The Institute for Fiscal Studies

ELECTION BRIEFING 2001

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LIVING STANDARDS UNDER LABOUR

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IFS Election Briefing Note No. 4
May 2001

Funding
The Nuffield Foundation has supported this work by financing the project, *An analysis of trends in inequalities in the 1990s* (Grant number OPD/00111/G). We would also like to thank the Economic and Social Research Council (www.esrc.ac.uk) for overall support for our election analysis through funding for the ESRC Centre for the Microeconomic Analysis of Fiscal Policy (Grant number M544285002).

This document is published on the IFS website, www.ifs.org.uk/election/index.shtml (May 2001).

Living standards under Labour

The four years of the new Labour government have seen a rise in living standards across the income distribution. This has been a period of consistent economic growth, during which time average earnings have risen, employment has grown and the generosity of many benefits, for those in and out of work, has risen. Despite the tax increases described in Election Briefing Note 2, net incomes are higher now on average than they were four years ago.

The gains in living standards over this Parliament have been unevenly spread across the income distribution – income inequality was higher in 1999–2000 than it was before Labour came to power. But in the final year for which we have data (1999–2000), inequality seems to have stopped rising. Despite the overall increase in inequality, the numbers in poverty, as measured both by absolute and by some relative measures, fell in the two years to 1998–99, although the changes in poverty occurring after this time are not yet known.

This Briefing Note examines the changes in living standards, inequality and poverty that have taken place under the Labour government, putting them in the context of the changes over the last two decades.

1. What has happened to average incomes?

A good starting-point for understanding the changes in living standards that have occurred is official statistics on real disposable household income per head from the National Accounts. These are published quarterly and are available up to the end of 2000. They show how the level of household incomes per head, net of income tax and National Insurance contributions, has changed in recent years. Changes in this series are shown in Table 1. Living standards have risen on average during this Parliament: real disposable income per head was approximately 9% higher in 2000 than it was when Blair first came to office. The average rate of growth each year implied by this, at 2.3%, is the same as the average annual growth rate during the entire period of Conservative government from 1979, although it is somewhat lower than that seen during the Thatcher years and higher than that seen while Major was Prime Minister.

Table 1. Changing real disposable household income per head (%)

	Overall growth	Average annual growth National Accounts
Conservative years	50.4	2.3
Thatcher years	33.0	2.6
Major years	13.0	2.0
Blair to December 2000	9.0	2.3

Source: IFS calculations based on *Economic Trends* (various years) and Office for National Statistics, Press Release, 'Quarterly National Accounts 4th Quarter and Year 2000', 26 March 2001.

Given that this government's period of office has seen consistent economic growth, it may seem surprising that the average growth in living standards over this time has been no higher than for the previous twenty years. One reason is that the disposable income measure used here better captures some of the increases in the tax burden in recent years than other commonly used measures. This is because income is measured net of *all* income tax, including the negative income tax implied by the income tax credits on pension funds' dividend income, which were abolished by this government in 1997. The abolition of these credits is equivalent to an income tax rise, since although its incidence is not on households directly, it does hit the pension funds that they hold. The abolition of these credits will have had the effect of reducing net incomes by an estimated £5bn paid out of total household income, which is now £620bn.[1]

As data from the first quarter of 2001 remain unavailable, the figures for this Parliament are incomplete. As well as growth in average earnings, and falls in unemployment over the early part of the year, a number of tax and benefit changes in April 2001 should help increase incomes further. These include increases in the basic state pension, higher means-tested benefits for families with children and income tax cuts delivered through the children's tax credit and the wider 10p band announced in the March 2001 Budget. There are also tax increases in April that will partly offset these rises in households' incomes, such as an increase in National Insurance contributions.

2. What has happened to the gap between rich and poor?

Before he became Prime Minister, Tony Blair stated 'if the next Labour government has not raised the living standards of the poorest by the end of its time in office, it will have failed'.[2] Our analysis shows that the living standards of the poorest have indeed risen under this government, although the gains experienced at the bottom of the income distribution in the first three years of the Parliament have been smaller than the growth in living standards experienced by those higher up the income scale.

In order to analyse the income changes across the distribution, we need to use information obtained from detailed household surveys, rather than the aggregate National Accounts data cited above. Although such data are published annually by the Department of Social Security in its Households Below Average Income (HBAI) series, these official statistics are currently only available for the first two years of the Parliament, up to 1998–99.[3] Using detailed information from the Family Expenditure Survey, we have been able to extend this analysis for a further year, in order to assess how living

[1] Sources: HM Treasury, *Financial Statement and Budget Report*, Hc85, The Stationery Office, London, 1997; Office for National Statistics, Press Release, 'Quarterly National Accounts 4th Quarter and Year 2000', 26 March 2001, Table J2.

[2] Interview in the *Independent on Sunday*, 26 July 1996.

[3] Data for 1999–2000 will be published by the DSS in the summer.

standards have changed for different groups up to April 2000.[4] The analysis is based on net weekly household income adjusted to take account of family size and measured before housing costs have been paid.

It should be noted that the HBAI series differs from the National Accounts data in certain important respects. First, it is likely to be less accurate because it is based entirely on interviews of samples of the population, and so is more subject to sampling and measurement error. The income definition also differs between the two series. For example, the HBAI series is measured net of council tax (and its local tax predecessors), whereas the National Accounts data are not; the National Accounts data are affected by changes such as the abolition of pension fund income tax credits (discussed in Section 1), whereas such changes are not captured by HBAI. These and other definitional differences mean that the average changes in living standards over different periods do not coincide exactly, although they do show a similar trend.[5]

In order to assess how the changes in living standards differ across the income distribution, the population has been divided into five equal-sized groups of the population ranked according to income, known as quintile groups. Box 1 shows the income levels at which different families fit into these quintile groups, expressed in January 2001 prices.

Box 1. Where do you fit in? Weekly net incomes of three family types, by quintile, January 2001 prices

	Single person, no children	**Couple, no children**	**Couple with two children (aged 4 and 13)**
Bottom quintile	£0 to £107	£0 to £176	£0 to £255
2nd quintile	£108 to £148	£177 to £243	£256 to £353
3rd quintile	£149 to £200	£244 to £328	£354 to £475
4th quintile	£201 to £278	£329 to £455	£476 to £660
Top quintile	£279+	£456+	£661+

Source: Family Resources Survey, 1998–99.

How have the living standards of these income groups changed over time? Figure 1 shows changes in living standards across the income distribution over different periods. During the Thatcher years (1979–90), income growth was highly unequal, with incomes growing most slowly in the bottom quintile, and more quickly in each subsequent quintile group. The real incomes of the bottom fifth barely rose at all in real terms each year, compared with real growth averaging 4.7% per year amongst the top fifth of the population.

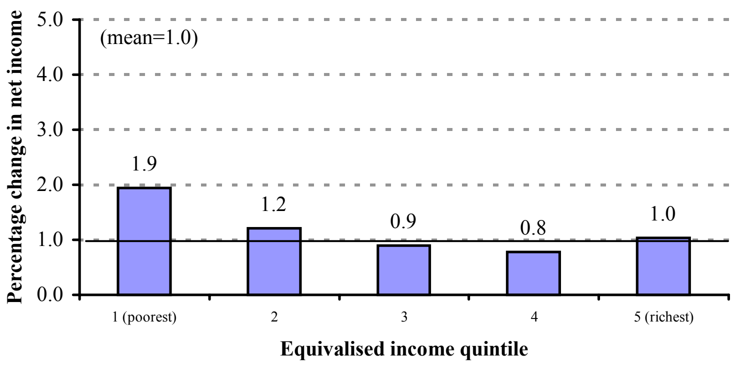
[4] The series has also been extended backwards in time and is available from IFS covering every year back to 1961.

[5] In particular, the HBAI series shows a substantially lower growth in average living standards under Major than is shown in the National Accounts.

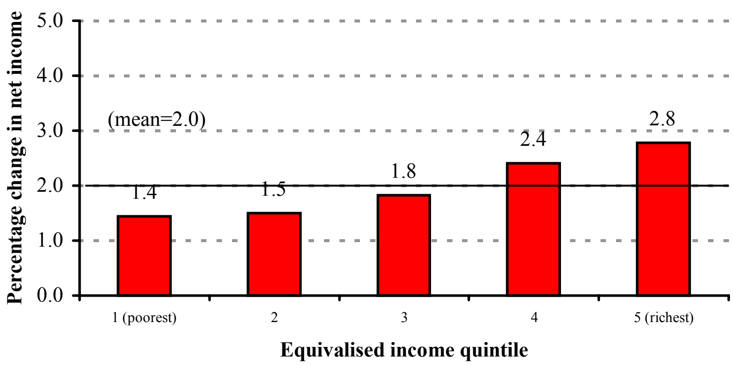
Figure 1. Income growth for rich and poor under different Prime Ministers (real annual average growth)

Thatcher years

Major years



Blair first THREE years



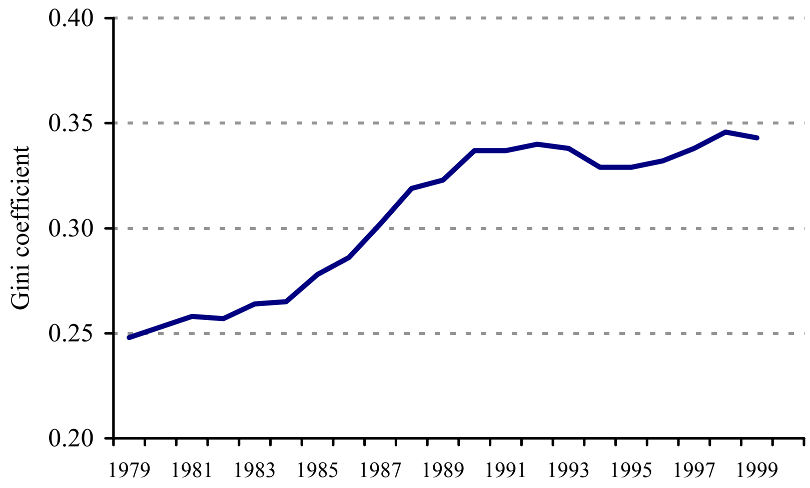
Note: The income measure used is net household weekly equivalent before-housing-costs income. This is the same measure as used by the DSS in its Households Below Average Income series.
Source: IFS calculations based on Family Expenditure Survey and Family Resources Survey.

During this time, it was those in work, particularly those higher up the income scale, who saw the largest rises in their living standards. People on low earnings and those in households with no earners – for example, many lone-parent families – saw their incomes stagnate in real terms.[6]

By comparison, the Major years (1990–97) saw considerably lower average income growth across the whole population, reflecting the recession of the early 1990s. But the income gains that there were over this period were disproportionately enjoyed by families at the lower end of the income distribution.

The pattern of changes in living standards over the first three years of the Blair government shows income growth that, as in the Thatcher years, is skewed towards the middle and upper parts of the income distribution, although it is clear from Figure 1 that these changes are not as unequal as those that took place during the 1980s. The mean income of the poorest fifth grew at an average annual rate of 1.4% over the three years to April 2000, with a similar rate of growth also shown in quintiles 2 and 3. The growth in the fourth quintile was equivalent to a 2.4% real-terms increase per year, with a 2.8% rise amongst the richest fifth.

Figure 2. The path of inequality: the Gini coefficient, 1979–1999/2000



Note: The income measure used is net household weekly equivalent before-housing-costs income. This is the same measure as used by the DSS in its Households Below Average Income series.
Source: IFS calculations based on Family Expenditure Survey and Family Resources Survey.

These changes in incomes across the distribution mean that income inequality rose over the first three years of this government. The most commonly used

[6] Of course, there is some mobility in the income distribution, so when analysing income differentials across the distribution over several years, it must be recalled that each quintile contains different individuals in each period. Similarly, in income analysis by family type, it is clear that the type of family an individual is classed as belonging to will vary over time.

measure of income dispersion – the Gini coefficient – is mapped out in Figure 2, which shows that inequality grew over the first two years of this Parliament, before falling back slightly in the year ending in April 2000. While such a small drop could certainly reflect nothing more than statistical sampling variation, the fact that inequality did not move upwards, as it has done in recent years, could also reflect both the effects of falling unemployment and the first results of increasing benefits for the poor. Despite this small fall in inequality in the final year, it remains the case that measured inequality was higher in 1999–2000 than before Labour came to power.

This compares with the strongly rising income inequality over the 1980s, which was followed by a modest decline in measured income inequality over the early 1990s as the wages of the best-off were temporarily restrained by recession. Economic growth in the middle part of the decade coincided with a new upturn in income inequality.

3. What has happened to poverty?

Although the government has not made a reduction in income inequality one of its explicit aims, in the last two years it has been explicit in its goals towards poverty, in particular in its ambition to eradicate child poverty in 20 years and halve it in 10 years. In his speech to Labour's Spring Conference this year, Gordon Brown hinted that a similar goal towards pensioner poverty might be in the pipeline, stating: 'Let us be the generation that abolished child and pensioner poverty'.[7]

The government has been keen to emphasise that low incomes are just one aspect of poverty, with 31 different indicators of poverty set out in its annual audit of poverty, *Opportunity for All*.[8] However, relative and absolute income poverty lines remain central. As with inequality, published data are only available for the first two years of the Parliament. These show modest falls in the number of non-pensioners and children below the government's headline measure (60% of median after-housing-costs income) but a small increase in the number of pensioners below this same line.

These results are shown in Table 2. The number of people in households whose income falls below 60% of median after-housing-costs (AHC) income fell slightly over the first two years of the Parliament, from approximately 24.6% of the population to 23.7% of the population, a drop of around half a million people. The number of children living below this poverty line also fell very slightly over the two years to April 1999, by about 150,000, but remained at more than 4m children, or approximately one in every three. By contrast, the number of pensioners below the line rose slightly, by about 40,000 over the two years in question.

[7] Gordon Brown, Labour Party Spring Conference in Glasgow, 16 February 2001.

[8] Department of Social Security, *Opportunity for All – One Year On: Making a Difference. Second Annual Report 2000.* Cm. 4865, The Stationery Office, London, 2000.

Table 2. Number of people with incomes below 60% median after-housing-costs income

	Below 60% contemporary median			Below 60% 1996–97 median		
	1996–97	**1997–98**	**1998–99**	**1996–97**	**1997–98**	**1998–99**
Total people						
Number (m)	13.9	13.6	13.4	13.9	13.3	12.6
Proportion	0.246	0.241	0.237	0.246	0.235	0.223
of whom:						
Children						
Number (m)	4.4	4.3	4.3	4.4	4.2	4.0
Proportion	0.340	0.334	0.332	0.340	0.328	0.315
Pensioners						
Number (m)	2.2	2.3	2.3	2.2	2.2	2.0
Proportion	0.266	0.271	0.271	0.266	0.260	0.241

Source: IFS calculations based on Family Resources Survey. These are the same as those to be found in Department of Social Security, *Households Below Average Income 1994/5 to 1998/9*, Corporate Document Services, Leeds, 2000.

These small falls in relative poverty are not robust to the choice of poverty line. Although the numbers below various fractions of median income, measured both before and after housing costs, have fallen, the number of people below 50% of the mean, which is influenced more strongly by income changes at the top of the income distribution, in fact rose slightly over the first two years of the Parliament.

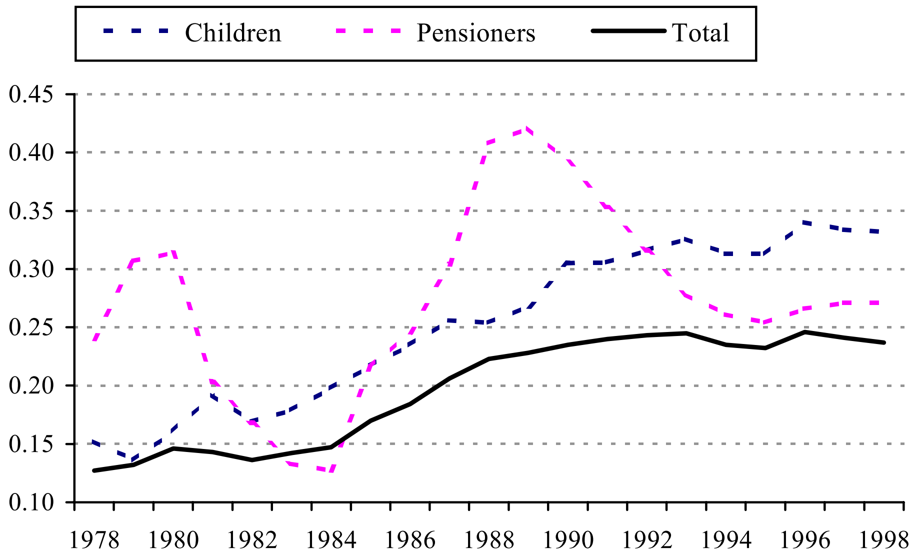
Because of the consistent income growth across the distribution – discussed in the previous section – the numbers falling below absolute levels of income have fallen more decisively. For example, the number of people living below £140 per week for a childless couple (60% of the median AHC income in 1996–97, uprated to 2001 prices) fell by about 1.2m in the first two years of the Parliament, from 13.9m (as shown in Table 2) to approximately 12.6m. Of this fall, 400,000 were children and 200,000 were pensioners.

If data were available for the full four years of the Parliament, it is likely that more unequivocal falls in both absolute and relative income poverty would be shown. It has been estimated that, other things being equal, reforms to the tax and benefit system over the first four Budgets of this Parliament will lift approximately 1.2m children out of poverty, with most of the measures effecting this reduction coming in the 1999 and 2000 Budgets.[9] Increases in employment in the second half of the Parliament should also have resulted in a reduction in the number of working-age families below the poverty line. The number of pensioners in relative poverty is also likely to have fallen over the last two years, with significant increases in the pensioner minimum income guarantee and increases in other pensioner benefits, such as the winter fuel allowance, coming into effect during this time.

[9] See: HM Treasury, *Financial Statement and Budget Report, March 2001*, Hc279, The Stationery Office, London, 2001 (http://www.hm-treasury.gov.uk/budget2001/index.html); H. Sutherland and D. Piachaud (2001), 'Reducing child poverty in Britain: an assessment of government policy 1997-2001', *Economic Journal*, vol. 111, no. 469, F85–F101, February 2001.

However, these benefit increases will not be sufficient to bring levels down to anywhere near the levels of relative poverty that were prevalent before the 1980s. This can be seen in Figure 3, which places the changes in relative poverty over the first two years of this Parliament in context. The graph shows the proportion of all people, pensioners and children whose household income fell below 60% of the contemporary median AHC income, for each year from 1978 to 1998–99. The total number of people falling below this poverty line rose rapidly over much of the 1980s, from approximately one in eight in 1979 to close to one in four at its peak in the early 1990s. Over the 1990s, the total number of people in poverty on this measure has fluctuated, but, as shown in Table 2, it has been falling since 1996–97.

Figure 3. Proportion of children, pensioners and all people with incomes below 60% median after-housing-costs income



Source: IFS calculations based on Family Expenditure Survey and Family Resources Survey.

The proportion of pensioners and children in poverty on this measure is higher than that of the population at large, since these families are heavily represented at the lower end of the income distribution. As Figure 3 shows, the proportion of children in relative poverty more than doubled over the 1980s, from about 15% to more than 30% in the early 1990s, and it peaked at 34% in 1996–97.

The number of pensioners in poverty on this measure has fluctuated quite dramatically over the entire period, with a strong cyclical pattern. During economic booms, relative pensioner poverty has risen, whilst during slowdowns and recessions, pensioner poverty has fallen. These large fluctuations arise for two reasons. First, pensioner benefits have tended to rise less quickly than earnings. This means that, during periods of high earnings growth, the number of pensioners below relative poverty lines has grown quickly; during economic slowdowns, the number has gone down. Second, the size of the fluctuations is mostly due to the heavy concentration of pensioners around the poverty line, meaning that small changes in the poverty line shift large numbers of pensioners into or out of measured poverty. This highlights one of the major drawbacks of using arbitrary poverty lines such as this one. A useful alternative is to look at direct measures of deprivation that accompanies low income.[10] Such movements also suggest that the increases in pensioner benefits that have been announced but are yet to be brought into effect are likely to reduce the number of pensioners in poverty on this measure quite considerably.

It is interesting to note that, having peaked at 42% in 1989–90 and fallen over the first part of the 1990s, the number of pensioners in poverty on this measure did not rise nearly as rapidly over the recent period of economic growth as it did over the 1980s. This reflects the fact that both the last government and this one have raised the level of means-tested pensioner benefits by more than inflation. Price-indexation schemes in many private pension schemes also mean that many pensioners benefited from the onset of low inflation in the early 1990s.

4. Conclusion

The extent to which the government is responsible for these changes in living standards and poverty is open to debate. Typically, governments tend to take credit for improvements when incomes are growing, but blame factors outside their control when incomes are falling. The impact of government tax and benefit measures, discussed in Election Briefing Note 5, provides a clearer indicator of government's direct impact on living standards.

Does the small measured fall in inequality seen in 1999–2000 represent the start of a sustained reduction? It remains too early to tell. Budget measures recently implemented and in the pipeline are likely to compress inequality somewhat, if all else is equal. But beyond this, predicting the path of income inequality is difficult and depends on what policies the new government chooses to implement. If the Labour government secures a second term, further redistribution through tax and social security policies is likely if the government pursues its stated aim of eradicating child poverty. In addition, the government's aspiration of increasing means-tested benefits for pensioners with earnings each year (rather than in line with prices, which has been the norm for the last twenty years) should mean that the incomes of the poorest pensioners will not fall further behind those of the rest of society as the economy grows. But perhaps the most important determinants of income inequality are found in the labour market, and changes here are much harder to predict and, indeed, harder for any government to control.

Whether or not income inequality will fall significantly remains to be seen. Whatever changes do take place, one thing is clear, however: even if inequality does fall, it is unlikely to return soon to the levels seen before the dramatic changes of the last twenty years.

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[10] See, for example, D. Gordon et al., *Poverty and Social Exclusion in Britain*, Joseph Rowntree Foundation, York, 2000.