



Institute for  
Fiscal Studies



## Living Standards and Inequality

Andrew Hood, IFS

15<sup>th</sup> July 2014

# Outline

- Living Standards
  - What happened to incomes in 2012–13 and the recent recession?
  - What was the effect of changes in housing costs?
  - How did changes vary geographically across the UK?
  
- Inequality
  - How did changes in income differ for rich and poor?
  - How does accounting for different housing cost trends affect the picture?

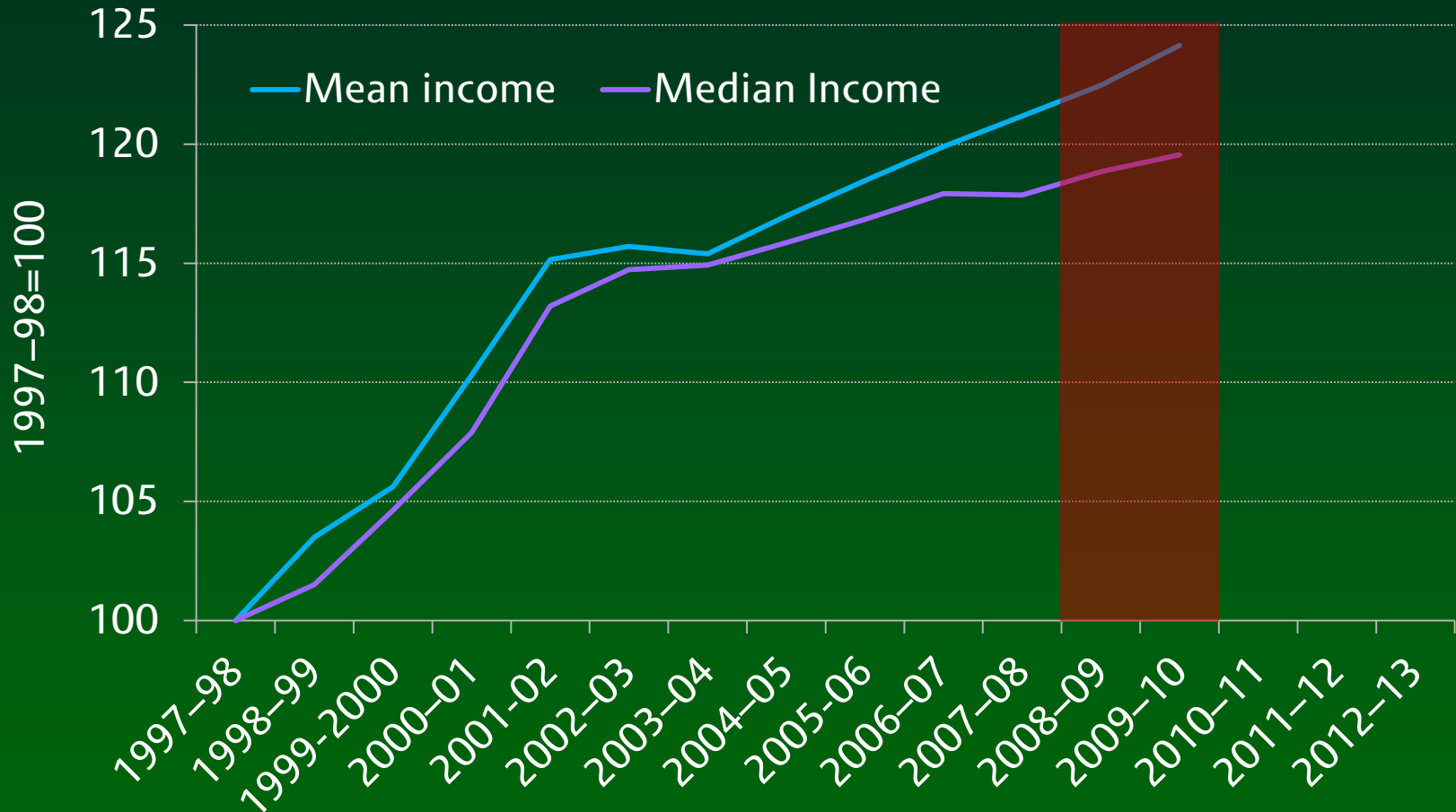
# Where do we get our data?

- Family Resources Survey and predecessors from 1961 to 2012–13
  - currently around 20,000 households per year across the UK
  - subject to sampling error
- Figures with data before 2002–03 refer to Great Britain not UK
  - Northern Ireland not included in the FRS until 2002-03

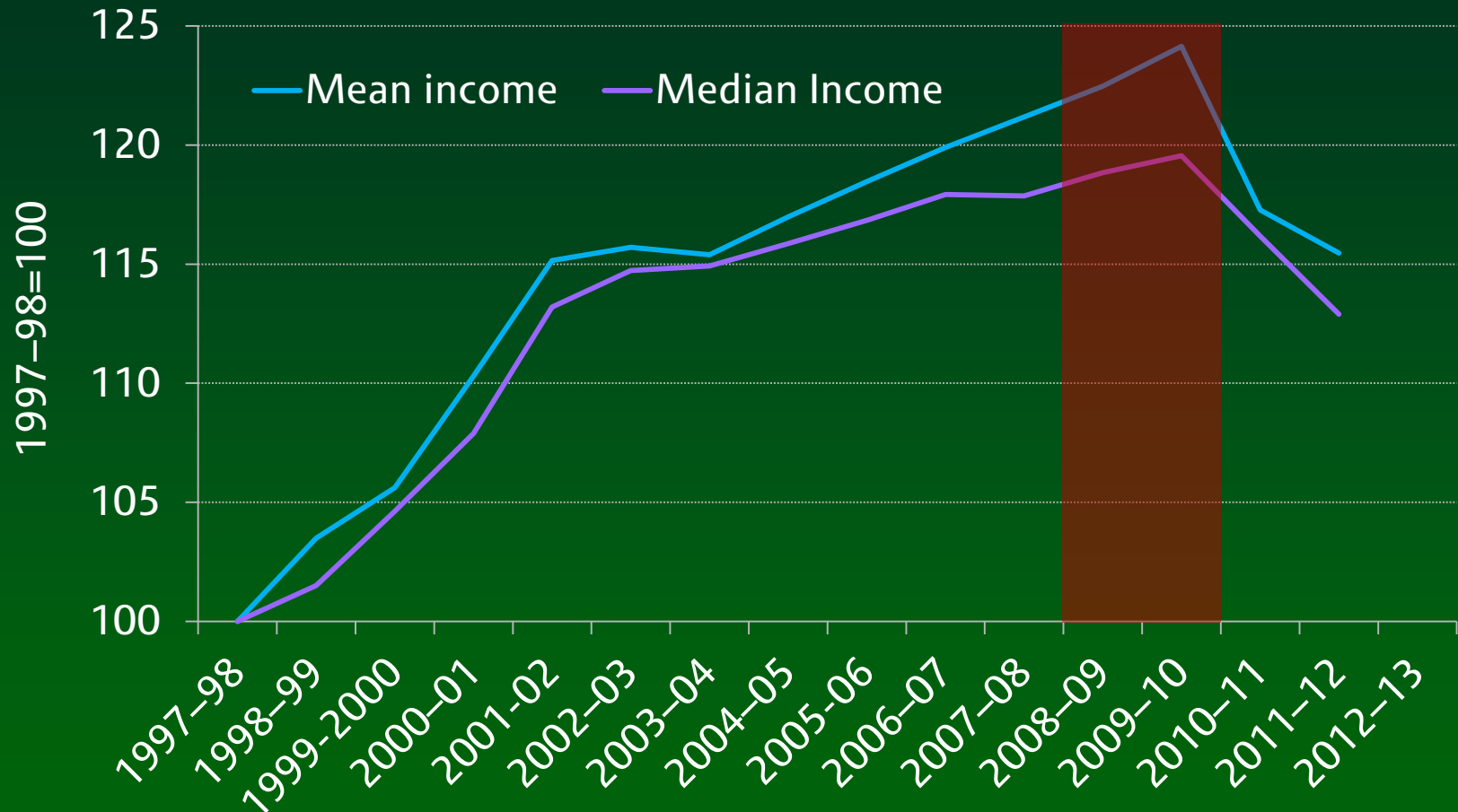
# What do we mean by “income”?

- HBAI income is measured net of direct taxes and benefits, and at the household level
- “Equivalised” to take account of household composition
  - all cash amounts are equivalents for a childless couple
- Adjusted for inflation
  - HBAI uses measure based on the Retail Prices Index (RPI)

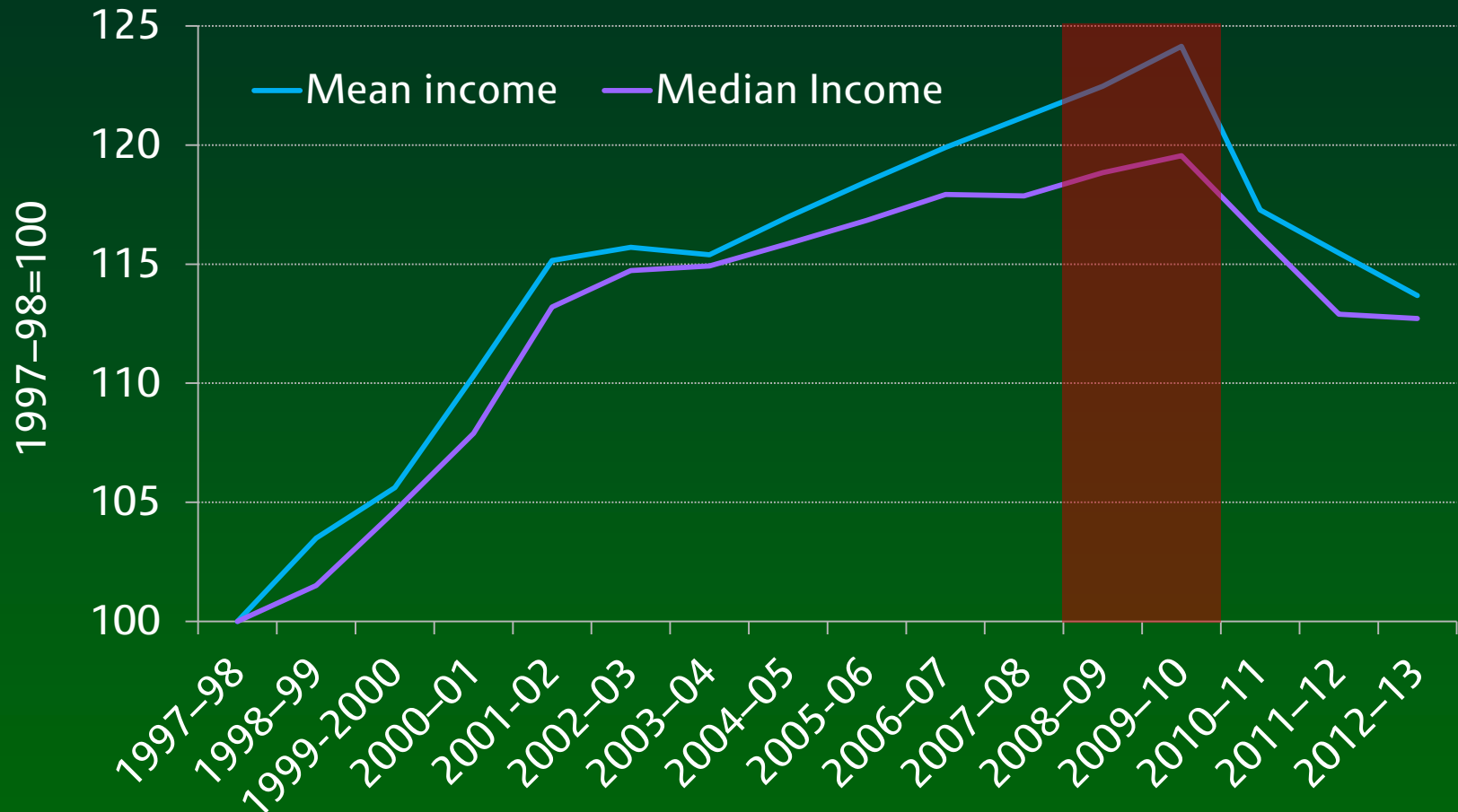
# Slow growth from the early 2000s...



... followed by large falls in 2010–11 and 2011–12...



## ... before average incomes stabilised in 2012–13



# Trends in average incomes

- Average incomes stabilised in 2012–13
  - but significant falls in previous two years leave median income 5.8% below (and mean income 8.5% below) 2009–10 peak
- Falls in income driven by sharp drop in real earnings
  - 9.4% fall in pre-tax earned income of households between 2009–10 and 2012–13, despite higher employment
- Picture slightly less bleak when we use the ONS' improved RPIJ measure of inflation
  - real median income 3.6% lower in 2012–13 than 2009–10 peak
  - 2012–13 median income no higher than 2005–06 using the RPIJ, compared to 2000–01 using the RPI



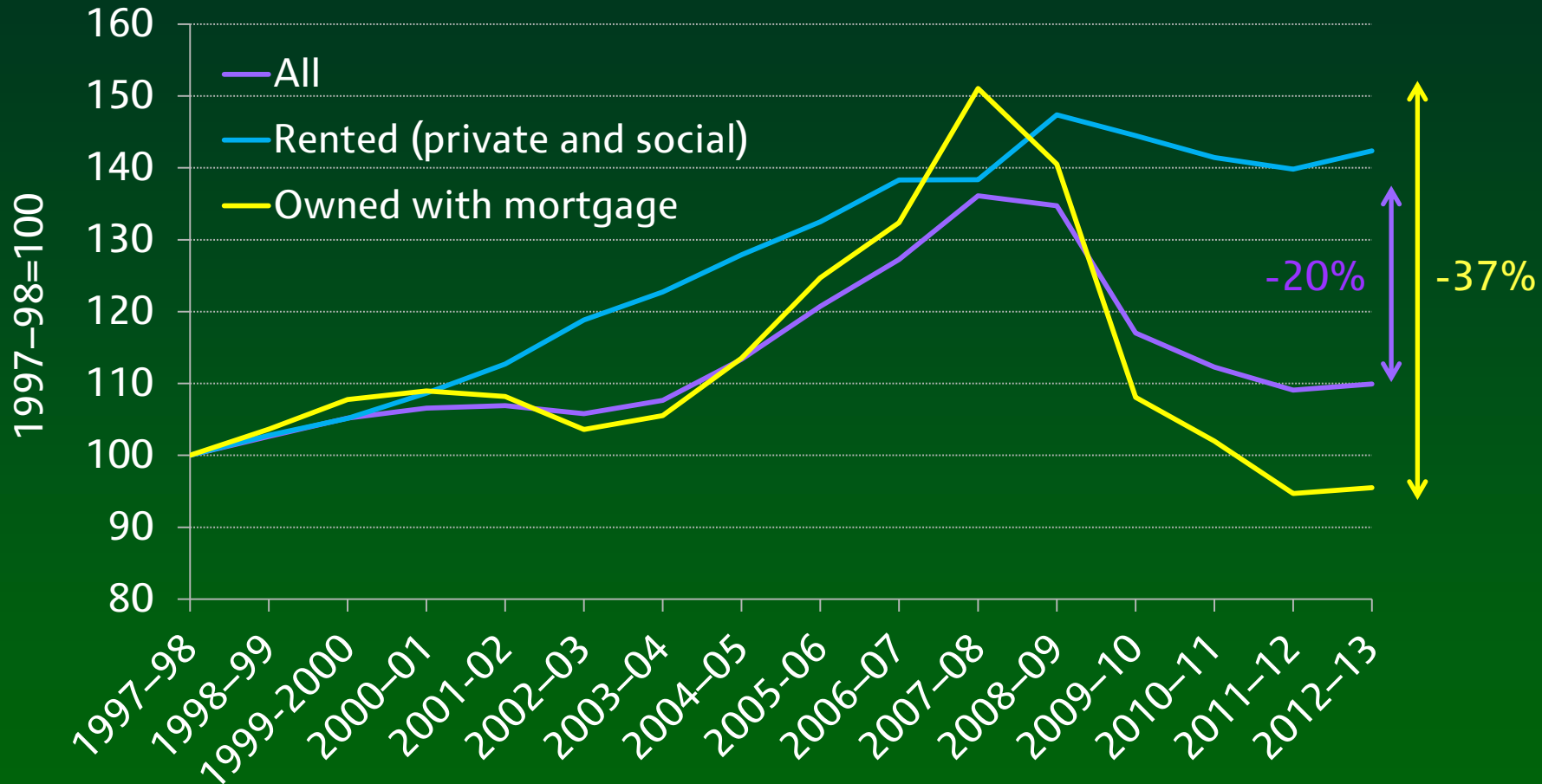
# Housing costs

- Rent or mortgage interest repayments paid by each household
  - does not include mortgage capital payments or house prices
- Incomes measured before housing costs (BHC) treat housing like any other consumption good
  - average change in housing costs included in overall inflation
- Incomes measured after housing costs (AHC) deduct housing costs from income for each household
  - capture different trends in housing costs for different groups

# Trends in housing costs

- Mean housing costs fell by 20% relative to other prices between 2007–08 and 2012–13
  - without lower housing costs, mean AHC income would have fallen by 13% rather than 10%
- Falls were not evenly spread across households

# Real mean housing costs by tenure



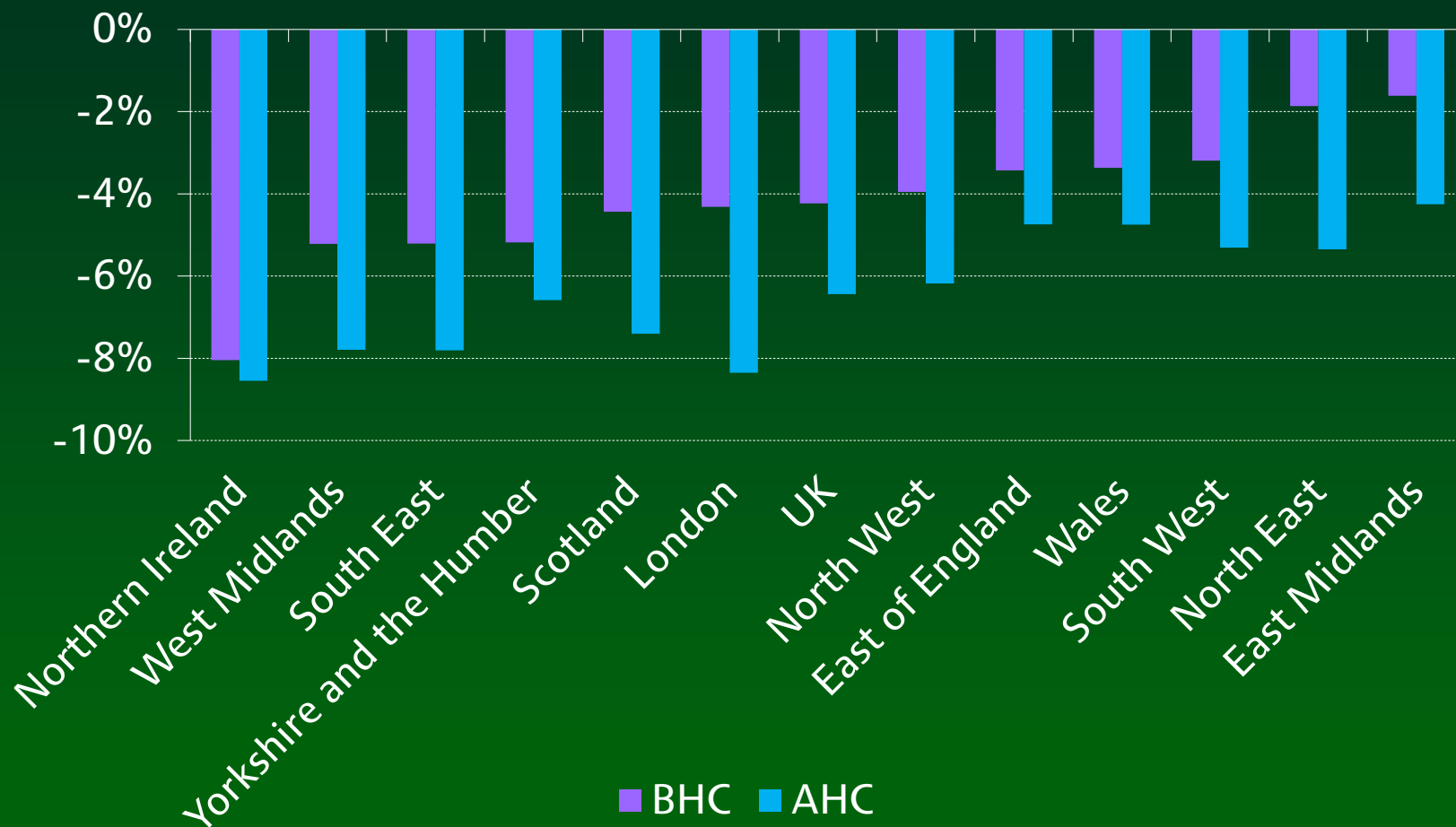
# Trends in housing costs

- Mean housing costs fell by 20% relative to other prices between 2007–08 and 2012–13
  - without lower housing costs, mean AHC income would have fallen by 13% rather than 10%
- 37% fall in real housing costs for those with mortgages
  - spent an average of 13% of income on housing costs in 2012–13, compared to 18% in 2007–08
  - but 5ppt fall in proportion of people living in a mortgaged home
- Only slight fall in real housing costs for renters
  - spent an average of 28% of income on housing costs in 2012–13, up from 26% in 2007–08

# Changes in incomes across the UK

- Recession had differing impacts across the UK

# Real changes in median income by region: 2007–08 to 2009–10 and 2010–11 to 2012–13



# Changes in incomes across the UK

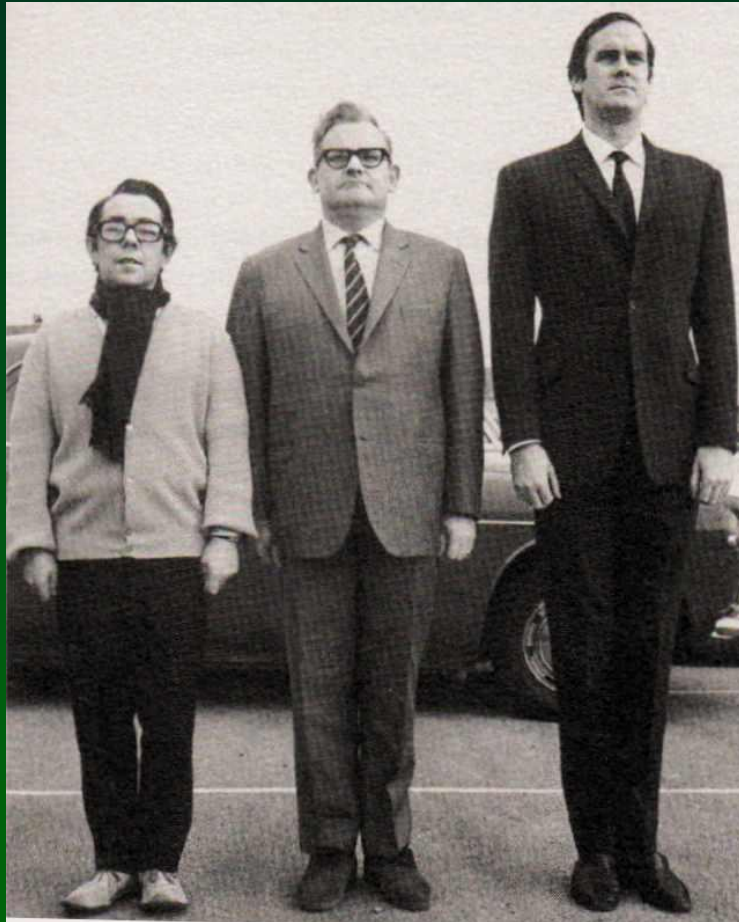
- Recession had differing impacts across the UK
  - falls in median BHC income ranging between 8% in Northern Ireland and 2% in the East Midlands
- Accounting for different housing costs trends makes an important difference
  - eg. median AHC income fell by 8% in London, compared to 4% BHC
  - London has lowest proportion of mortgagers
- No clear geographic relationship between pre-crisis income levels and income changes since the crisis

# Prospects for living standards

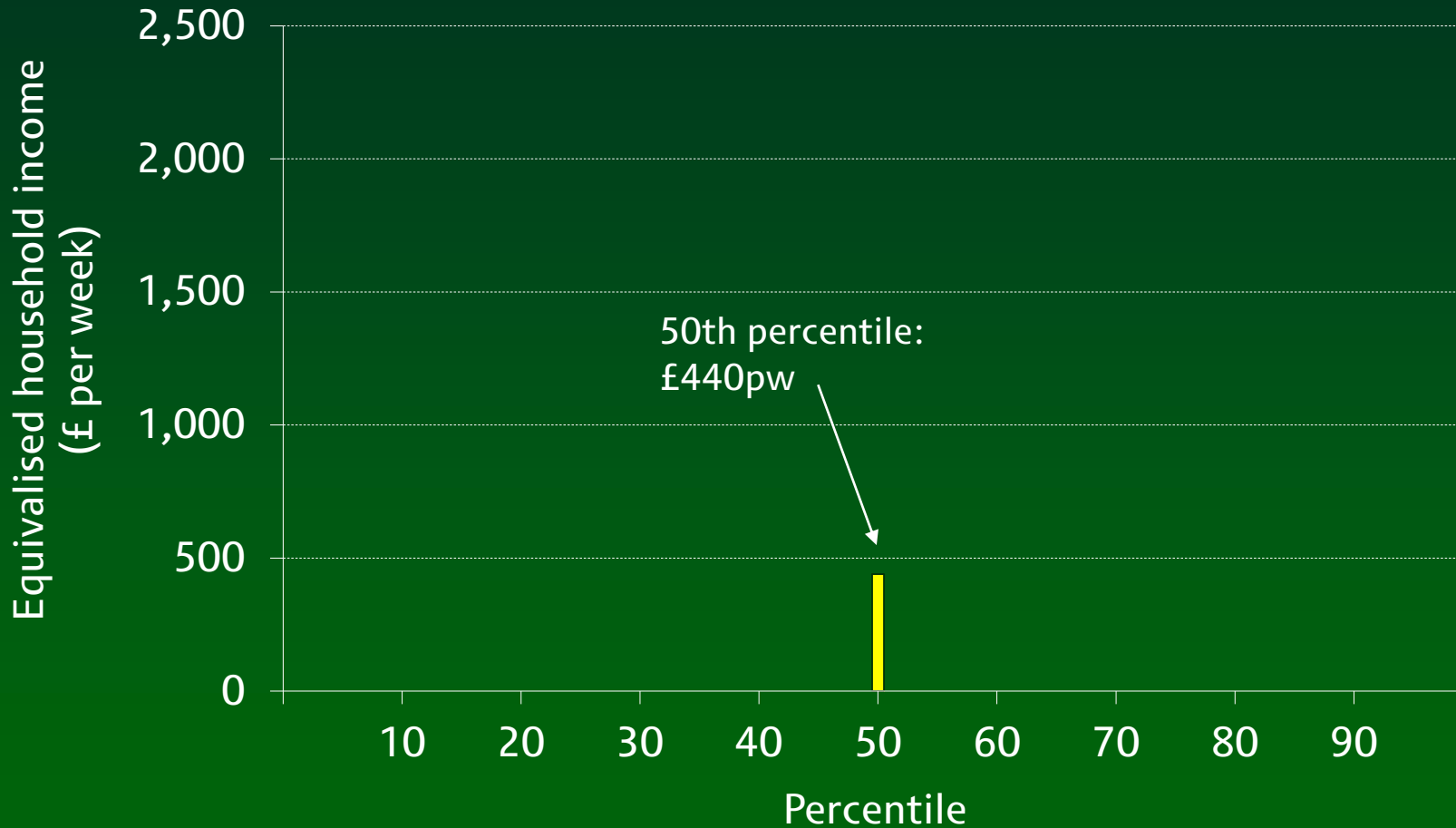
- Employment rising, but earnings growth remains weak
  - employment rate among 16-64s up 1ppt in 2013–14, but average earnings rose at best as fast as prices
  - OBR forecasts suggest real earnings will return to 2009–10 levels by 2018–19 at the earliest
- Benefit cuts accelerated from 2013–14 onwards
  - eg. 3 years of 1% nominal increases from April 2013
- So seems likely to be some time before living standards return to their peak



# Income inequality



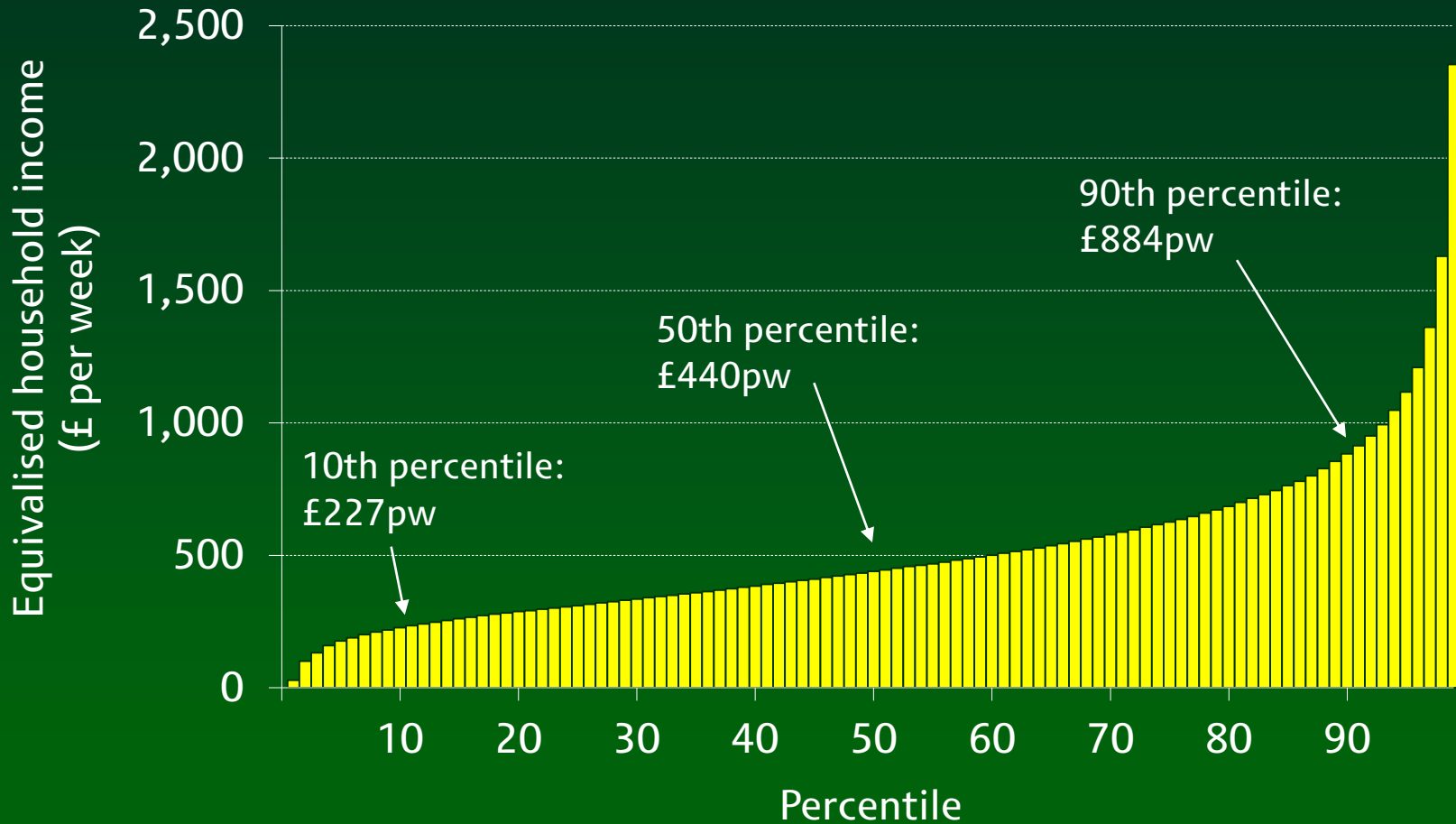
# The UK income distribution in 2012–13



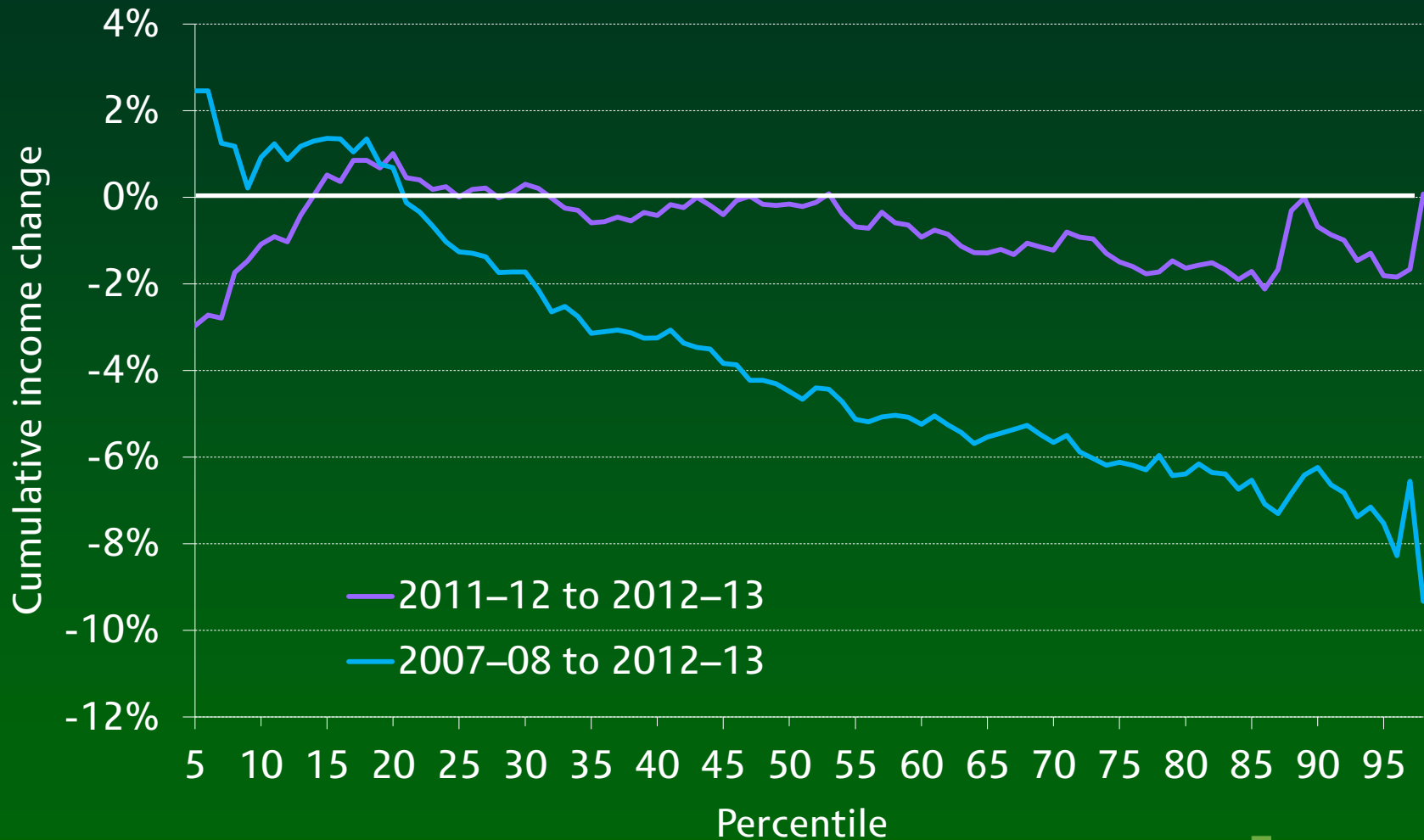
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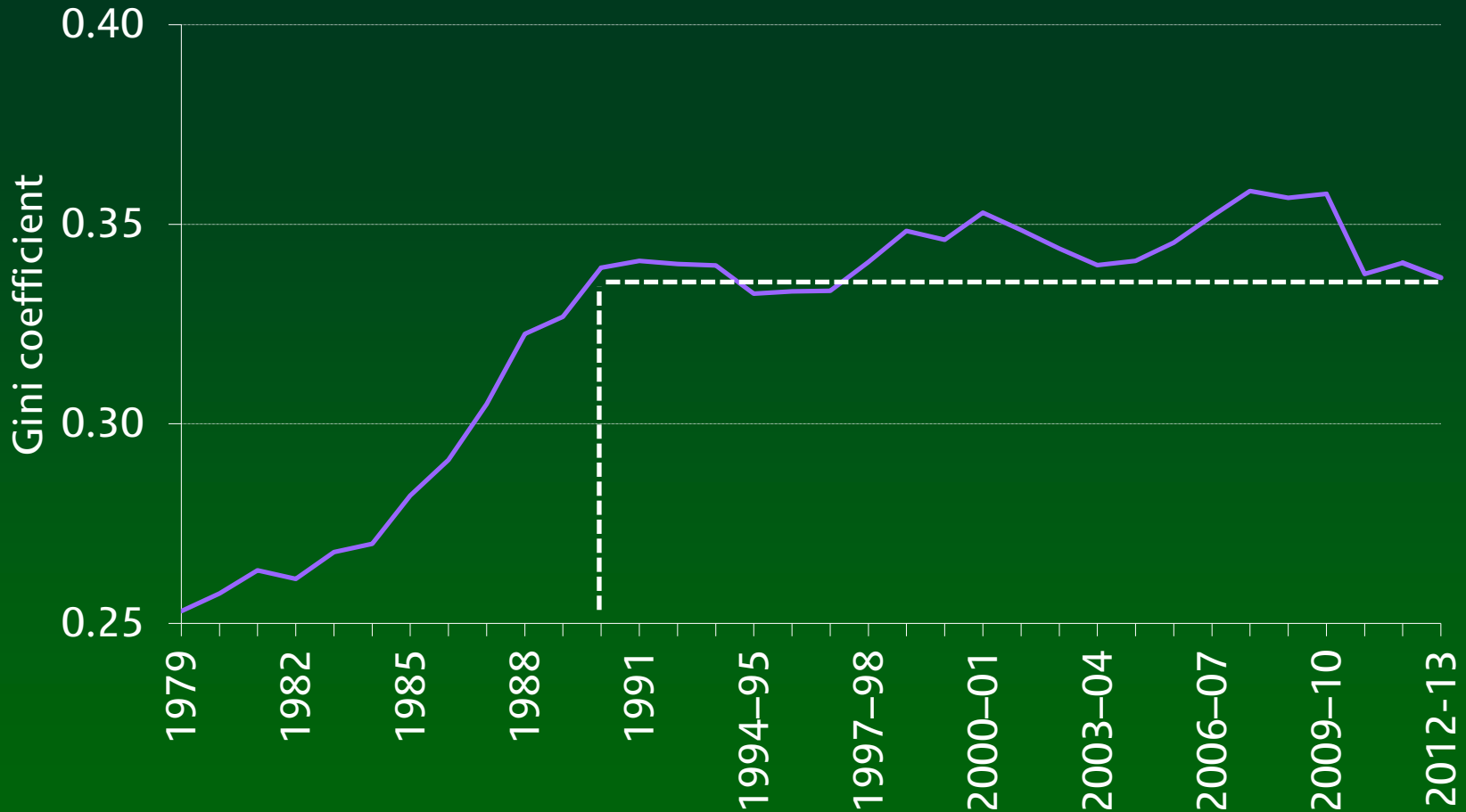
# Income changes by percentile point



# Trends in income inequality

- Inequality barely changed in 2012–13
- But inequality remained significantly lower than in 2007–08
  - real income 6.2% lower at the 90<sup>th</sup> percentile, 4.5% lower at the median, and 0.9% higher at the 10<sup>th</sup> percentile

# Gini coefficient: 1979 to 2012-13



# Trends in income inequality

- Inequality barely changed in 2012–13
- But inequality remained significantly lower than in 2007–08
  - real income 6.2% lower at the 90<sup>th</sup> percentile, 4.5% lower at the median, and 0.9% *higher* at the 10<sup>th</sup> percentile
- Gini coefficient fell from 0.36 in 2007–08 to 0.34 in 2012–13
  - lower than 1990 level



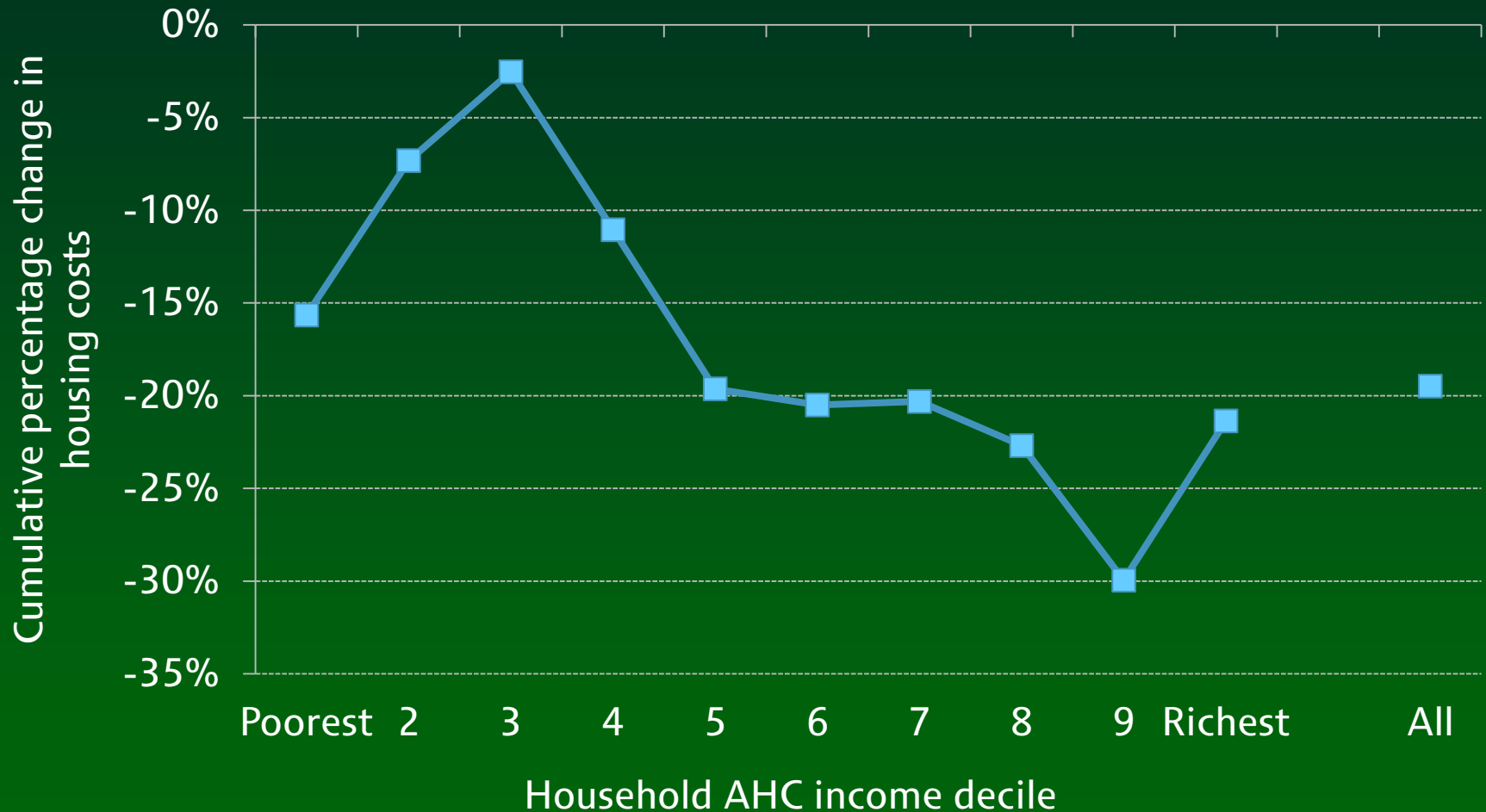
# Why has income inequality fallen?

- Real earnings fell sharply but benefit entitlements remained relatively stable
- Between 2007–08 and 2012–13 real median income fell 6.6% for working households, but rose by 4.9% for other households
  - median income for non-working households rose from 60% to 67% of median income for working households
- 40% of total fall in inequality explained by “catch up” of non-working households
  - 20% if we restrict focus to working-age population

# Housing costs and inequality

- Housing costs have fallen less towards the bottom of the income distribution

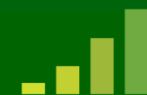
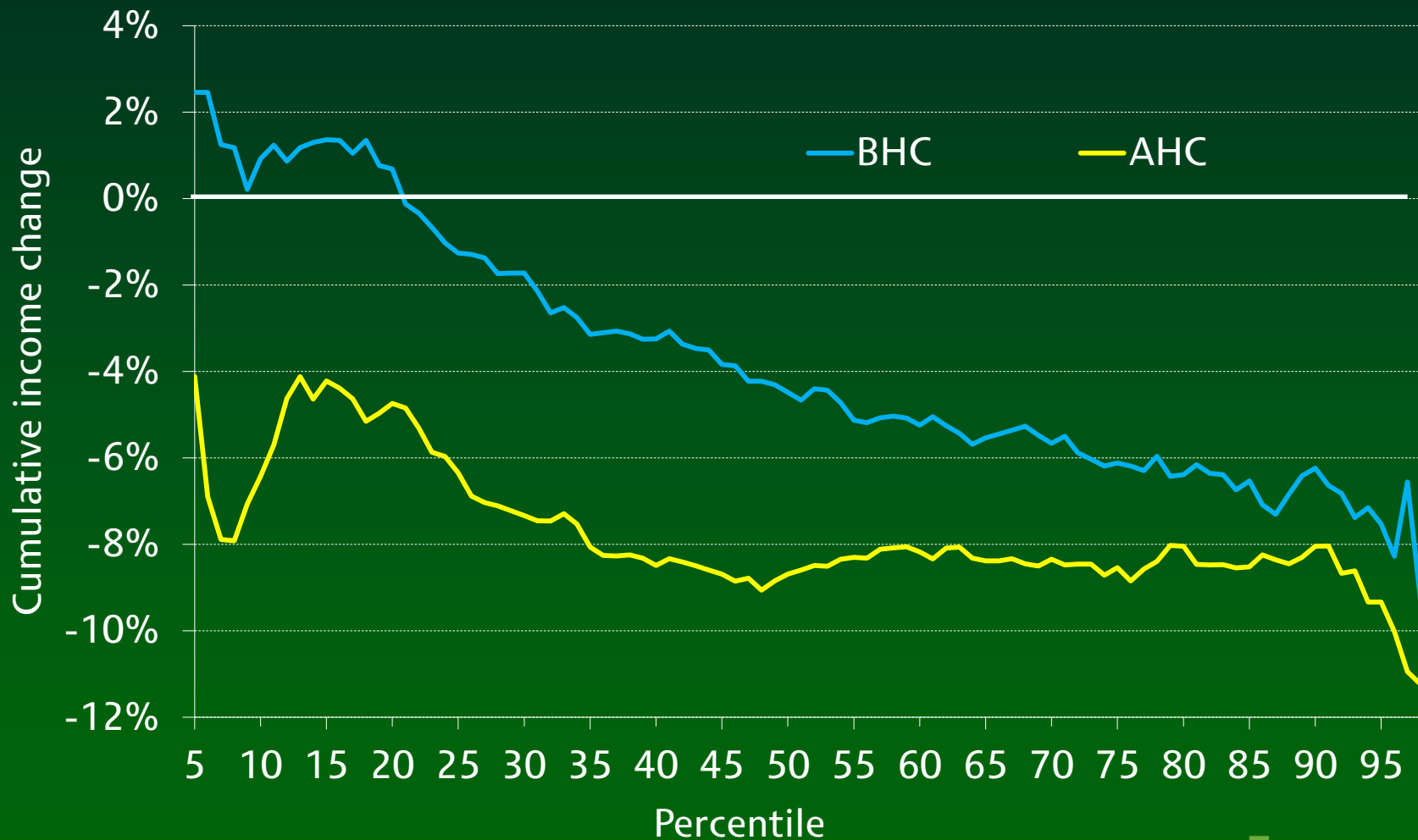
# % change in housing costs by AHC income decile: 2007–08 to 2012–13



# Housing costs and inequality

- Housing costs have fallen less towards the bottom of the income distribution
  - low income households less likely to have a mortgage
- What effect does taking this into account have on changes in inequality?

# Income changes by percentile point before and after housing costs: 2007–08 to 2012–13



# Housing costs and inequality

- Housing costs have fallen less towards the bottom of the income distribution
  - low income households less likely to have a mortgage
- So falls in income inequality are much smaller when incomes are measured after deducting housing costs
  - falls of 8.0% and 6.4% at the 90<sup>th</sup> and 10<sup>th</sup> percentiles respectively
  - Compared to a fall of 6.2% and a rise of 0.9% before housing costs
- More generally, higher inflation faced by low-income households since 2007–08 has counteracted favourable trends in incomes

# Prospects for income inequality

- Good reason to think that falls in inequality since 2007–08 are currently being reversed
- Recovery in earnings primarily boosts incomes for middle- and high-income households
- Direct tax and benefit reforms introduced or planned between April 2013 and April 2015 are inequality-increasing
  - act to reduce incomes for the lowest income third, but increase them across the rest of the population
- But rising mortgage interest costs are likely to lead to smaller rises in inequality after housing costs

# Summary

- Average incomes stabilised in 2012–13
  - but remained well below their 2009–10 peak
- Income inequality barely changed in 2012–13
  - but remained significantly lower than pre-crisis levels
- Falls in inequality much smaller after accounting for different changes in housing costs
  - low-income households less likely to benefit from huge falls in mortgage costs