Labour. Although this group has a lower-than-average risk of falling into poverty, this risk changed little over Labour’s first two terms of office.

Having increased since 2004–05, the risk of poverty for this group was 2.0 percentage points higher using incomes measured AHC in 2008–09 than in 1996–97. Measured BHC, the trends are even less favourable: the 1996–97 level of relative poverty has been exceeded in every year since 1999–2000, and is now 2.7 percentage points higher than it was in 1996–97. If the rate of poverty for this group had remained at its 1996–97 level, there would be 500,000 fewer working-age adults without children in poverty using incomes measured AHC and 600,000 fewer using incomes measured BHC.

Before looking at relative poverty amongst each of the groups in more detail, we look at how changes in inflation, policy and the impact of the recession may have impacted upon poverty in the latest year of data, and how they might be expected to affect it over the next few years.

### ***Level of benefits and tax credits over time***

The majority of net income of individuals in the second and third deciles (roughly those just below and just above the poverty line) comes from state benefits and tax credits. Changes in the entitlement to state benefits and tax credits are therefore likely to be a key determinant of what happens to relative poverty. Table 4.3 shows year-on-year growth rates in cash-terms entitlements to social security benefits and tax credits for some key family types likely to be in or close to poverty, and compares these with the year-on-year changes in the poverty line (in cash terms) and in prices. Numbers in bold in the table mark the instances where entitlements to benefits and tax credits grew by more than inflation (as measured by RPI and ROSSI). Shaded cells mark instances where entitlements to benefits and tax credits grew faster than both the BHC and AHC poverty lines; considered in isolation, this would suggest a declining relative poverty rate for that family type in that year.<sup>22</sup>

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<sup>22</sup> Some of these benefits are designed only to cover non-housing costs, and so it might be more appropriate to compare them with changes in the ROSSI index or growth in the AHC poverty line. For example, growth in the rate of jobseeker’s allowance for a single adult has exceeded the change in RPI in only two years, but it has exceeded the change in ROSSI in seven years.

Table 4.3. Growth in nominal entitlements to state support for certain family types (%)

	Couple, 3 children, no work	Lone parent, 1 child, no work	Lone parent, 1 child, part-time work	Single person, on jobseeker's allowance (JSA)	Single person, on incapacity benefit (IB)	Basic state pension (single)	Single pensioner entitled to means- tested benefits	Couple pensioner entitled to means- tested benefits	Poverty line (BHC)	Poverty line (AHC)	RPI	ROSSI
1997-98	2.6	2.1	2.0	2.6	2.1	2.1	2.6	2.6	5.0	3.8	3.3	2.4
1998-99	2.4	-3.8	-5.5	2.4	<b>3.6</b>	<b>3.6</b>	2.4	2.4	3.8	4.3	3.1	2.2
1999-00	<b>9.3</b>	<b>8.6</b>	<b>9.3</b>	<b>2.1</b>	<b>3.2</b>	<b>3.2</b>	<b>6.5</b>	<b>6.5</b>	5.0	5.5	1.6	1.7
2000-01	<b>13.4</b>	<b>8.8</b>	<b>18.1</b>	1.6	1.1	1.1	<b>4.6</b>	<b>4.6</b>	5.9	5.8	3.0	1.4
2001-02	<b>9.1</b>	<b>6.4</b>	<b>7.2</b>	1.6	<b>3.3</b>	<b>7.4</b>	<b>17.5</b>	<b>15.3</b>	6.3	7.5	1.5	1.7
2002-03	4.1	3.2	4.2	1.7	1.7	4.1	<b>6.5</b>	<b>6.6</b>	3.7	4.8	2.1	1.5
2003-04	<b>8.6</b>	<b>6.6</b>	<b>7.4</b>	1.3	1.7	2.6	<b>4.3</b>	<b>4.0</b>	2.4	2.4	2.8	1.7
2004-05	<b>6.0</b>	<b>4.6</b>	<b>5.0</b>	1.8	2.8	2.8	3.0	<b>3.3</b>	4.0	2.6	3.1	1.3
2005-06	2.5	2.0	3.1	1.0	<b>3.1</b>	<b>3.1</b>	<b>3.8</b>	<b>3.8</b>	3.5	3.2	2.6	1.9
2006-07	3.1	2.7	3.0	2.2	2.7	2.7	<b>4.2</b>	<b>4.2</b>	4.1	3.7	3.7	3.1
2007-08	3.7	3.3	3.7	3.0	3.6	3.6	<b>4.4</b>	<b>4.4</b>	4.3	3.4	4.1	2.8
2008-09	<b>6.9</b>	<b>5.4</b>	<b>6.2</b>	2.3	3.9	3.9	4.2	4.2	3.6	3.4	3.0	4.5
2009-10	<b>6.3</b>	<b>6.1</b>	<b>5.5</b>	<b>6.3</b>	<b>6.4</b>	<b>5.0</b>	<b>4.8</b>	<b>4.8</b>	n/a	n/a	0.5	3.2
2010-11	2.2	2.0	1.9	1.8	1.7	2.5	2.0	2.0	n/a	n/a	3.3	3.5

Notes: The table shows annual changes in maximum entitlements to benefits for various family types with no private income (except the working lone parent, who is assumed to earn an amount that is below the personal income tax allowance and the primary threshold for National Insurance contributions) ignoring housing benefit and council tax benefit and the value of free school meals for families with children. 'RPI' measures change in annual average of RPI all items index since the previous year (except 2010-11); 'ROSSI' measures change in annual average of ROSSI since the previous year (except 2010-11). For 2010-11, RPI and ROSSI show estimated annual growth in September 2010 as estimated in table C1 of the March 2010 Budget (HM Treasury, 2010). Values in bold are greater than both the change in the RPI and the change in ROSSI over the same period; shaded cells are greater than the change in both the BHC and AHC poverty lines. For further details, contact authors. Source: Authors' calculations.



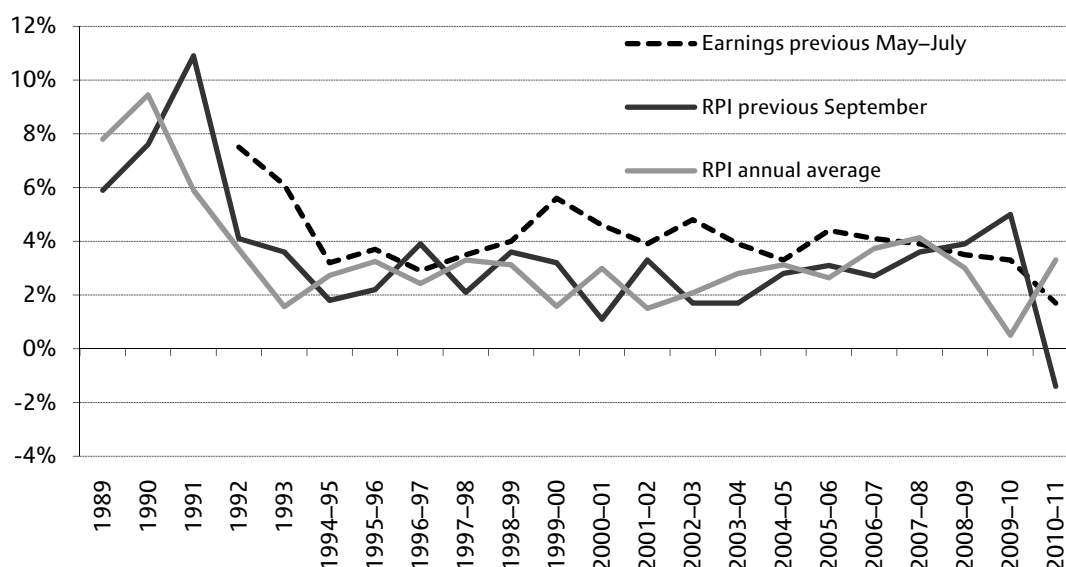
Table 4.3 shows the following:

- All the family types shown, except the single JSA (jobseeker's allowance) recipient, saw the real value of maximum entitlements to benefits and tax credits increase in 2008–09 (where 'real' is defined after accounting for inflation as measured by the RPI). RPI growth was 3.0% that year, whilst these family types saw cash increases in entitlement of 3.9% or above for that year.
- If we compare the growth in entitlements to ROSSI inflation (which strips out housing costs and council tax) instead, only the family types with children in the table saw a real increase in their maximum entitlement. This was because the ROSSI rose by more than the RPI: this is unusual, and reflects the fact that housing costs as measured in the RPI began falling in the second half of the year as the Bank of England cut interest rates.
- Given that the BHC poverty line grew by just 3.6% in cash terms in 2008–09, and the AHC poverty line increased by 3.4% in cash terms, maximum entitlements to benefits and tax credits for all families bar the single JSA recipient increased more than the poverty lines in cash terms in 2008–09. This is the first time that maximum entitlements have grown faster than the poverty lines for the non-pensioner families since 2004–05.
- Although many other things affect the level of incomes received by those around the poverty line, it is notable that child poverty has fallen in the first year since 2004–05 that benefits and tax credit entitlements have grown in real terms and relative to the poverty line, and it rose in the previous three years of relatively small increases in benefits and tax credits.<sup>23</sup> The significant rise in maximum entitlements partly reflects a discretionary increase in tax credits in April 2008 and partly reflects the fall-back in inflation.
- Since 2000–01, the growth in maximum entitlements to benefits for pensioner families with no private income has exceeded the growth in the poverty line (measuring incomes AHC) in each year (and in each year except 2004–05 measuring incomes BHC). Since 2003–04, this has been because maximum entitlements to benefits rise each year in line with average earnings, growth in which has tended to be above the growth in median income.
- The level of JSA for a single unemployed person has risen more slowly than the poverty line (measuring incomes AHC or BHC) in every year since 1996–97; the same is true for the level of incapacity benefit (IB), except in 2008–09 (AHC and BHC), and in 2007–08 and 2004–05 (AHC only). This will have presumably contributed towards the rise in poverty amongst working-age adults without children over this period.

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<sup>23</sup> The per-child element of the child tax credit has been increased at least in line with average earnings since 2004–05. However, a non-working family with children also receives income from child benefit (increased in line with RPI), income support (increased in line with ROSSI) and the family element of the child tax credit (frozen in nominal terms), so the total value of state support will increase by considerably less than average earnings. Working families with children do not receive income support, but they receive working tax credit, which is increased in line with RPI.

Figure 4.2. RPI inflation in survey year compared with RPI in previous September and average earnings<sup>a</sup> in previous May–July



a. Including bonus; seasonally adjusted.

Sources: ONS RPI inflation (CZBH) and average earnings (LNNC) series. March 2010 Budget (HM Treasury, 2010).

One reason why some maximum entitlements to benefits and tax credits increased in real terms for the first time in several years (relative to the RPI) is that, following the generally increasing inflation of the period 2005 to 2008, inflation fell from late 2008.<sup>24</sup> This affects the real value of benefits and tax credits even when those benefits are supposedly uprated by inflation. This is because most benefits and tax credits are uprated each April using the rate of inflation in the September of the previous year. Hence, benefits for the year 2008–09 were increased in April 2008 above the previous year's level by the rate of inflation prevailing in September 2007. Figure 4.2 shows that this rate of increase (3.9%) was higher than the subsequent annual average inflation rate during 2008–09 (3.0%), and this means that the real value of benefits linked to the RPI (such as the state pension) was higher in 2008–09 than in 2007–08.

The volatility of inflation means that the real value of benefits and tax credits continued to rise in 2009–10. Having peaked in September 2008 (at 5.0% for RPI and 6.3% for ROSSI), leading to large increases in inflation-linked benefits and tax credits in April 2009, inflation fell significantly following the VAT cut, cuts in mortgage interest rates and general economic weakness during the recession so that inflation in 2009–10 was just 0.5%. The value of RPI inflation in September 2009 was negative (–1.4%). In general, when inflation is negative, benefit and tax credit rates are frozen, but in the 2009 Pre-Budget Report,<sup>25</sup> the government decided to increase the rates of benefits and tax credits normally uprated with RPI by 1.5% in April 2010, a rise that is due to be undone in April 2011 by an increase of 1.5 percentage points less than the rate of RPI in September 2010.

<sup>24</sup> If private incomes respond to changes in the rate of inflation more rapidly than state benefits (as may be, given that, for instance, wage negotiations are likely to take into account expected future inflation as well as past inflation), falling inflation may also increase the value of benefits relative to the poverty line.

<sup>25</sup> HM Treasury, 2009.

The fact that these RPI-linked benefits and tax credits were not cut even though the relevant value of the RPI was negative represents a genuine rise in their value. However, because inflation is projected to increase during the current financial year, the real value of benefits and tax credits is likely to fall in 2010–11.

Similarly, pension credit (and its predecessor, the minimum income guarantee (MIG)) and the child element of the child tax credit are uprated in each April by the growth in average earnings measured over the previous May to July. This series was above the rate of inflation in every year between 1992 and 2006–07 inclusive, but the implied real rate of growth in the benefits has fluctuated; it was just 0.5% in 2008–09 (with the cash rise only just greater than the cash growth in the poverty line measuring incomes BHC), whilst it averaged 1.5% between 1996–97 and 2005–06. In 2009–10, the fall in inflation was larger than the fall in the rate of growth of earnings between May and July of the previous year, but it looks like inflation in 2010–11 will be higher than the 1.7% earnings growth in May to July 2009 used to increase these benefits and tax credits in April 2010.

When inflation and earnings growth are volatile, the real value of benefits is likely to fluctuate year on year, and this will clearly affect the rate of poverty. In the long run, however, this effect should be close to zero over time, with small real rises in one year being balanced by small real falls in others. However, because benefits were not cut when inflation was negative, the period of negative inflation during 2009 will lead to benefit rates that are permanently higher in real terms.<sup>26</sup>

### ***The recession, policy and poverty***

In last year's poverty and inequality Commentary, we assessed how poverty might evolve during the recession (i.e. during 2008–09 and 2009–10) and further into the future.<sup>27</sup> In this section, we assess what happened during the first year of the recession (2008–09) and note the likely impact of announced policy changes.

Last year, we highlighted that, in principle, the likely effects of the recession on relative poverty are uncertain. There are two main effects. First, increasing levels of unemployment would seem likely to lead to falls in household incomes, thus leading to greater numbers of individuals being classed as living in relative poverty. Second, these falls in income might also lead to falls in median income, which on their own would tend to reduce relative poverty, as the threshold for classifying people as living in relative poverty would also fall. Muriel and Sibieta (2009) showed that there were falls in overall levels of relative poverty during previous recessions, driven by large reductions in pensioner poverty (since pensioners are much less likely to be affected by rising levels of unemployment).

Tables 4.1 and 4.2 show that in 2008–09, overall poverty fell slightly, with higher rates of poverty for working-age adults more than offset by lower rates of poverty for children and pensioners. This is broadly in line with our predictions last year, even though median income (measured BHC) did not fall (see Chapter 2). So pensioner and child poverty (at least measured BHC) has fallen largely because low-income pensioners and children have seen their incomes grow by more than the poverty line, rather than because the poverty line fell, as occurred in previous recessions.

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<sup>26</sup> Brewer, Browne, Leicester and Miller (2010) estimate that undoing the real rise in benefits that occurred because benefits were not cut when RPI was negative would save around £700 million a year from 2011–12.

<sup>27</sup> Brewer, Muriel, Phillips and Sibieta, 2009, p. 40.

Looking to 2009–10, further increases in unemployment are likely to have acted to increase poverty, particularly for working-age adults, whilst real-terms growth in benefit entitlements will likely have acted to reduce poverty. However, it is difficult to predict how median income, and thus the poverty line, will have evolved over this period.

The changes in poverty amongst children, pensioners and working-age adults without dependent children are now explored in more detail. We focus upon poverty rates derived using income measured BHC for children, as this is the indicator of relative low income used in the targets in the Child Poverty Act; for consistency, we use this measure in detailed analyses of the other types of households. However, poverty rates derived from income measured AHC are also provided.

## Child poverty

The numbers of children living in poverty in the UK in 2008–09 were 3.9 million (AHC) and 2.8 million (BHC), both down by 100,000 since the previous year. These correspond to falls in the rate of 0.8 percentage points (AHC) and 0.7 percentage points (BHC). Neither of these changes is statistically different from zero at the 5% significance level, and poverty measuring incomes AHC remains statistically significantly higher in 2008–09 than it was in 2004–05, meaning the recent fall has not been enough to undo the combined impact of three consecutive increases in poverty between 2004–05 and 2007–08.

Table 4.4. Decomposition of the rise in relative child poverty (BHC), 2007–08 to 2008–09, by family type and work status

	<i>Poverty rate</i>		<i>Percentage of child population</i>		<i>Compositional effect</i>	<i>Incidence effect</i>	<i>Total change in poverty</i>
	2007–08	2008–09	2007–08	2008–09			
<b>Lone parents</b>							
Full-time	10.2%	12.0%	5.1%	5.6%	–7,859	12,313	4,454
Part-time	21.6%	18.8%	6.6%	6.6%	59	–24,316	–24,257
Workless	55.0%	54.0%	12.1%	11.8%	–10,619	–15,927	–26,546
All/Total			23.8%	24.1%	–18,418	–27,930	–46,348
<b>Couples with children</b>							
Self-employed	22.8%	21.6%	12.3%	11.4%	–22	–18,726	–18,748
Two full-time earners	2.1%	1.5%	12.9%	12.3%	13,237	–10,530	2,707
One full-time, one part-time	3.7%	4.2%	22.2%	22.6%	–7,816	13,726	5,910
One full-time, one not working	18.1%	18.7%	18.0%	18.4%	–1,747	13,328	11,581
One or two part-time	54.3%	52.5%	4.5%	5.8%	49,610	–11,648	37,962
Workless	68.2%	63.8%	6.3%	5.5%	–45,617	–32,752	–78,369
All/Total			76.2%	75.9%	7,646	–46,602	–38,956
<b>All children</b>	22.5%	21.8%	100.0%	100.0%	–10,772	–74,532	–95,160

Notes: Poverty rates are measured as the proportion of the group with income below 60% of the population-wide BHC median income. The ‘All children’ total change includes an effect due to the total size of the child population, and hence cannot be derived by simply summing the other totals.

Source: Authors’ calculations based on Family Resources Survey, 2007–08 and 2008–09.

A decomposition of the fall in child poverty from 2007–08 to 2008–09 can help tell us why child poverty has fallen, and Table 4.4 gives such a breakdown. The principle behind the table is to divide all children into nine family types (according to the number of adults in the family and their working patterns) and then divide all changes in poverty into incidence effects – which represent changes in the risk of poverty for particular family types – and compositional effects – which reflect changes in the distribution of children between these nine family types.<sup>28</sup> It should be pointed out that because the overall fall in child poverty (BHC) between 2007–08 and 2008–09 was not statistically different from zero, it is highly likely that the same is true for the estimated incidence and compositional effects in Table 4.4. The decomposition does, however, explain the *mechanics* of why child poverty has fallen.

The bottom row of Table 4.4 shows that the fall in child poverty is mostly due to incidence effects (a reduced risk of poverty for particular family types), with changes in the composition of families acting to reduce poverty slightly.<sup>29</sup> Considering the pattern of changes in more detail:

- The incidence of poverty has fallen for children living in most family types, with the exceptions being children living with either a full-time working lone parent or a couple with one full-time worker and one part-time or not working (these children together account for 46.6% of all children). The fall in the incidence of poverty has been most notable for workless couples with children.
- Contrary to what one would expect during a recession, the fraction of children living in households where no-one works fell from 18.4% in 2007–08 to 17.3% in 2008–09 (although, as mentioned earlier, this change may not be statistically significant).
- There was an increase in the fraction of children living with couples with only one full-time worker, and with only part-time workers, with the fraction living with self-employed parents or two full-time working parents falling. This is more consistent with changes in employment and working hours one would expect to see during a recession.

Manipulation of the numbers in Table 4.4 reveals that the fraction of children in poverty who live in couple families was 62.0% in 2008–09 and the fraction in families with someone in work was 54.8%, up from 51.4% in 2007–08. The fact that the fraction of poor children whose parent(s) work(s) increased during the first year of the recession is strange and it will be interesting to see whether this pattern is continued in the data for 2009–10. However, the risk of poverty is still higher for children in lone-parent families than for those in couple families, and workless households still face a far greater risk of poverty than those in work.<sup>30</sup>

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<sup>28</sup> For more details, see appendix D of Brewer, Goodman, Shaw and Sibieta (2006). The authors acknowledge that they were motivated to present these decompositions by the analysis in Sutherland, Sefton and Piachaud (2003).

<sup>29</sup> Note that the relative importance of incidence and compositional effects is sensitive to the number and definition of family types used in the decomposition.

<sup>30</sup> Those interested in the changing pattern of poverty risk across family types for a longer time series are directed to a previous poverty and inequality Commentary (Brewer, Muriel, Phillips and Sibieta, 2008, p. 44).

**Child poverty targets**

The last government had a target for child poverty in the UK in 2010–11 to be one-half its 1998–99 level. Progress was to be assessed using three definitions of poverty – a relative low income indicator, an absolute low income indicator and a combined relative low income and material deprivation indicator. For an earlier target in 2004–05 (which was missed), only a relative low income indicator was used to measure progress, with slight differences in the measure of income used.<sup>31</sup> Table 4.5 and Figure 4.3 review progress to date.

The most-watched of these three measures was the pure relative poverty target, which was for child poverty in the UK in 2010–11 to be one-half its level in 1998–99, using a poverty line of 60% of median BHC income and the modified OECD equivalence scale. As we saw earlier, the number of children in poverty under this measure fell by 100,000 in 2008–09 to 2.8 million. This means that child poverty has fallen by 600,000 to the nearest hundred thousand (or just under one-fifth) in the ten years since 1998–99 and needs to fall by a further 1.1 million in the remaining two years until 2010–11 to meet this element of the target. Thus, child poverty would have to fall by an average of 550,000 a year for the next two years, having fallen by an average 64,000 a year for the past ten years.

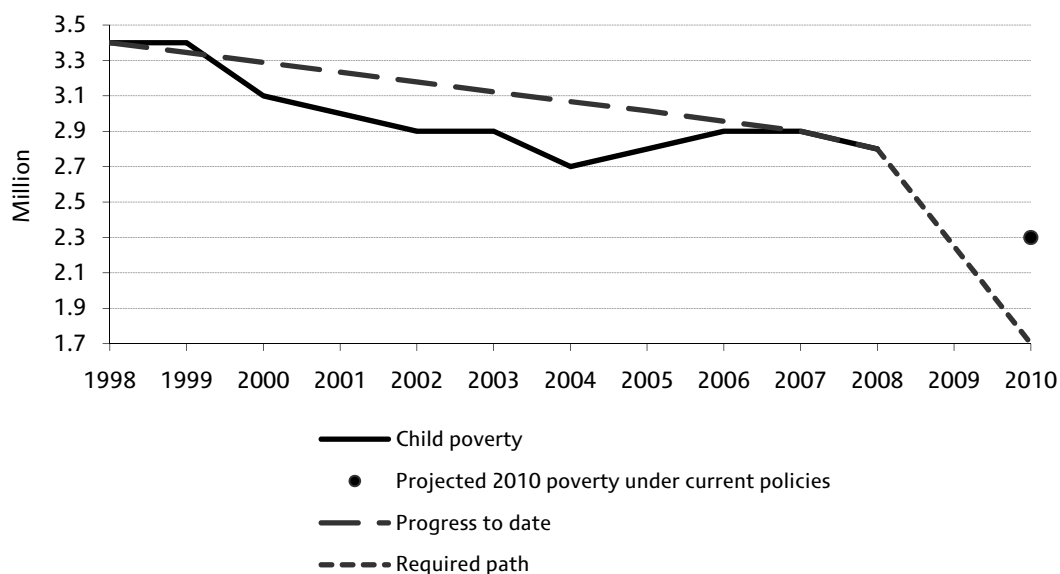
Table 4.5. Progress towards halving child poverty in the UK by 2010–11

	<i>Relative poverty, UK, modified OECD (BHC)</i>		<i>Absolute poverty, UK, modified OECD (BHC)</i>		<i>Material deprivation and relative low income</i>	
	%	Million	%	Million	%	Million
1998–99	26.1	3.4	26.1	3.4	20.8	2.6
1999–00	25.7	3.4	23.4	3.1		
2000–01	23.4	3.1	19.1	2.5		
2001–02	23.2	3.0	15.2	2.0		
2002–03	22.6	2.9	14.1	1.8		
2003–04	22.1	2.9	13.7	1.8		
2004–05	21.3	2.7	12.9	1.7	17.1	2.2
2005–06	22.0	2.8	12.7	1.6	16.3	2.1
2006–07	22.3	2.9	13.1	1.7	15.6	2.0
2007–08	22.5	2.9	13.4	1.7	17.2	2.2
2008–09	21.8	2.8	12.4	1.6	17.1	2.2
Change since 1998–99	–4.2	–0.6	–13.6	–1.8	–3.7	–0.4
Target for 2010–11		1.7		1.7		1.3

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. The table uses data for the UK and incomes equivalised using the modified OECD equivalence scale. For the purposes of the child poverty target in 2010–11, the DWP has had to estimate the level of relative child poverty in the UK in 1998–99 (Northern Ireland was first included in the official HBAI series in 2002–03). Sources: Authors' calculations based on Family Resources Survey, various years; Department for Work and Pensions (2010). UK poverty levels for the years 1998–99 through 2001–02 draw on the DWP's imputed estimates of poverty levels in Northern Ireland over this period.

<sup>31</sup> See HM Treasury (2007a).

Figure 4.3. Actual, required and projected path of child poverty, 1998–99 to 2010–11



Notes: Years are financial years (e.g. 1998 refers to financial year 1998–99). Child poverty is defined as living in households in the UK with less than 60% of median household income (BHC) using the modified OECD equivalence scale.

Sources: Authors' calculations based on the Family Resources Survey, various years; Brewer, Browne, Joyce and Sutherland (2009).

Table 4.5 also shows that the combined indicator of material deprivation and a relative low income fell by 200,000 between 2004–05 and 2006–07. However, in 2007–08 it rose by 200,000, returning to its 2004–05 level. Despite relative child poverty falling in 2008–09 (measured both AHC and BHC, and across a range of thresholds), the number of children facing material deprivation and a relatively low income remained at 2.2 million in 2008–09. Falls in the number of children with relatively low incomes were offset by an increase in the number of children experiencing material deprivation. Such a situation might be expected if absolute living standards were declining, particularly if they were declining more rapidly for poorer families with children. However, average incomes rose in real terms in 2008–09 according to HBAI (though they fell slightly when measured AHC), and there is little evidence of falls for those on lower incomes (see Figure 3.3).<sup>32</sup>

Brewer, Browne, Joyce and Sutherland (2009) projected a fall in the number of children in poverty to 2.3 million in 2010–11 (using incomes measured BHC). Of the projected fall of 600,000 in poverty between 2006–07 (the year of data on which that research was based) and 2010–11, 200,000 was estimated to be the result of changes in policy that took place during 2008–09. We have seen that child poverty fell by 100,000 in 2008–09 – less than we might have expected given the increase in child tax credits, suggesting that Brewer et al.'s projections for 2010–11 may prove a little too optimistic. However, even if their projections are met, this still means that the number of children in poverty in 2010–11 would exceed the previous government's target by 600,000.

<sup>32</sup> However, it is important to note that the material deprivation measure used is based on the family's perceptions of what it can and cannot afford as opposed to an independent assessment of what can be afforded given its income and assets. For instance, if families perceive an increase in the risk that their income will fall during the recession, they may wish to increase their precautionary savings, leaving less to spend, shrinking the set of goods and services they feel able to afford.

### Box 4.3. The eradication of child poverty

The Child Poverty Act 2010, passed with cross-party support, gives the target to eradicate child poverty by 2020 a new significance; it is now a legal requirement. The Act sets four UK-wide targets that define the eradication of child poverty: a rate of relative income poverty less than 10%; fewer than 5% of children both having an income less than 70% of the median and suffering material deprivation; fewer than 5% of children living in households with an income less than 60% of the 2010–11 median income; and a rate of persistent poverty less than a yet-to-be-specified target (presumably less than 10%). The most-watched measure is likely to be the relative income poverty indicator.

It is notable that the indicators in the Act are almost exclusively income-based.<sup>a</sup> In previous poverty and inequality reports,<sup>b</sup> we have argued that a focus on income-based measures may skew the policy response towards reforms that have immediate and predictable impacts on household incomes – such as tax and benefit changes – rather than those that most cost-effectively improve children’s quality of life or reduce the risk of intergenerational transmission of poverty – such as improvements to education. However, a wider set of targets may run the risk of reducing verifiability and accountability, so any expansion of the scope of the targets should be accompanied by a strengthening in the process of independent verification of the child poverty strategy and progress towards meeting the targets.

Perhaps more important than how to measure child poverty are the policies one would use in order to reduce child poverty. The Child Poverty Act requires the government to publish a National Strategy (by 25 March 2011) setting out how it will eradicate child poverty. The policy report accompanying the March 2010 Budget<sup>c</sup> gave more detail on the previous government’s proposed strategy. This focused on promoting work as the best route out of poverty, the need to improve early childhood development and narrow the gap in educational attainment, smoothing the path from adolescence to adulthood, and targeting geographical areas with significant concentrations of deprivation.

The report also provided simulations of the level of child poverty in 2020–21. These simulations are actually more pessimistic than those previously published by IFS researchers,<sup>d</sup> but confirm the general conclusion of that work that, if there are no major economic or demographic changes, and if tax credits and benefits are not comprehensively uprated in line with average earnings, then child poverty will rise considerably. The simulations show a shortfall of 2.1 million children in 2020–21. The report tried to show how some of this projected deficit might be closed. A set of very ambitious assumptions about parental employment and the decline in teenage pregnancies might reduce the simulated shortfall by 1 million children. But the document was much less clear on how the remaining 1.1 million children might be lifted out of poverty: it suggested that improved take-up of benefits, and a reduction in in-work poverty, would both help, but the first is hard to achieve in practice and the second is a leap of faith, and this would still leave a residual 200,000 children to be lifted out of poverty by unspecified ‘other’ policies.

The new Conservative–Liberal-Democrat coalition government has (at the time of writing) yet to produce a report on its child poverty strategy. However, prior to the election, both parties supported the aim of eradication of child poverty. For instance, Lord Freud, the Conservative’s former Work and Pensions spokesman, identified four key areas a Conservative government would aim to tackle: family breakdown; access to drugs and alcohol; education and skills; and a work strategy. The Liberal Democrats supported the Child Poverty Bill as it was going through parliament.



Full details on the tax, benefit and social policies of the new government are not yet known, but a number of the proposals in the coalition agreement may have an impact on child poverty. For instance, the parties have agreed moves towards a £10,000 personal allowance, cuts in tax credits and the Child Trust Fund for above-average-income families, and the introduction of a pupil premium into the school funding system (which may help to reduce inequalities in child outcomes in the longer run). The Liberal Democrats have also agreed not to oppose Conservative Party plans to introduce a partly-transferable personal allowance for certain married couples. However, the impact of such policies on child poverty in 2020 is highly uncertain, and it is very unlikely that these measures alone would be enough to meet the 2020 child poverty targets.

a. We also have more specific concerns about the relevance of the absolute poverty measure. For more detail on this issue, see Brewer, Joyce, Muriel, O’Dea, Paull, Phillips and Sibieta (2009), IFS researchers’ response to the Child Poverty Bill consultation.

b. See, for example, box 4.2 of Brewer, Muriel, Phillips and Sibieta (2009).

c. HM Treasury, Department for Children, Schools and Families, and DWP, 2010.

d. Brewer, Browne, Joyce and Sutherland, 2009.

Looking further ahead, to 2020, the Child Poverty Act 2010 commits the government of the time to the ‘eradication’ of child poverty. Partly because of fluctuations in incomes and the potential for incomes to be misreported by survey respondents, and partly because there will always be a small number of people who fail to claim benefits or make use of opportunities they are entitled to, defining ‘eradication’ as a zero relative income poverty rate is impractical. The Act states that a rate of relative income poverty of 10% would be a level comparable to the lowest in Europe (and this is at least 3 percentage points lower than that achieved in the UK at any time since at least 1960) and would be consistent with eradication of child poverty. Box 4.3 discusses the Child Poverty Act 2010 in more detail, with a focus on the choice of poverty measures, and the formulation of policies to tackle child poverty.

## Pensioner poverty

Under the HBAI methodology, pensioners are defined as individuals above the current state pension age – 65 for men and 60 for women – (i.e. excluding those who have retired early and rely on occupational or private pensions) and pensioner incomes depend on the combined income of the household, which may include working-age adults.

Having risen in 2006–07, pensioner poverty fell a little in 2007–08 and then more substantially in 2008–09, as can be seen in Tables 4.1 and 4.2. The poverty rate fell in the latest year of data by 2.1 percentage points measuring incomes AHC, from 18.1% to 16.0%, and by 2.3 percentage points measuring incomes BHC, from 22.7% to 20.4%. Both of the changes are statistically significantly different from zero. Figure 4.4 shows that the fall in poverty is not restricted to the 60% of median income measure, but the falls for the 50% and 40% poverty lines are small and not statistically significant.

Using a poverty line of 60% median income, there are now 1.8 million pensioners in poverty measuring incomes AHC and 2.3 million measuring incomes BHC in the UK. Pensioner poverty is at its lowest level since the first half of the 1980s. In particular, the rate of pensioner poverty has been lower than that in 2008–09 in only two years of the last 48 (1983 and 1984) using incomes measured AHC and in only four years (1982 to 1985) using incomes measured BHC. Furthermore, for only the second time since at least 1960, the rate of poverty amongst pensioners is lower than that for any of the other three

population groups considered (i.e. children, and working-age adults with and without dependent children) measuring incomes AHC.

Tables 4.1 and 4.2 set out poverty rates amongst pensioners since 1996–97. Measuring incomes AHC, pensioner poverty has declined extremely rapidly: the 13.1 percentage point fall since 1996–97 at 60% of median AHC income constitutes a cut in poverty of almost one-half (45%). There has also been a fall in pensioner poverty measuring incomes BHC, by 4.2 percentage points (or a cut of just over one-sixth) between 1996–97 and 2008–09, and this is also statistically significant. These falls in pensioner poverty (BHC and AHC) tended to be concentrated during the Labour government’s second term

Figure 4.4a. Relative poverty: percentage of pensioners living in households with incomes below various fractions of median income (AHC)

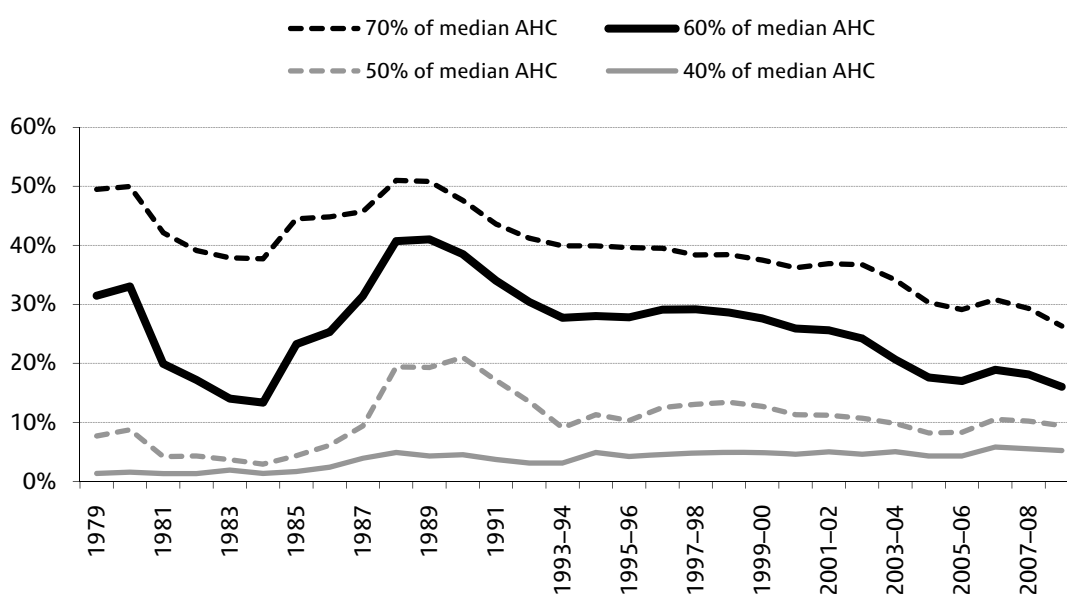
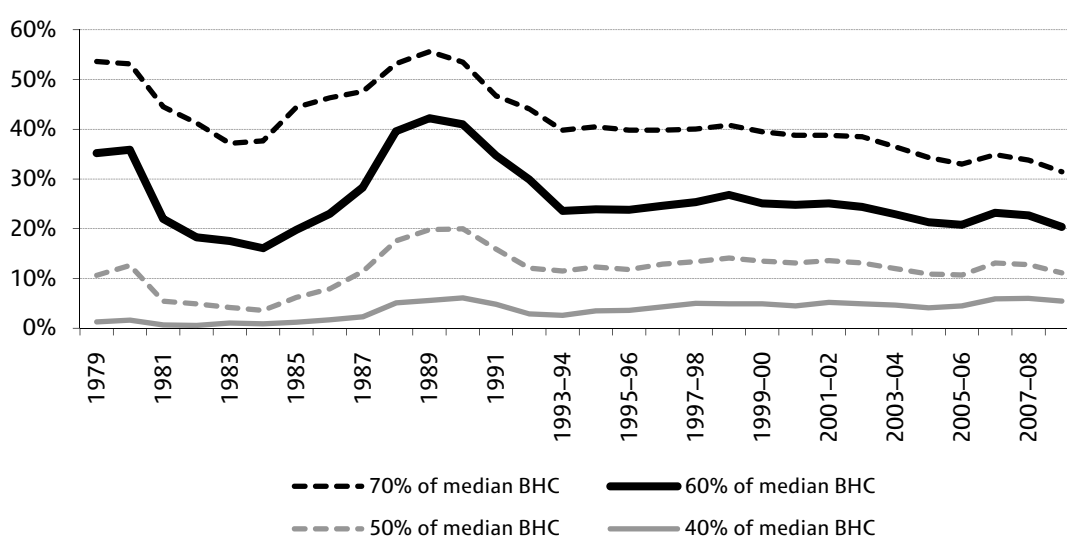


Figure 4.4b. Relative poverty: percentage of pensioners living in households with incomes below various fractions of median income (BHC)



Note: Figures are presented for GB up until 2001–02 and then for the whole of the UK from 2002–03 onwards. Source: Authors’ calculations based on Family Expenditure Survey and Family Resources Survey, various years.

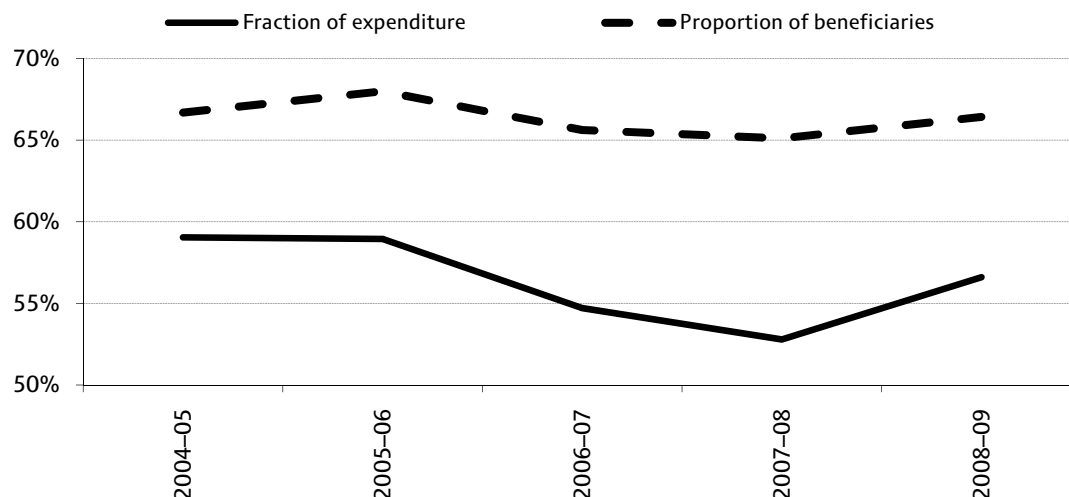
rather than its first or third term. Figure 4.4 shows how pensioner poverty has evolved over a longer time frame (since 1979) with a variety of poverty thresholds. It shows that poverty rates amongst pensioners have fallen using a variety of thresholds measuring incomes AHC or BHC.

Why did pensioner poverty fall in 2008–09? As already mentioned, pensioner poverty fell in previous recessions because, at least in part, falls in employment and wages acted to reduce median income, whereas the incomes of pensioners proved relatively resilient. In 2008–09, median income continued to grow on a BHC basis (although it fell somewhat on an AHC basis), so this cannot have had a role in the fall in pensioner poverty this time round. Instead, pensioner incomes must have grown relatively rapidly.

One reason for this may be an increase in the rates of the winter fuel payment. The amount payable to households containing someone aged over 60 increased from £200 to £250 in 2008–09 and the amount payable to households containing someone aged over 80 increased from £300 to £400. We estimate that this can explain between 30,000 (AHC) and 40,000 (BHC) of the approximate 200,000 fall in pensioner poverty. These higher winter fuel payments were continued in the winter of 2009–10 and are due to remain in place for the coming winter as well.

Two years ago, we detailed how the Family Resources Survey (FRS) was particularly poor at recording receipt of the pension credit.<sup>33</sup> Figure 4.5 shows that the performance of the FRS at capturing receipts of the pension credit improved a little in 2008–09. It shows that in 2008–09, the FRS picked up just over 66% of pension credit recipients (up from 65% in 2007–08) and just under 57% of expenditure on the pension credit (up from just under 53% in 2007–08). If the increase in the reporting of pension credit receipt is concentrated amongst households that would otherwise be just under the poverty line, clearly this could be one factor explaining part of the fall in measured pensioner poverty.

Figure 4.5. Fraction of expenditure on the pension credit, and the proportion of beneficiaries, recorded by the FRS



Note: Figures are presented for GB only, as benefit payments in Northern Ireland are administered by the Department for Social Development in Northern Ireland, not the DWP.

Sources: Authors' calculations based on Family Resources Survey, various years; DWP medium-term expenditure tables, available at [http://research.dwp.gov.uk/asd/asd4/medium\\_term.asp](http://research.dwp.gov.uk/asd/asd4/medium_term.asp).

<sup>33</sup> See appendix C of Brewer, Muriel, Phillips and Sibieta (2008).

Table 4.6. Exploring the fall in relative pensioner poverty (AHC), 2007–08 to 2008–09, by partnership status, sex and age

	<i>Poverty rate</i>		<i>Fraction of pensioners</i>	
	2007–08	2008–09	2007–08	2008–09
<b>Couples</b>				
Male partner aged 80+	19.3%	17.0%	10.0%	9.9%
Male partner aged 70–79	16.2%	14.5%	24.1%	24.5%
Male partner aged under 70	15.0%	13.7%	24.8%	24.3%
<b>Single</b>				
Female aged 80+	22.6%	20.6%	11.3%	11.1%
Female aged 70–79	22.4%	16.9%	10.2%	9.7%
Female aged 60–69	23.1%	20.6%	9.0%	9.6%
Male aged 80+	14.2%	16.3%	3.4%	3.6%
Male aged 70–79	15.9%	11.6%	4.6%	4.6%
Male aged 65–69	15.8%	15.5%	2.6%	2.8%
<b>All pensioners</b>	18.1%	16.0%	100%	100%

Note: Poverty rates are measured as the proportion of the group with income below 60% of the population-wide AHC median income.

Source: Authors' calculations based on Family Resources Survey, 2007–08 and 2008–09.

It is also worthwhile investigating how poverty changed for different groups of pensioners in 2008–09. Table 4.6 shows how the rate of poverty using incomes measured AHC changed for a number of groups of pensioners based on the age, sex and partnership status of pensioners.<sup>34</sup> This shows that the rate of poverty fell for all groups bar one (single males aged 80-plus) and that the fall was greatest for single female pensioners (and particularly those aged 70 to 79), although their risk of poverty remains above those for single male pensioners and for people living as part of a pensioner couple. Single males aged 70 to 79 also saw a sizeable fall in their risk of poverty.

### Poverty amongst working-age adults with no dependent children

Poverty among the remainder of the population – working-age adults – has changed little since 1996–97. Because income is measured at the household level, poverty among working-age parents usually follows a similar path to that for children, and for this reason it is informative to consider working-age adults without children separately from working-age parents, as was done in Tables 4.1 and 4.2 (this approach is different from what is done in HBAI, which focuses on poverty rates for working-age individuals as a whole).

Using a poverty threshold of 60% of the median, there are now 4.4 million working-age adults without dependent children living in poverty in the UK measuring incomes AHC (3.4 million BHC). These figures are up 200,000 from 2007–08, or by 1.0 and 0.7 percentage points respectively. As shown in Figure 4.6, the rates of poverty for this group are now 19.1% (AHC) and 14.7% (BHC), with both of these figures being the highest poverty rate amongst working-age non-parents since the start of our consistent time

<sup>34</sup> For couples, the categorisation is based on the age of the man.

series in 1961 and both being statistically significantly higher than the rate in 1996–97. The increase in the AHC measure between 2007–08 and 2008–09 is also statistically significant.

In last year's Commentary, we explored reasons for the change in the rate of poverty amongst working-age non-parents between 1996–97 and 2007–08, measuring incomes

Figure 4.6a. Relative poverty: percentage of working-age non-parents living in households with incomes below various fractions of median income (AHC)

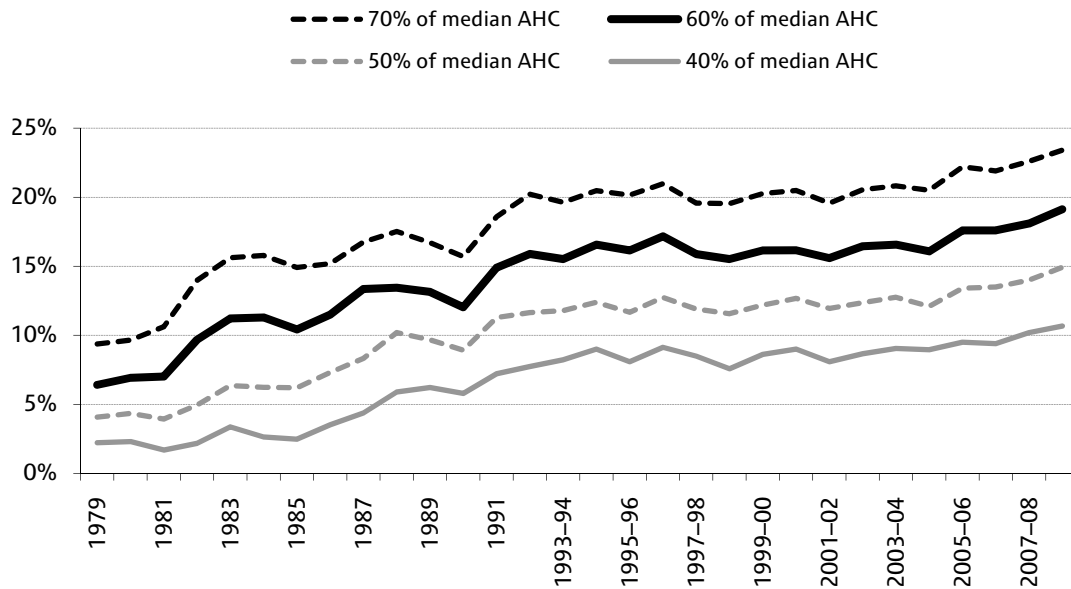
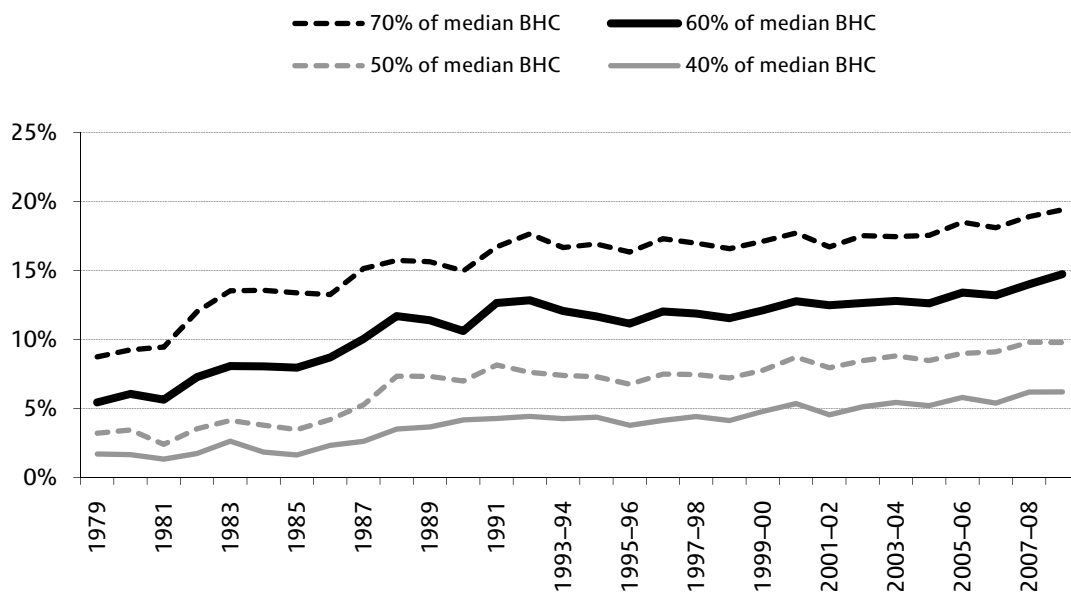


Figure 4.6b. Relative poverty: percentage of working-age non-parents living in households with incomes below various fractions of median income (BHC)



Note: Figures are presented for GB up until 2001–02 and then for the whole of the UK from 2002–03 onwards. Source: Authors' calculations based on Family Expenditure Survey and Family Resources Survey, various years.

AHC.<sup>35</sup> To do this, we split changes into changes in the risk of being in poverty for particular groups (the incidence effect) and the changing composition of the working-age non-parent population (the compositional effect). We found that:

- Increased employment led to compositional shifts towards family types with adults in work rather than not in work, acting to reduce relative poverty.
- On the other hand, the incidence effects acted to increase relative poverty overall, because most of the family types saw a rising risk of relative poverty over the period. The most important of these were the rise in the (already high) risk of poverty for workless couple households and the increase in the risk of poverty for single individuals working full-time.

Table 4.7 repeats the same type of analysis, but this time comparing 2007–08 and 2008–09. The increase in the poverty rate measured AHC was larger during this one-year period than during the previous 11 years. The pattern of changes in the most recent rise is rather different, however. In particular:

- A fall in employment led to compositional shifts towards family types with adults not in work (particularly amongst single adults), acting to increase relative poverty (having a positive value in Table 4.7).

Table 4.7. Decomposition of the rise in relative poverty amongst working-age non-parents (AHC), 2007–08 to 2008–09, by family type and work status

	<i>Poverty rate</i>		<i>Percentage of working-age non-parent population</i>		<i>Compositional effect</i>	<i>Incidence effect</i>	<i>Total change in poverty</i>
	2007–08	2008–09	2007–08	2008–09			
<b>Single individuals</b>							
Full-time	8.4%	9.4%	25.5%	24.3%	0.1%	0.3%	0.4%
Part-time	29.4%	27.3%	5.8%	5.6%	–0.0%	–0.1%	–0.1%
Workless	52.4%	51.5%	14.5%	16.2%	0.6%	–0.1%	0.4%
<b>Couples, no children</b>							
Self-employed	17.3%	17.0%	7.2%	6.5%	0.0%	–0.0%	–0.0%
Two full-time earners	2.0%	1.3%	20.6%	21.2%	–0.1%	–0.1%	–0.2%
One full-time, one part-time	5.0%	6.3%	9.0%	8.4%	0.1%	0.1%	0.2%
One full-time, one not working	12.9%	16.8%	8.0%	8.2%	–0.0%	0.3%	0.3%
One or two part-time	28.0%	29.0%	4.0%	4.0%	0.0%	0.0%	0.0%
Workless	44.7%	44.9%	5.4%	5.6%	0.1%	0.0%	0.1%
<b>All working-age non-parents</b>	18.1%	19.1%	100.0%	100.0%	0.7%	0.3%	1.0%

Note: Poverty rates are measured as the proportion of the group with income below 60% of the UK population-wide AHC median.

Source: Authors' calculations based on Family Resources Survey, 2007–08 and 2008–09.

<sup>35</sup> See pages 48 and 50 of Brewer, Muriel, Phillips and Sibieta (2009).

- Incidence effects also acted to increase poverty, but to a lesser extent. Increases in the risk of poverty for single individuals working full-time, and for couples with only one full-time worker, were only partly offset by falls in the risk of poverty for workless and part-time single individuals, and for couples consisting of two full-time earners.

As discussed in Box 2.2, the reforms introduced in April 2008 hit this group relatively hard because of poor take-up of tax credits amongst those without children and because those without children and aged under 25 are ineligible for the working tax credit.

### 4.3 Regional trends in poverty

Two years ago, we took an in-depth look at the trends in poverty across the regions and nations of the UK for the whole population.<sup>36</sup> We repeat this analysis below, and go further, breaking down results for children, pensioners and working-age adults without dependent children. To calculate the number of individuals in poverty in a region, we simply count how many individuals in that region live in households with equivalised incomes below 60% of the *national* median; in other words, we do not calculate a separate poverty line for each region on the basis of its own median income.

The official HBAI report presents figures for regional poverty rates without adjusting incomes for the different costs of living in different parts of the country. This means that poverty is likely to be overstated somewhat in the less expensive regions of the country (for instance, northern England and Wales) and understated for the more expensive areas (such as London and the South East of England). In our 2008 publication, we made use of regional price indices constructed by the Office for National Statistics on an experimental basis (for 2004–05) to show how the use of regional prices would change the picture on variation in poverty rates (and living standards) across the regions for that year. This time, we use the 2004–05 price indices to adjust for differences in the cost of living across regions for various years between 1996–97 and 2008–09. It is unlikely that relative prices were the same as they were in 2004–05 throughout this period, but it is highly likely that using the 2004–05 regional price indices is a better approximation than assuming the cost of living is the same throughout the UK. When presenting results for the overall population, we show poverty rates using both national and regional prices, but when breaking down results by population subgroup, we present our new results using regional prices only; the comparable numbers using national prices can be obtained from the DWP's official HBAI publication.<sup>37</sup>

Table 4.8a shows the rate of (BHC) poverty using national prices for three periods: the three financial years corresponding to Labour's commencement of office (1996–97, 1997–98 and 1998–99); the three years corresponding to the period when overall poverty was approaching its lowest recent level (2002–03, 2003–04 and 2004–05); and the three most recent years of data (2006–07, 2007–08 and 2008–09). (Three-year averages are used to ensure adequate sample sizes.) The regions are ordered from highest to lowest poverty rate (in the three most recent years of data). Table 4.8b repeats this analysis using regional prices, again ordering regions from highest to lowest poverty rate. The rankings using national prices are shown in parentheses in this table.

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<sup>36</sup> See section 4.3 of Brewer, Muriel, Phillips and Sibieta (2008).

<sup>37</sup> Department for Work and Pensions, 2010.

Table 4.8a. Relative poverty across the United Kingdom (BHC)  
using national prices

Region	Average poverty rate in period			Change (C) – (A) (ppt)
	1996–97 to 1998–99 (A)	2002–03 to 2004–05 (B)	2006–07 to 2008–09 (C)	
North East	24.9%	22.3%	22.0%	–2.9%
West Midlands	20.0%	20.1%	21.9%	+1.9%
Wales	22.7%	20.8%	20.9%	–1.9%
East Midlands	20.3%	19.2%	20.7%	+0.4%
Yorkshire and Humber	23.4%	19.2%	20.6%	–2.8%
North West	22.7%	18.9%	20.3%	–2.4%
Northern Ireland	–	20.3%	20.3%	n/a
London	18.6%	18.5%	17.7%	–0.9%
Scotland	20.5%	18.6%	16.9%	–3.6%
South West	18.8%	15.5%	16.1%	–2.8%
East of England	15.7%	14.3%	15.1%	–0.6%
South East	13.3%	12.1%	12.9%	–0.5%
Total	19.4%	17.6%	18.1%	–1.3%

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Northern Ireland was not included in the FRS until 2002–03 onwards. Regions are defined as Government Office Regions.

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

Table 4.8b. Relative poverty across the United Kingdom (BHC)  
using regional prices

Region	Average poverty rate in period			Change (C) – (A) (ppt)
	1996–97 to 1998–99 (A)	2002–03 to 2004–05 (B)	2006–07 to 2008–09 (C)	
London (8)	23.5%	22.9%	22.1%	–1.4%
West Midlands (2)	19.4%	19.3%	21.1%	+1.7%
East Midlands (4)	19.2%	18.4%	19.8%	+0.6%
North West (6)	21.2%	17.5%	18.9%	–2.3%
Northern Ireland (7)	–	18.3%	18.2%	n/a
North East (1)	21.2%	18.6%	17.7%	–3.5%
Yorkshire and Humber (5)	20.5%	16.0%	17.4%	–3.0%
Wales (3)	19.0%	16.7%	17.4%	–1.6%
South West (10)	19.8%	16.6%	17.0%	–2.8%
East of England (11)	16.5%	15.3%	16.1%	–0.5%
South East (12)	15.6%	14.4%	15.2%	–0.5%
Scotland (9)	17.8%	16.3%	14.6%	–3.1%
Total	19.4%	17.5%	18.0%	–1.4%

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Northern Ireland was not included in the FRS until 2002–03 onwards. Regions are defined as Government Office Regions. The numbers in parentheses are the rankings in 2006–07 to 2008–09 using national prices, from Table 4.8a.

Source: Authors' calculations based on Family Resources Survey, various years, and ONS regional price indices for 2004–05 (see Wingfield, Fenwick and Smith (2005)).



In the most recent three years of data, using national prices, overall poverty based on incomes measured BHC is highest in the North East of England (22.0%) and lowest in the South East of England (12.9%). Poverty fell most rapidly over the period under consideration in Scotland, the North East and the South West of England, and Yorkshire and the Humber. Relative poverty rose in the West Midlands and the East Midlands (albeit only marginally in the latter case).

When we adjust for differences in the cost of living, London has the highest rate of poverty measured BHC (up from the eighth-highest rate before adjusting for cost-of-living differences). On the other hand, the North East and Wales have the sixth- and eighth-highest rates respectively (as opposed to first and third before adjusting for cost-of-living differences), and Scotland replaces the South East of England as the area with the lowest rate of poverty. The pattern of changes when using regional prices is similar to that found when using national prices. The small differences are the result of the adjustment for regional cost-of-living differences shifting the poverty line around in cash terms to parts of the income distribution that might be somewhat more or less dense than the parts around the original national-prices poverty line.

Tables 4.9a to 4.9c show the rates of poverty across the regions and nations of the UK by population subgroup: children (4.9a); pensioners (4.9b); and working-age adults without dependent children (4.9c). An examination of the results reveals some interesting patterns.

Table 4.9a. Relative child poverty across the United Kingdom (BHC) using regional prices

Region	Average poverty rate in period		Change (ppt)
	1996–97 to 1998–99	2006–07 to 2008–09	
North East	30.5%	21.6%	–8.9%
North West	30.7%	23.8%	–6.9%
Yorkshire and Humber	28.5%	22.1%	–6.5%
East Midlands	24.2%	23.1%	–1.1%
West Midlands	27.4%	28.1%	0.7%
East of England	20.8%	17.0%	–3.9%
London	34.1%	29.3%	–4.7%
South East	19.7%	18.1%	–1.6%
South West	24.7%	19.0%	–5.7%
Wales	25.1%	20.9%	–4.3%
Scotland	26.4%	17.8%	–8.6%
Northern Ireland	–	21.0%	n/a
Total	26.6%	22.1%	–4.5%

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Northern Ireland was not included in the FRS until 2002–03 onwards. Regions are defined as Government Office Regions.

Source: Authors' calculations based on Family Resources Survey, various years, and ONS regional price indices for 2004–05 (see Wingfield, Fenwick and Smith (2005)).

Table 4.9b. Relative pensioner poverty across the United Kingdom (BHC) using regional prices

Region	Average poverty rate in period		Change (ppt)
	1996–97 to 1998–99	2006–07 to 2008–09	
North East	20.6%	17.0%	–3.6%
North West	24.4%	20.6%	–3.8%
Yorkshire and Humber	24.2%	21.0%	–3.2%
East Midlands	27.9%	25.7%	–2.1%
West Midlands	26.2%	20.8%	–5.4%
East of England	26.7%	22.5%	–4.2%
London	27.9%	27.4%	–0.5%
South East	25.6%	21.7%	–3.9%
South West	27.6%	22.8%	–4.8%
Wales	21.5%	20.5%	–1.0%
Scotland	20.8%	15.5%	–5.3%
Northern Ireland	–	26.8%	n/a
Total	25.2%	21.8%	–3.5%

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Northern Ireland was not included in the FRS until 2002–03 onwards. Regions are defined as Government Office Regions.

Source: Authors' calculations based on Family Resources Survey, various years, and ONS regional price indices for 2004–05 (see Wingfield, Fenwick and Smith (2005)).

Table 4.9c. Relative poverty across the United Kingdom (BHC) for working-age adults without dependent children using regional prices

Region	Average poverty rate in period		Change (ppt)
	1996–97 to 1998–99	2006–07 to 2008–09	
North East	14.2%	16.2%	+2.0%
North West	12.7%	14.6%	+1.8%
Yorkshire and Humber	12.8%	12.9%	+0.1%
East Midlands	12.3%	15.8%	+3.5%
West Midlands	10.2%	15.8%	+5.6%
East of England	9.3%	12.9%	+3.6%
London	14.7%	16.1%	+1.4%
South East	8.6%	10.4%	+1.8%
South West	12.4%	13.4%	+1.0%
Wales	13.0%	14.4%	+1.4%
Scotland	11.0%	12.7%	+1.6%
Northern Ireland	–	13.8%	n/a
Total	11.8%	13.9%	2.2%

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Northern Ireland was not included in the FRS until 2002–03 onwards. Regions are defined as Government Office Regions.

Source: Authors' calculations based on Family Resources Survey, various years, and ONS regional price indices for 2004–05 (see Wingfield, Fenwick and Smith (2005)).

In the most recent three years of data, once we adjust for differences in the cost of living, child poverty measured BHC is highest in London (29.3%) and the West Midlands (28.1%) and lowest in Scotland (17.8%) and the East of England (17.0%). Since the three years 1996–97 to 1998–99, child poverty has fallen most in Scotland and northern regions of England (by more than 6 percentage points) and least in the South East of England, the East Midlands and the West Midlands (where it has actually risen slightly).

Pensioner poverty (BHC) is highest in London (27.4%) and Northern Ireland (26.8%) and lowest in the North East of England (17.0%) and Scotland (15.5%). Perhaps surprisingly (given its overall poor performance), the biggest fall in pensioner poverty has been in the West Midlands, followed by Scotland (both by just over 5 percentage points). The smallest falls have been in London and Wales (although pensioners in Wales have a below-average risk of living in poverty after adjusting for differences in the cost of living).

Poverty amongst working-age adults without dependent children is highest in the North East of England (16.2%) and London (16.1%) and lowest in Scotland (12.7%) and the South East of England (10.4%). Poverty has increased in all parts of the UK for this group, with the rise being most notable in the West Midlands, East Midlands and East of England and smallest in Yorkshire and the Humber (where it has barely increased).

Overall, the relatively poor performance of London and the Midlands stands out, as does the relatively strong performance of Scotland. An analysis of the causes of the differences in the rates of poverty and the differences in the trends in poverty across regions and by population group is beyond the scope of this Commentary. However, it is likely that differences and changes in employment rates, wage distributions and economic structures play a key role, but it is not possible to quantify the impact of these potential mechanisms at present.

## **4.4 Absolute poverty**

Nearly all the poverty figures presented so far have been based on relative measures of poverty: that is, measures of poverty where the poverty line moves each year in line with median income growth. Tables 4.10 and 4.11 set out estimates of the number of individuals in poverty, where the poverty line is fixed in real terms at 60% of 1996–97 median income, measuring incomes AHC and BHC respectively. The tables show poverty for the population as a whole, and separately for children, pensioners and working-age adults. The choice of a base year for an absolute poverty line is arbitrary, but 1996–97 seems reasonable as it was the last year prior to the Labour government coming to power (note that the absolute poverty tier of the previous government's child poverty target is assessed against 60% of median income in 1998–99). However, it should be noted that there could well be drawbacks in using absolute poverty indicators over a long time frame.<sup>38</sup>

In 2008–09, there were 8.2 million individuals (13.6% of the UK population) living in absolute poverty measuring incomes AHC, a rise of 200,000 since 2007–08. Measuring incomes BHC, there were 6.1 million individuals in absolute poverty, 300,000 fewer than in 2007–08 (the rate of absolute poverty measuring incomes BHC fell from 10.8% to 10.2%). The rise in absolute poverty measuring incomes AHC is not statistically significant, but the fall in absolute poverty measuring incomes BHC is, and undoes most of

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<sup>38</sup> See box 4.2 of Brewer, Muriel, Phillips and Sibieta (2009).

the rise over the previous three years. Absolute poverty measuring incomes AHC is currently at its highest level since 2002–03.

Absolute child and pensioner poverty (using 60% of the 1996–97 median income as a poverty line) both fell a little in 2008–09. Absolute child poverty fell 100,000 (or 0.5 percentage points) on an AHC basis (although rounded to the nearest 0.1 million, the level remained unchanged), and by 100,000 (or 0.8 percentage points) on a BHC basis, the latter being statistically significantly different from zero. The fall in absolute pensioner poverty was zero to the nearest hundred thousand (0.4 percentage points) on an AHC basis, and 200,000 on a BHC basis (or a statistically significant 2.0 percentage points), meaning all the rise in the latter measure since 2004–05 was undone in 2008–09. However, absolute pensioner poverty (AHC) remains statistically significantly higher than in 2004–05. Working-age absolute poverty rates rose in 2008–09 measuring incomes AHC (and by a statistically significant amount for those without dependent children), and were broadly unchanged on a BHC basis.

Table 4.10. Absolute poverty: percentage and number of individuals in households with incomes below 60% of 1996–97 median AHC income

	<i>Children</i>		<i>Pensioners</i>		<i>Working-age parents</i>		<i>Working-age non-parents</i>		<i>All</i>	
	%	Million	%	Million	%	Million	%	Million	%	Million
1996–97 (GB)	34.1	4.3	29.1	2.9	26.6	3.3	17.2	3.5	25.3	14.0
1997–98 (GB)	32.4	4.1	27.7	2.8	25.1	3.1	15.4	3.2	23.6	13.2
1998–99 (GB)	31.7	4.0	26.0	2.6	24.4	3.0	14.8	3.1	22.7	12.7
1999–00 (GB)	29.0	3.7	21.1	2.1	22.6	2.8	14.4	3.0	20.7	11.6
2000–01 (GB)	24.6	3.1	16.2	1.6	19.6	2.4	14.0	3.0	18.0	10.1
2001–02 (GB)	20.7	2.6	11.6	1.2	17.1	2.1	12.1	2.6	15.0	8.5
2002–03 (UK)	18.2	2.4	9.7	1.0	15.4	1.9	11.9	2.7	13.6	8.0
2003–04 (UK)	17.4	2.3	8.6	0.9	14.9	1.9	12.2	2.7	13.3	7.8
2004–05 (UK)	15.9	2.0	6.8	0.7	13.6	1.7	11.3	2.6	12.0	7.1
2005–06 (UK)	16.4	2.1	7.0	0.8	14.5	1.8	12.3	2.8	12.7	7.5
2006–07 (UK)	17.2	2.2	8.8	1.0	14.9	1.9	12.2	2.8	13.2	7.9
2007–08 (UK)	17.4	2.2	8.3	0.9	14.9	1.9	12.6	2.9	13.4	8.0
2008–09 (UK)	16.9	2.2	7.9	0.9	15.6	2.0	13.4	3.1	13.6	8.2
<b>Changes</b>										
1996–97 to 2000–01	–9.5		–12.9		–7.0		–3.2		–7.3	
2000–01 to 2004–05	–8.7		–9.3		–6.0		–2.7		–6.0	
2004–05 to 2008–09	(1.0)	(0.1)	1.0	0.2	2.0	0.3	2.1	0.5	1.6	1.1
2007–08 to 2008–09	(–0.5)	(–0.1)	(–0.4)	(–0.0)	(0.7)	(0.1)	0.8	0.2	(0.2)	(0.2)

Notes: Reported changes may not equal differences between the corresponding numbers due to rounding. Changes in parentheses are not significantly different from zero at the 5% level. Because of the discontinuity in the series due to the inclusion of Northern Ireland from 2002–03, changes in the number of people in poverty since 1996–97 are not available. However, due to Northern Ireland's small population and similar poverty rates, the changes in poverty rate reported should be accurate. All figures are presented using the modified OECD equivalence scale.

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

Table 4.11. Absolute poverty: percentage and number of individuals in households with incomes below 60% of 1996–97 median BHC income

	<i>Children</i>		<i>Pensioners</i>		<i>Working-age parents</i>		<i>Working-age non-parents</i>		<i>All</i>	
	%	Million	%	Million	%	Million	%	Million	%	Million
1996–97 (GB)	26.7	3.4	24.6	2.4	20.2	2.5	12.0	2.5	19.4	10.8
1997–98 (GB)	25.8	3.3	23.7	2.4	19.5	2.4	11.4	2.4	18.6	10.4
1998–99 (GB)	24.1	3.1	23.8	2.4	18.0	2.2	10.7	2.2	17.7	9.9
1999–00 (GB)	21.0	2.7	20.2	2.0	16.4	2.0	10.4	2.2	15.8	8.9
2000–01 (GB)	17.2	2.2	17.5	1.8	13.5	1.6	10.4	2.2	13.9	7.8
2001–02 (GB)	13.3	1.7	15.6	1.6	11.1	1.3	8.8	1.9	11.5	6.5
2002–03 (UK)	12.4	1.6	14.1	1.5	10.3	1.3	8.9	2.0	10.9	6.4
2003–04 (UK)	12.0	1.6	13.1	1.4	10.0	1.2	9.2	2.1	10.7	6.2
2004–05 (UK)	11.3	1.5	11.7	1.3	9.5	1.2	8.7	2.0	10.0	5.9
2005–06 (UK)	11.4	1.5	10.9	1.2	9.9	1.3	9.1	2.1	10.1	5.9
2006–07 (UK)	11.8	1.5	13.0	1.4	10.0	1.3	9.0	2.1	10.6	6.3
2007–08 (UK)	11.8	1.5	12.8	1.4	9.8	1.3	9.7	2.2	10.8	6.4
2008–09 (UK)	11.0	1.4	10.8	1.2	9.9	1.3	9.6	2.2	10.2	6.1
<b>Changes</b>										
1996–97 to 2000–01	-9.5		-7.1		-6.6		-1.7		-5.6	
2000–01 to 2004–05	-5.9		-5.8		-4.1		-1.7		-3.9	
2004–05 to 2008–09	(-0.3)	(-0.0)	(-0.9)	(-0.0)	(0.4)	(0.1)	0.9	0.2	(0.2)	(0.3)
2007–08 to 2008–09	-0.8	-0.1	-2.0	-0.2	(0.1)	(0.0)	(-0.2)	(-0.0)	-0.6	-0.3

Notes: Reported changes may not equal differences between the corresponding numbers due to rounding.

Changes in parentheses are not significantly different from zero at the 5% level. Because of the discontinuity in the series due to the inclusion of Northern Ireland from 2002–03, changes in the number of people in poverty since 1996–97 are not available. However, due to Northern Ireland's small population and similar poverty rates, the changes in poverty rate reported should be accurate. All figures are presented using the modified OECD equivalence scale.

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

## 4.5 Conclusion

For the first time since 2004–05, poverty fell in 2008–09, by 100,000 (or 0.3 percentage points) measuring incomes BHC, and by zero to the nearest 100,000 (or 0.2 percentage points) measuring incomes AHC. The poverty rates fell for children and pensioners, who benefited from tax and benefit reforms, but increased for working-age adults without dependent children, a group not favoured by the tax and benefit reforms. Indeed, poverty for this last group has increased by 2.7 percentage points (BHC) and 2.0 percentage points (AHC) since 1996–97, and is at a record high (at least since the start of our consistent time series on poverty going back to 1961).

Looking forward, child poverty is likely to fall in 2009–10, even after accounting for a potential fall in the level of employment during the current recession, because of further real increases in benefits. Even after these reforms, earlier IFS work has predicted that the previous government's 2010 child poverty target will be missed by about 600,000. The Child Poverty Act 2010 makes meeting the 2020 target to 'eradicate' child poverty legally binding, but, to date, a credible policy strategy for meeting this challenge has not been presented by the coalition government or any major opposition party.

Pensioner poverty fell by 200,000 in 2008–09, part of which (about 30,000 to 40,000) was due to higher winter fuel payments. Partly as a result of declining levels of inflation, pensioners are likely to see real increases in the value of their state benefits in 2009–10. This seems likely to translate into reduced levels of pensioner poverty, especially if the second year of the recession delivers falls in average or median incomes. Indeed, pensioner poverty fell by substantially more in previous recessions than it has done so far in this recession, though from a higher base.

Poverty rates and the recent trends in poverty vary significantly across the United Kingdom. After adjusting for differences in the cost of living in different parts of the country (which is found to be very important), overall poverty is highest in London and lowest in Scotland. Since 1996–97 to 1998–99, it has fallen most in the North East of England and risen most in the West Midlands. London has the highest rates of child and pensioner poverty, and it is joined by the North East of England in having the highest rates of poverty amongst working-age non-parents. The East of England has the lowest rate of child poverty, Scotland the lowest rate of pensioner poverty and the South East of England the lowest rate of poverty amongst working-age non-parents. Pensioner poverty has fallen in all regions, child poverty has fallen in all regions bar the West Midlands and poverty amongst working-age non-parents has increased in all regions.

## 5. Conclusion

This Commentary has analysed what the latest set of Households Below Average Income (HBAI) statistics tell us about changes in living standards and relative income poverty in the UK up to the year 2008–09, the first full financial year of the recent recession.

Taking the period from 1996–97 to 2008–09 as a whole, living standards in Great Britain have risen by, on average, the equivalent of 2.0% per year at the mean and 1.6% at the median. Given the significant drop in national income and employment seen during 2008–09, we may have expected disposable incomes to have fallen over this year. In fact, average disposable incomes as measured in HBAI grew in 2008–09, though at a fairly slow rate. This may be surprising, but it continues the slow growth in incomes observed over the seven years up to 2008–09. It appears as if the growth in average incomes in 2008–09 was largely driven by rising incomes amongst those still in work as well as amongst pensioners; falls in employment are observed in the data and would have led to falling average incomes had this not been the case. However, the growth in earnings observed in HBAI does not match the stagnation in the average earnings index, the most widely-used measure of average earnings.

Although this year's figures for average incomes represent something of a puzzle, we should not place too much emphasis on one year's worth of data as these statistics are subject to uncertainty and sampling error from year to year. Future years may show a different pattern for mean incomes, which could well have been underestimated in previous years (thereby upwardly biasing the estimate of income growth between 2007–08 and 2008–09). Continued falls in employment and weak earnings growth over 2009–10 would lead us to expect average incomes to fall over this period, all else being equal.

On commonly-used measures, income inequality was higher in 2008–09 than when Labour came to power. This overall rise in inequality is, of course, much smaller in magnitude than that which occurred during the 1980s. Considering each of Labour's three terms individually, income inequality increased during Labour's first term, fell during Labour's second term and then increased again during Labour's third term up to 2008–09. In the latest year of data, income inequality was largely unchanged, remaining close to its highest level since at least 1960.

There is evidence that income growth at the very top of the distribution was low or negative, which is unsurprising given the turmoil in the financial markets in 2008–09 and the historical correlation between top incomes and the performance of the financial sector. Given that 2009–10 has seen a recovery in financial markets following the crisis, we may well expect this decline to reverse in the future. However, several changes to the tax and benefit system look set to hit those on high incomes particularly hard in the coming years, which will tend to reduce income inequality, all else being equal.

Relative poverty has fallen since Labour came to power, falling most for pensioners and children. This contrasts with a rise in poverty observed under the previous period of Conservative government between 1979 and 1997. However, poverty rose during the first three years of Labour's third term. In the latest year of data, 2008–09, the overall rate of poverty has fallen, but this masks variation amongst different family types. The poverty rate fell for children and pensioners, who benefited from tax and benefit reforms, but increased for working-age adults without dependent children, a group not favoured by the tax and benefit reforms. Indeed, poverty for this last group has increased since

1996–97 and is at its highest level since the start of our consistent time series on poverty in 1961.

Child poverty has fallen for the first time since 2004–05, although it remains above the low recorded in that year. This fall was not unexpected, given particularly generous increases in benefits and tax credits aimed at low-income families that came into effect in April 2008. Looking forward, child poverty may fall further in 2009–10, even after accounting for a potential fall in the level of employment during the current recession, because of further real increases in benefits. However, even after these reforms, it is almost certain that the 2010 child relative poverty target will be missed. The Child Poverty Act 2010 makes meeting the 2020 target to ‘eradicate’ child poverty legally binding, but, to date, a credible policy strategy for meeting this challenge has not been presented. At the time of writing, the coalition government’s strategy is uncertain. However, the Act requires the new coalition government to present a National Strategy for eradicating child poverty (to be published before 25 March 2011).

In 2008–09, pensioner poverty fell by 200,000 (measuring incomes both before and after housing costs), about 30,000 to 40,000 of which can be attributed to the re-introduction of higher rates of the winter fuel payment in that year. Pensioner poverty is now at its lowest level since 1985 (BHC) or 1984 (AHC). Measuring incomes after housing costs, the rate of poverty amongst pensioners is now lower than the rate for any other population group. Partly as a result of declining levels of inflation, pensioners are likely to see real increases in the value of their state benefits in 2009–10. This seems likely to translate into reduced levels of pensioner poverty, especially if the second year of the recession delivers falls in average or median incomes. Indeed, pensioner poverty fell by substantially more in previous recessions than it has done so far in this recession, though from a higher base.

The future course for living standards, inequality and poverty is highly uncertain. The UK has only recently exited its deepest recession since, perhaps, the 1930s, and the future for growth is still uncertain. The new coalition government between the Conservatives and Liberal Democrats is a novelty for the UK, and is still in its infancy at the time of writing. However, the most pressing issue for this new government is clearly the reduction of the sizeable structural deficit. How the public finances are rebalanced seems likely to be the single most important determinant of the future path for living standards, poverty and inequality over the next five years.



# Appendix A. The Households Below Average Income (HBAI) methodology<sup>39</sup>

## 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 main approach to living standards taken in the HBAI document (and therefore in this Commentary too) is to focus solely on material circumstances, and to use income as a simple proxy for most of the analysis. For families with children, there is also a 'material deprivation' indicator, which is based upon both income and the inability of a family with children to afford specific goods and services; discussion and analysis of this indicator can be found in chapter 5 of Brewer, Muriel, Phillips and Sibieta (2008).

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 Family Resources Survey (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. Using consumption as our measure of well-being can change our interpretation of who is 'poor' and how rates of poverty have changed over time.<sup>40</sup>

## 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). Initially, the government treated these as complementary indicators of living standards, presenting both in its HBAI publications, but the last government's 2010–11 target for child poverty was defined solely in terms of income measured BHC, as are the measures of child poverty in the Child Poverty Act 2010.

The case for using these different income measures arises from variation in housing costs. When deciding whether 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

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<sup>39</sup> Many of these issues are also discussed in Berthoud and Zantomio (2008).

<sup>40</sup> See Brewer, Goodman and Leicester (2006).

individuals, it could be argued that an AHC measure is a more suitable measure of their well-being. 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. Consider, for instance, a tenant of a socially-rented property entitled to full housing benefit, and suppose that their social landlord increases their rent by £10 per week. Because their housing benefit receipts would increase to compensate them for this, their BHC income would increase by £10 and their AHC income would remain unchanged. As the rental increase does not reflect an increase in their housing quality, their living standards would remain unchanged and, hence, the AHC measure would better reflect the (lack of) change in their living standards.

However, for individuals who do exercise a considerable degree of choice over cost and quality, housing can be seen more as a consumption good like any other, and a BHC income measure may therefore be preferable. For instance, consider two households with the same BHC income, one of which decides to spend a larger fraction of that income on a larger house in a better neighbourhood, and the other on consumer durables. On an AHC basis, the former household would be considered poorer, whilst their living standards may be comparable (and, indeed, the household spending more on housing has revealed through its choice that it is 'better off' spending more on housing rather than having more to spend on other goods and services).

Pensioners are another group for whom an AHC measure has often been considered appropriate. This is because around 70% of pensioners own their homes outright (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 that is of benefit to those who own their own homes. On a BHC measure, an individual who owns their 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.<sup>41</sup>

For these reasons, commentators (including the authors of this Commentary) 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, but looked at incomes measured BHC when considering the entire income distribution. However, for a fuller picture of living standards, it is best to keep in mind both measures.

## 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 on their own income, but also on the incomes 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. This is by no means the only 'reasonable' assumption that we can make: for example, we could assume that there

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<sup>41</sup> 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.

is complete income sharing *within* the different benefit units of a household but not *between* them. However, given the data available, it is one of the least arbitrary assumptions that can be made.

## 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 modified OECD scale, shown in Table A.1, 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 OECD scale implies that a single person would require 67% of the income that a childless couple would require to attain the same standard of living. So, to get the equivalent income of that single person, we divide their actual income by 0.67. This process is referred to as ‘income equivalisation’.

Table A.1. OECD equivalence scales

	BHC equivalence scale	AHC equivalence scale
First adult	0.67	0.58
Spouse	0.33	0.42
Other second adult	0.33	0.42
Third and subsequent adults	0.33	0.42
Child aged under 14	0.20	0.20
Child aged 14 and over	0.33	0.42

The modified OECD scale does not take into account other characteristics of the household besides the age and number of individuals in the household, although there may be other factors affecting a household’s needs. An important example of these would be the disability or health status of household members. The conventional methodology in HBAI would place a household receiving disability benefits higher up the income distribution than an otherwise-equivalent household without such benefits. But if this higher level of income only compensates the household for the greater needs it has or the extra costs it faces, then the standard of living of this household may be no higher.<sup>42</sup>

## Sample weighting, and adjusting the incomes of the ‘very rich’

The incomes analysed in this Commentary are derived from the Family Resources Survey (FRS) and, prior to 1994–95, the Family Expenditure Survey (FES). These surveys are designed to provide a broadly representative sample of households in Great Britain until 2001–02, and in the whole United Kingdom from 2002–03 onwards. 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)

<sup>42</sup> See also section 5.3 of Brewer, Muriel, Phillips and Sibieta (2008).

reflects the true UK population.<sup>43</sup> For example, if there are proportionately fewer lone parents in the sample than there are in the population, then relatively more weight must be placed upon the data from those who actually do respond.

Second, 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 projected data from HMRC's Survey of Personal Incomes (SPI) – a supposedly more reliable source of data for the richest individuals, based on income tax returns. 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 0.9% of the population (corresponding to around 540,000 individuals, or 133 benefit units in the sample). 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, meaning caution should be used when considering those with the very lowest incomes.

### **The income measure summarised**

In the analysis in this Commentary, we therefore follow 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 2008–09 prices, as our measure of living standards. For brevity, we often use this term interchangeably with 'income'.

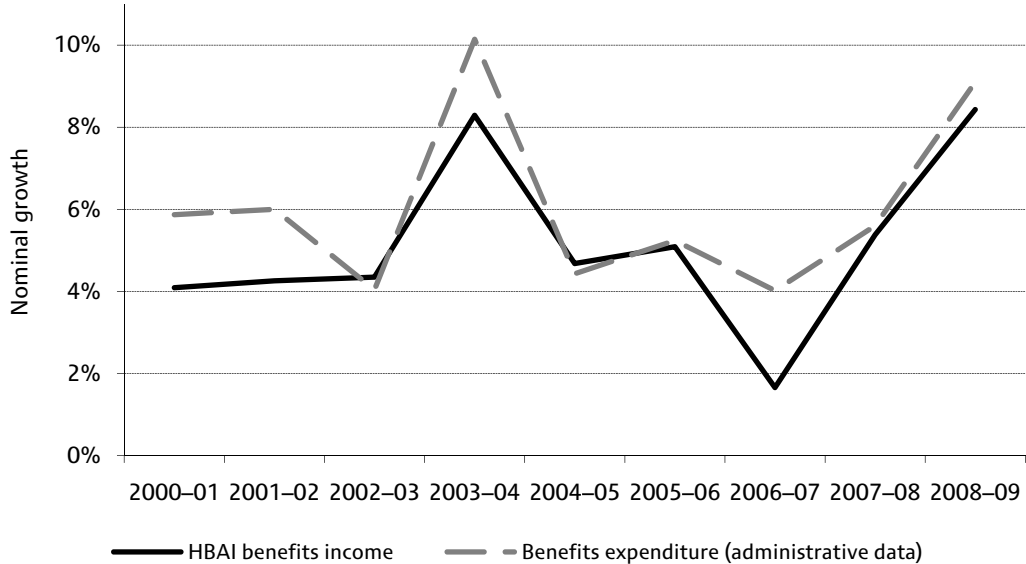
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<sup>43</sup> See Department for Work and Pensions (2010).

# Appendix B. Growth in benefits income: comparing HBAI and administrative data

Given the significant real increase in benefits receipts reported in Section 2.2, it is important to check whether the strong growth in benefits income found in the HBAI data matches with the benefits spending reported by HMRC and DWP. Figure B.1 shows total benefits spending (including tax credits) as reported from administrative data by DWP and HMRC, compared with nominal growth in benefits income measured by HBAI (for Great Britain only). It shows that the increase in benefits receipts found in the HBAI data in 2008–09 closely matches the increase in the amount that the government records as being paid out in its administrative records.

Figure B.1. Nominal growth in spending on benefits and tax credits: comparing HBAI and administrative data



Sources: HBAI benefits income from authors’ calculations using Family Resources Survey, various years. Benefits expenditure (administrative data) from DWP benefit expenditure table 1 (<http://research.dwp.gov.uk/asd/asd4/expenditure.asp>) and HMRC annual accounts, various years (available at <http://www.hmrc.gov.uk/about/reports.htm>).

However, considered over a longer time period, the growth in benefits receipts in HBAI has significantly lagged the growth recorded in administrative payments records. In 2000–01, 2001–02, 2003–04 and 2006–07, growth in benefits receipts in HBAI was about 2 percentage points less than the growth in the amount DWP and HMRC record as being paid. Hence, whilst administrative records show an increase in benefits and tax credit spending (in cash terms) of 69% between 1999–2000 and 2008–09, HBAI records an increase of 57%. This means that HBAI has become relatively worse at capturing benefits receipts over the last 10 years (because even in 1999–2000, benefits receipts were under-recorded in HBAI). The effect of this under-reporting on median income, inequality and poverty is unknown and depends upon where in the income distribution those whose benefits receipts are under-reported can be found.

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