What is happening to inequality?

Paul Johnson

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What is actually happening to inequality

• The standard analysis
  – What HBAI tells us
  – The components of inequality

• The complications
  – Under reporting of income
  – Other measures of income and consumption

• The role of government
  – Importance of tax and transfers
  – How different measures give different answers
  – Going beyond transfers

• Conclusions
Median household £419 a week in 2010-11

Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2012*
90th centile income about 4 times 10th centile

Source: Figure 3.1 of Living Standards, Poverty and Inequality: 2012
Income growth 1996-97 to 2009-10 equalising over middle 90%

Source: Figure 3.5 of *Living Standards, Poverty and Inequality: 2012*
Income falls in 2010-11 bigger at top end

Source: Figure 3.5 of *Living Standards, Poverty and Inequality: 2012*
In stark contrast to story since 1979

Source: Figure 3.5 of *Living Standards, Poverty and Inequality: 2012*
Gini up sharply to 1990, modestly 1996-2009

1979 to 1990 Gini increased from 0.25 to 0.34

1996-97 to 2009-10 Gini rose from 0.33 to 0.36

Source: Figure 3.7 of *Living Standards, Poverty and Inequality: 2012*
With sharp fall in 2010-11

- Gini fell from 0.36 to 0.34 in 2010-11
- Largest one year fall since at least 1961
- Returns Gini to below its 1997-98 level

Source: Figure 3.7 of *Living Standards, Poverty and Inequality: 2012*
Inequality ratios: 1979 to 2010-11 (GB)

99/50 ratio fell to 5.1
(still higher than 2008-09)

Source: Figure 3.9a of *Living Standards, Poverty and Inequality: 2012*
At the bottom of the distribution

- Pensioners have done very well
Relative pensioner poverty lowest since 1984

Number of pensioners living in poverty now:
- 2.0 million (BHC)
- 1.7 million (AHC)

Source: HBAI Data (FES and FRS)
At the bottom of the distribution

- Pensioners have done very well
- Families with children on an improving trend
While relative BHC child poverty rates are back at mid 1980s levels

Notes: Poverty line is 60% of median income. Years up to and including 1992 are calendar years; thereafter, years refer to financial years. Incomes are measured before housing costs have been deducted.
Source: Authors’ calculations using Family Resources Survey and Family Expenditure Survey.

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At the bottom of the distribution

- Pensioners have done very well
- Families with children on an improving trend
- But the working age childless have not done well
Relative poverty among working-age adults without children on continuing upward trend

Source: HBAI Data (FES and FRS)
Absolute poverty among working-age adults without children similar to 1970s levels...

Source: HBAI Data (FES and FRS)
Families with children have done better than the childless across the distribution since 1998-99

Notes: Changes in income at the 1\textsuperscript{st}, 2\textsuperscript{nd}, 98\textsuperscript{th} and 99\textsuperscript{th} percentiles are not shown on this graph due to very high levels of statistical uncertainty. Incomes have been measured before housing costs have been deducted.

Source: Authors' calculations using Family Resources Survey, 1998-99 and 2010-11.
So the story seems to be

- Big increase in inequality since 1979
- Modest increase during 2000s driven by the tails
- Childless working age done particularly badly
- But inequality growth is overwhelmingly *within* identifiable groups
Income inequality – factor decomposition

Source: HBAI Data (FES and FRS) and authors’ analysis
But is that the whole story?

- Two good reasons for thinking we are (increasingly) underestimating living standards lower down the distribution
  - First: important elements of benefit spending appear to be very poorly captured in the data
Only half of tax credit and two thirds of Income Support spending captured in the data

<table>
<thead>
<tr>
<th>Benefit Category</th>
<th>Coverage</th>
<th>Spend (£m/yr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement pension</td>
<td>95%</td>
<td>66,480</td>
</tr>
<tr>
<td>“Other”</td>
<td>52%</td>
<td>27,970</td>
</tr>
<tr>
<td>Working and child tax credits</td>
<td>50%</td>
<td>21,270</td>
</tr>
<tr>
<td>Rent rebates and allowances</td>
<td>83%</td>
<td>18,930</td>
</tr>
<tr>
<td>Income support &amp; pension credit</td>
<td>68%</td>
<td>16,580</td>
</tr>
<tr>
<td>Child benefit</td>
<td>96%</td>
<td>11,880</td>
</tr>
<tr>
<td>Incapacity benefit</td>
<td>74%</td>
<td>6,670</td>
</tr>
<tr>
<td>Maternity/Statutory maternity pay</td>
<td>119%</td>
<td>1,900</td>
</tr>
<tr>
<td>Jobseekers allowance</td>
<td>80%</td>
<td>1,200</td>
</tr>
<tr>
<td>War pensions</td>
<td>33%</td>
<td>1,020</td>
</tr>
<tr>
<td>Student support</td>
<td>236%</td>
<td>970</td>
</tr>
</tbody>
</table>

Notes: based on Barnard (2011) analysis of LCFS 2009 and 2010
But is that the whole story?

- Two good reasons for thinking we are (increasingly) underestimating living standards lower down the distribution
  - First: important elements of benefit spending appear to be very poorly captured in the data
  - Second: incomes at the bottom of the distribution don’t match consumption
Those with the lowest cash incomes do not have the lowest cash outlays...

Notes: LCFS 2009; Great Britain only
...but those with the lowest cash outlays do have the lowest cash income

Notes: LCFS 2009; Great Britain only
But is that the whole story?

• Two good reasons for thinking we are (increasingly) underestimating living standards lower down the distribution
  – First: important elements of benefit spending appear to be very poorly captured in the data
  – Second: incomes at the bottom of the distribution don’t match consumption

• In addition
  – Inequality in consumption has grown much less quickly than inequality in income
Remember the rising Gini
Doesn’t look so dramatic when you look at consumption
While a broader measure of income matters little
But is that the whole story?

- Two good reasons for thinking we are (increasingly) underestimating living standards lower down the distribution
  - First: important elements of benefit spending appear to be very poorly captured in the data
  - Second: incomes at the bottom of the distribution don’t match consumption
- In addition
  - Inequality in consumption has grown much less quickly than inequality in income
  - Relative performance of different groups is highly sensitive to measure of income/consumption used
Relative poverty rate, HBAI income (<60% of median household income)
Relative poverty rate, broad income (<60% of median household income)
Relative poverty rate, consumption (<60% of median household income)
Relative poverty rate by age and time, HBAI income

![Graph showing the relative poverty rate by age and time for HBAI income from 1978-1982 and 2003-](image-url)
So overall

- There may have been more a reduction in inequality in living standards in the 2000s than HBAI data suggests.
- Once you account for a broader definition of income, pensioners have not only done relatively better than other groups but are now significantly less likely to be poor than working age people with or without children.
What about the role of government

• Of course the tax and transfer system is important
• 2000s saw an additional £30 billion a year spent on benefits and tax credits
  – Mostly focussed on pensioners and families with children
Effects of tax benefit changes 1997-2010

Loss as a percentage of net income

Income decile group

Families with children
Pensioners
Working-age without children
All

Poorest
2
3
4
5
6
7
8
9
Richest
All
A very close correspondence between movements in benefit levels and child poverty levels

<table>
<thead>
<tr>
<th>Year</th>
<th>Couple, 3 children, no work</th>
<th>Lone parent, 1 child, no work</th>
<th>Lone parent, 1 child, part-time work</th>
<th>Change in BHC relative child poverty rate in UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999-00</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>-</td>
</tr>
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<td>2000-01</td>
<td>+</td>
<td>+</td>
<td>+</td>
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<td>2001-02</td>
<td>+</td>
<td>+</td>
<td>+</td>
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<td>+</td>
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<td>2009-10</td>
<td>+</td>
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</tr>
<tr>
<td>2010-11</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>-</td>
</tr>
</tbody>
</table>

- Entitlements grew faster than relative poverty line (median income)
- Entitlements grew more slowly than relative poverty line (median income)

Notes: Ignores Housing Benefit, Council Tax Benefit and the value of free school meals. The working lone parent earns an amount that is below the personal income tax allowance and the primary threshold for National Insurance contributions.
Source: Authors’ calculations using TAXBEN, the IFS tax and benefit micro-simulation model.
What about the role of government

• Of course the tax and transfer system is important
• 2000s saw an additional £30 billion a year spent on benefits and tax credits
  – Mostly focussed on pensioners and families with children
• This had a big effect on inequality
Actual income changes 1997-2009 favoured deciles 2 to 4 (and 10)
Very heavily driven by tax and benefit changes
Without those changes pattern is much less progressive
I increased the gap between rich and poor. Vote for me.

Or vote for change. Vote Conservative.
I MITIGATED THE INCREASE IN THE GAP BETWEEN RICH AND POOR, LEAVING THE GAP SMALLER THAN IT OTHERWISE WOULD HAVE BEEN (UNDER RPI UPRATING OF THE 1996-97 TAX AND BENEFIT SYSTEM)
What about the role of government

- Of course the tax and transfer system is important
- 2000s saw an additional £30 billion a year spent on benefits and tax credits
  - Mostly focussed on pensioners and families with children
- This had a big effect on inequality
- Other spending is also equalising
  - *At least* in the sense that cost of service provided is a higher proportion of income of poor than of rich
Benefits in kind matter a lot

Summary of the effects of taxes and benefits by quintile groups, ALL households, 2009

Average per household (£ per year)

- Benefits in kind
- Cash benefits
- Direct taxes
- Indirect taxes

Note:
1 Households are ranked by their equivalised disposable incomes, using the modified-OECD scale.

Source: Office for National Statistics
What about the role of government

- Of course the tax and transfer system is important
- 2000s saw an additional £30 billion a year spent on benefits and tax credits
  - Mostly focussed on pensioners and families with children
- This had a big effect on inequality
- Other spending is also equalising
  - At least in the sense that cost of service provided is a higher proportion of income of poor than of rich
- And spending on the welfare state has become much more important over time
Public spending in 2010-11

- Social protection: 29%
- Personal social services: 10%
- Health: 18%
- Education: 13%
- Transport: 6%
- Defence: 5%
- Public order and safety: 4%
- Gross debt interest: 3%
- Housing: 2%
- TIEEE: 1%
- AFF: 1%
- Other: 10%

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Public spending in 1978-79

- Social security: 23%
- Personal social services: 9%
- Health: 10%
- Education: 4%
- Transport: 4%
- Defence: 10%
- Law, order & protection: 12%
- Gross debt interest: 1%
- Housing: 2%
- TIEEE: 6%
- AFFF: 1%
- Other: 9%

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What about the role of government

- Of course the tax and transfer system is important.
- 2000s saw an additional £30 billion a year spent on benefits and tax credits.
  - Mostly focussed on pensioners and families with children.
- This had a big effect on inequality.
- Other spending is also equalising.
  - *At least* in the sense that cost of service provided is a higher proportion of income of poor than of rich.
- And spending on the welfare state has become much more important over time.
- A lot of that spending now more skewed to those on low incomes.
Funding focused more deprived schools

Notes: Implicit FSM Premium calculated as the extra funding associated with one extra pupil eligible for FSM, holding other pupil and school characteristics constant.

Sources: For a full list of sources please see Table 2.2. (link)
Though we don’t know how much value that adds
What about the role of government

• Of course the tax and transfer system is important
• 2000s saw an additional £30 billion a year spent on benefits and tax credits
  – Mostly focussed on pensioners and families with children
• This had a big effect on inequality
• Other spending is also equalising
  – At least in the sense that cost of service provided is a higher proportion of income of poor than of rich
• And spending on the welfare state has become much more important over time
• A lot of that spending now more skewed to those on low incomes
• And just as with measuring living standards need be clear what measure of inequality government is impacting on
VAT reform: effects by income

% rise in non-housing expenditure  % rise in income

cash gain/loss (£/week, RH axis)

Poorest 2 3 4 5 6 7 8 9 Richest

Income Decile Group

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VAT reform: effects by expenditure

% rise in non-housing expenditure  % rise in income

Expenditure Decile Group

Cash gain/loss (£/week, RH axis)

Poorest 2 3 4 5 6 7 8 9 Richest

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To conclude

• The HBAI story tells us what has happened to household incomes over time
  – But only on a particular measure
  – Using a broader measure of income changes the picture between groups
  – And inequality in measured consumption has grown much less

• Redistribution through the welfare system over recent years has been very important
  – Though very costly and being partially reversed

• And don’t forget the wider role of the state in redistributing
  – Nor the costs (as well as the benefits) inherent in that redistribution