

Institute for
Fiscal Studies



Living Standards and Inequality

Andrew Hood, IFS

14th June 2013

Outline

- Living Standards
 - What happened to incomes in 2011–12 and the recent recession?
 - Are we comparing living standards across time accurately?

- Inequality
 - How did changes in income differ for rich and poor?
 - What drove the changes in inequality?

What do we mean by “income”?

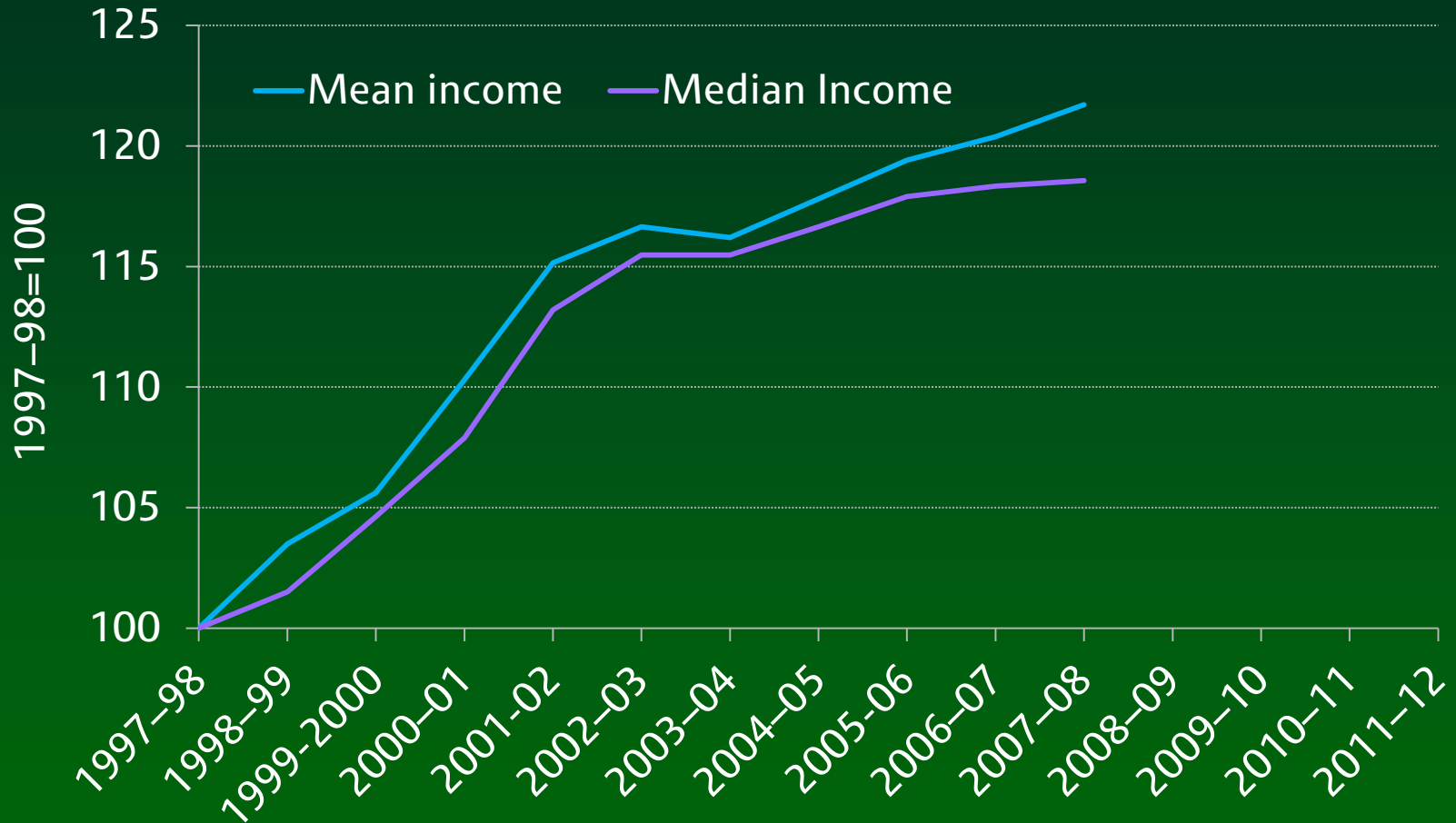
- HBAI income is measured net of direct taxes and benefits, and at the household level
- “Equivalised” to take account of household size
 - All cash amounts are equivalents for a childless couple
- Measured before and after housing costs are deducted (BHC/AHC)
- Adjusted for inflation
 - HBAI uses measure based on the Retail Prices Index (RPI)

Data

- Based on Family Resources Survey in 2011–12
 - 20,000 households across the UK
 - Subject to sampling error

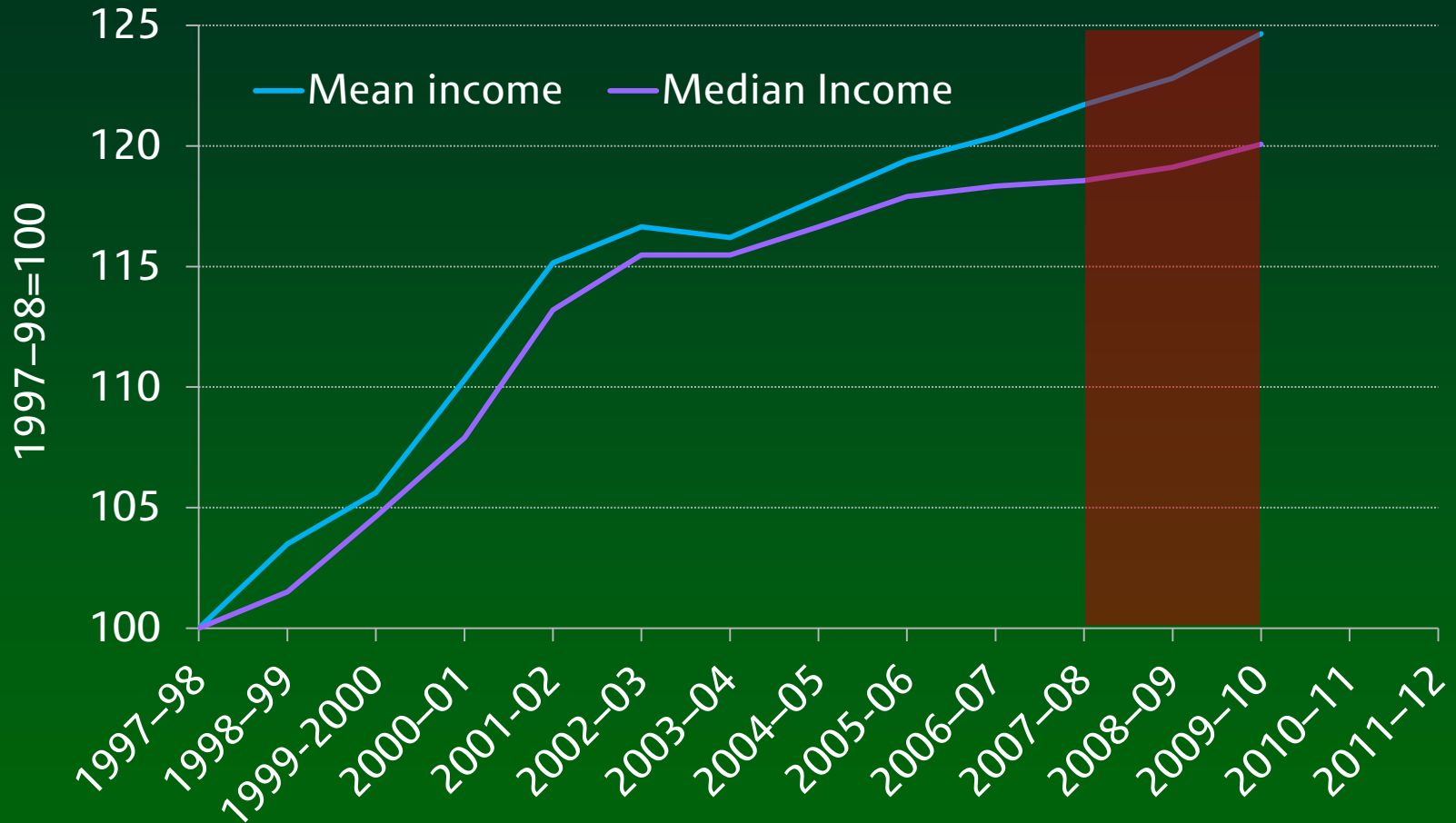
- Figures with data before 2002–03 refer to Great Britain not UK
 - Northern Ireland not included in the FRS until 2002-03

Slow growth from the early 2000s...



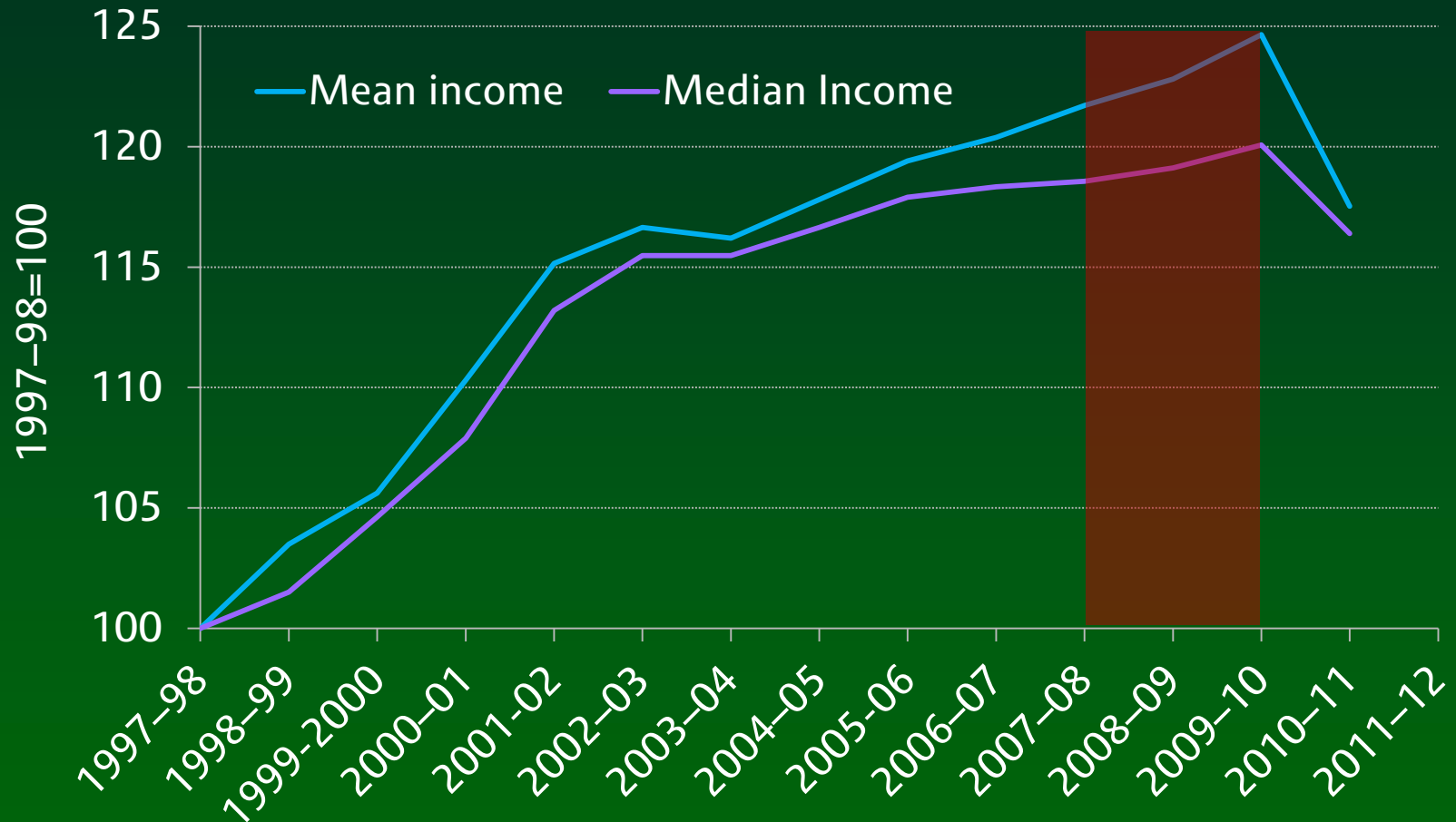
Source: Family Resources Survey, various years

Slow growth from the early 2000s...



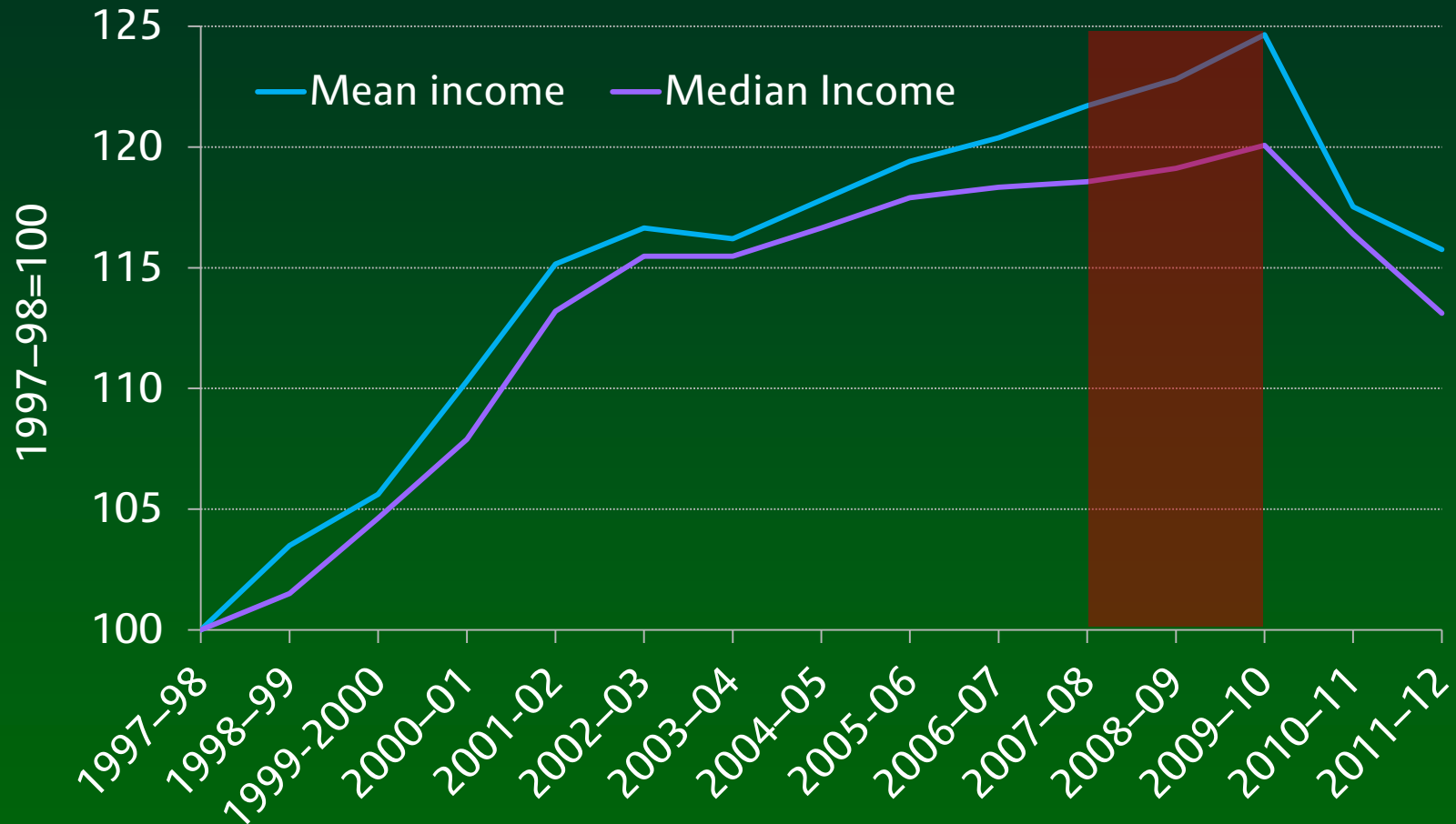
Source: Family Resources Survey, various years

... followed by large falls in 2010–11



Source: Family Resources Survey, various years

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

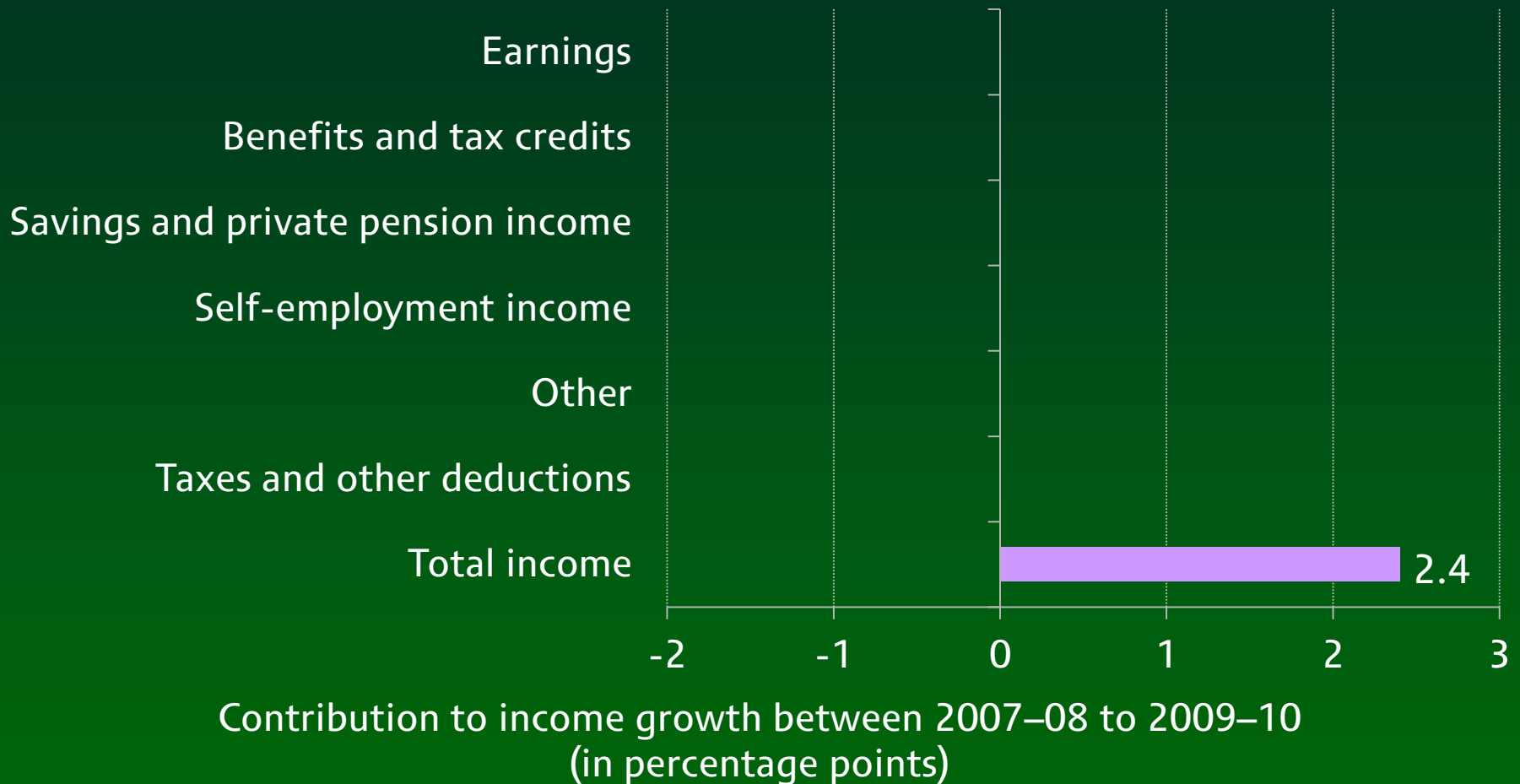


Source: Family Resources Survey, various years

Trends in average incomes

- Average incomes fell in 2011–12
 - Median income fell by 2.8% to £427 a week
 - Mean income fell by 1.6% to £528 a week
- Substantial falls between 2009–10 and 2011–12
 - Median income fell 5.8%, mean income by 7.2%
- These falls were very large in historical terms
 - Biggest falls in average incomes since the mid-1970s
 - Pattern of slow growth followed by large falls unprecedented

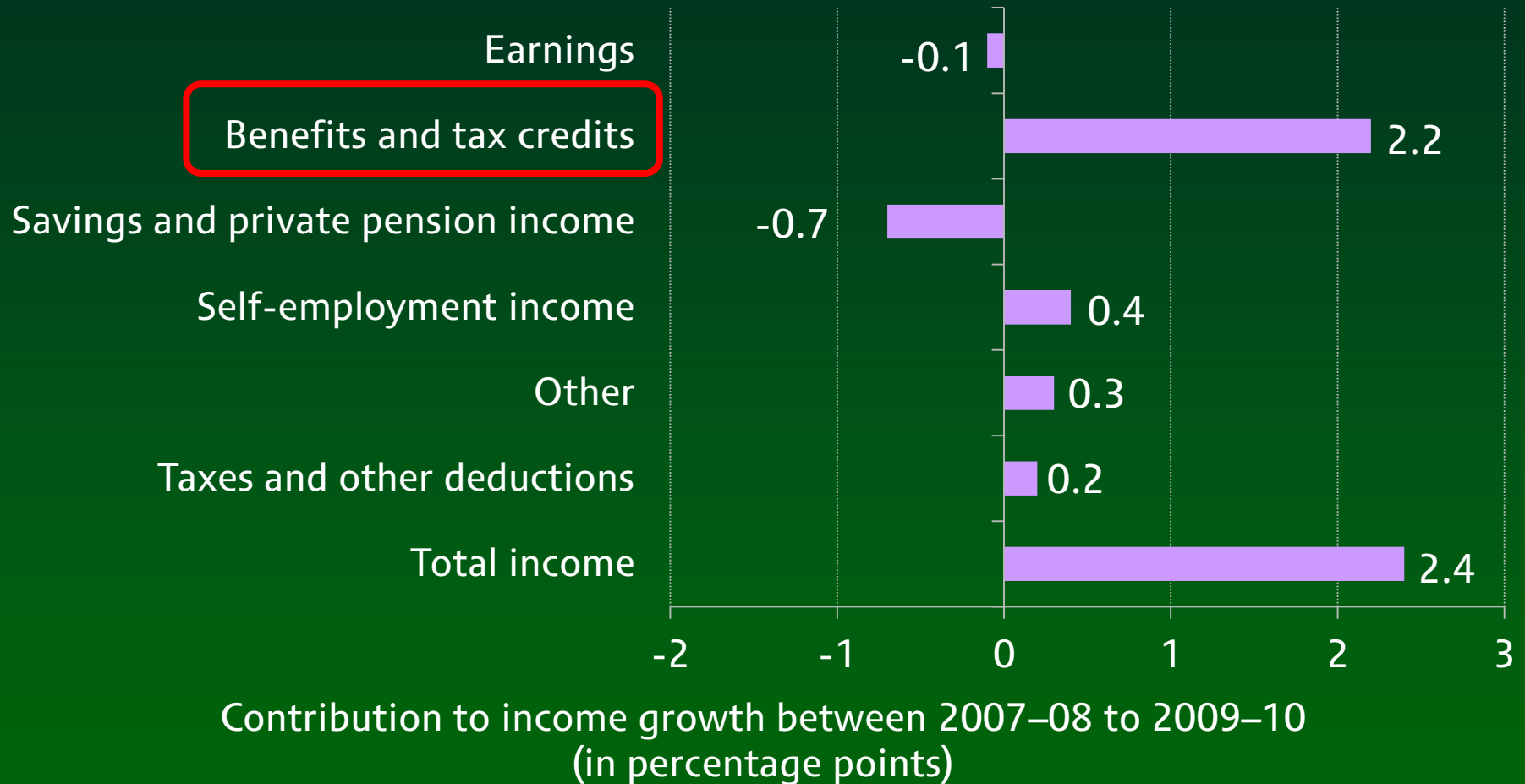
Income sources: 2007–08 to 2009–10



Source: Table: 2.4 of *Living Standards, Poverty and Inequality: 2013*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

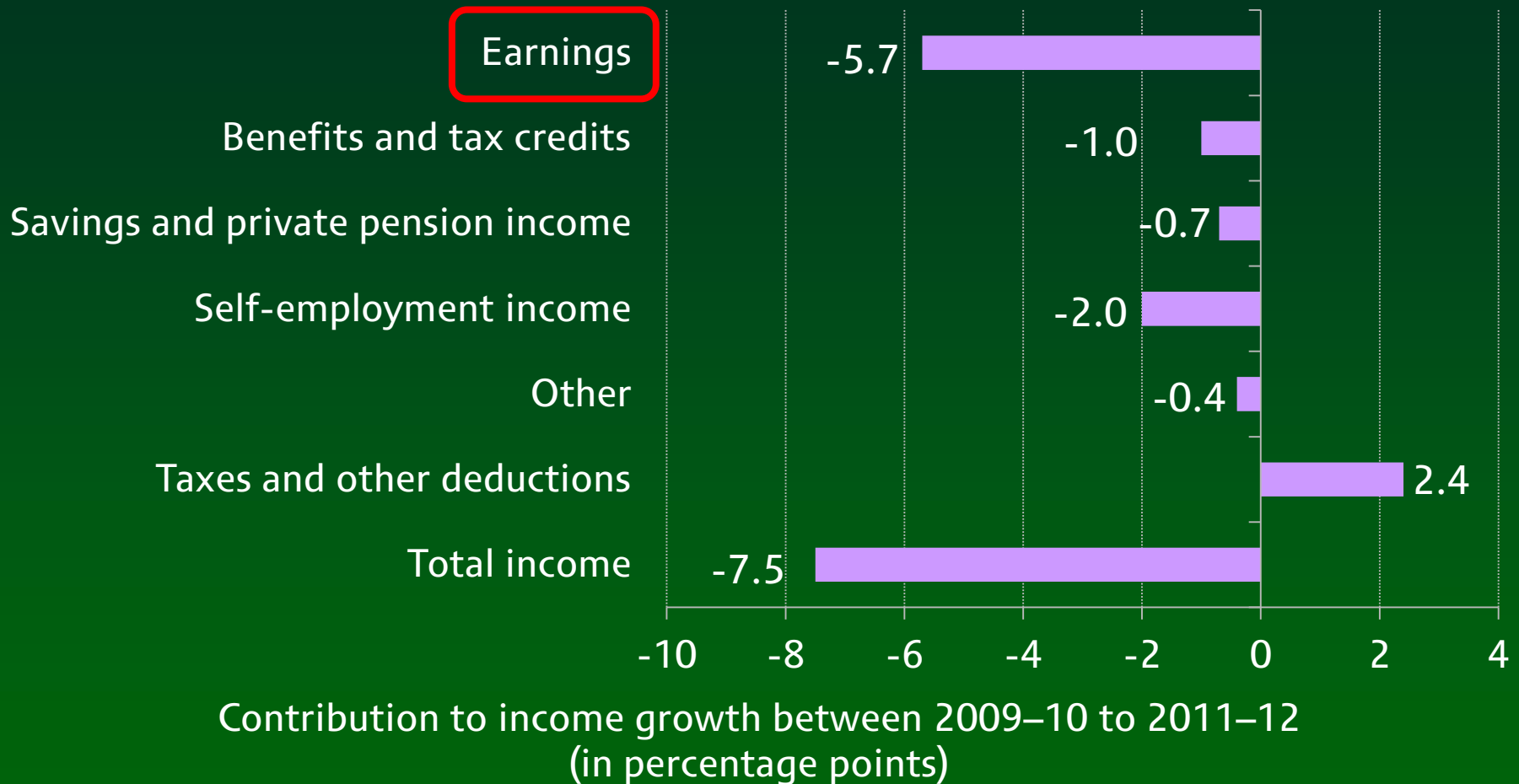
Income sources: 2007–08 to 2009–10



Source: Table: 2.4 of *Living Standards, Poverty and Inequality: 2013*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

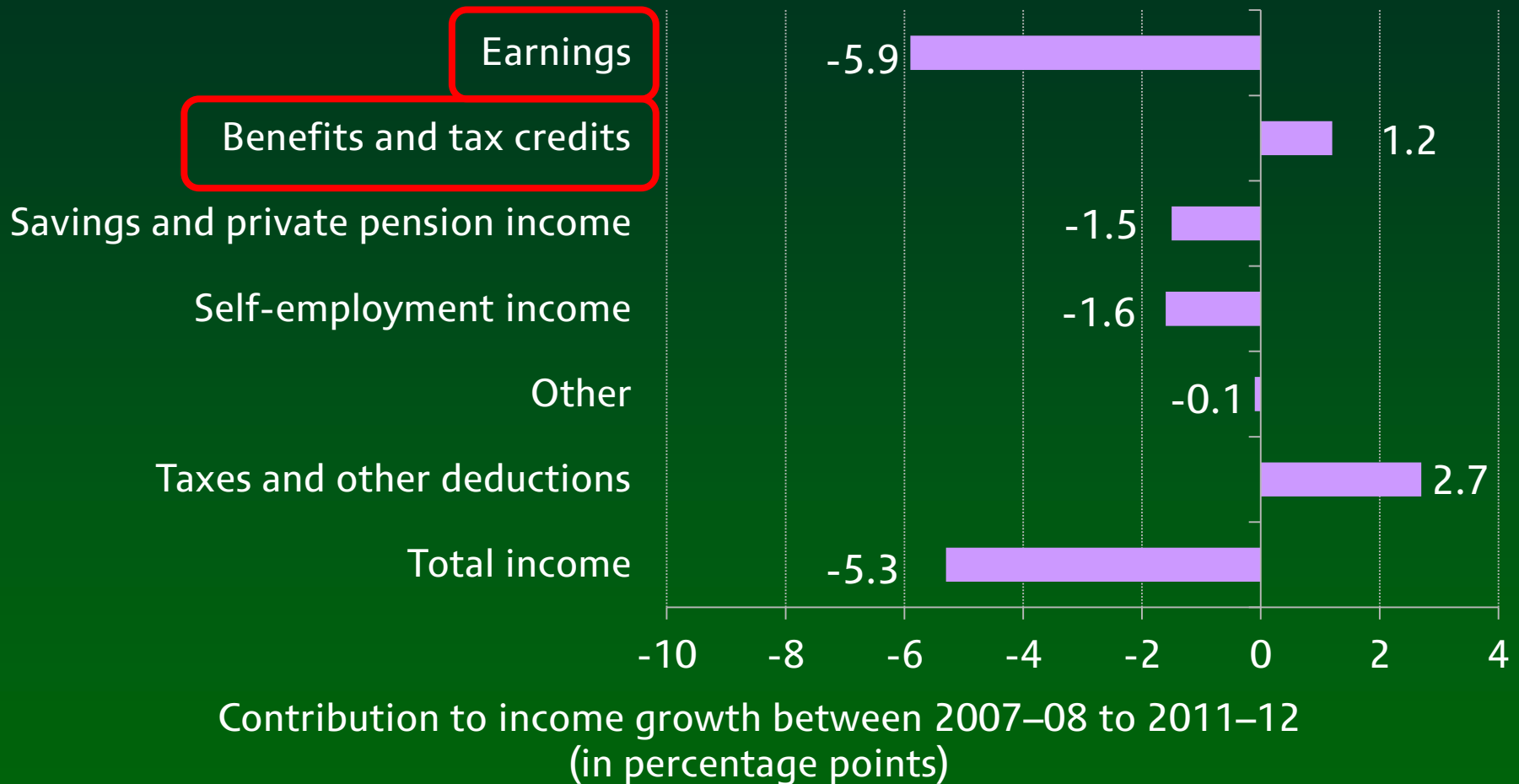
Income sources: 2009–10 to 2011–12



Source: Table: 2.4 of *Living Standards, Poverty and Inequality: 2013*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

Income sources: 2007–08 to 2011–12



Source: Table: 2.4 of *Living Standards, Poverty and Inequality: 2013*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

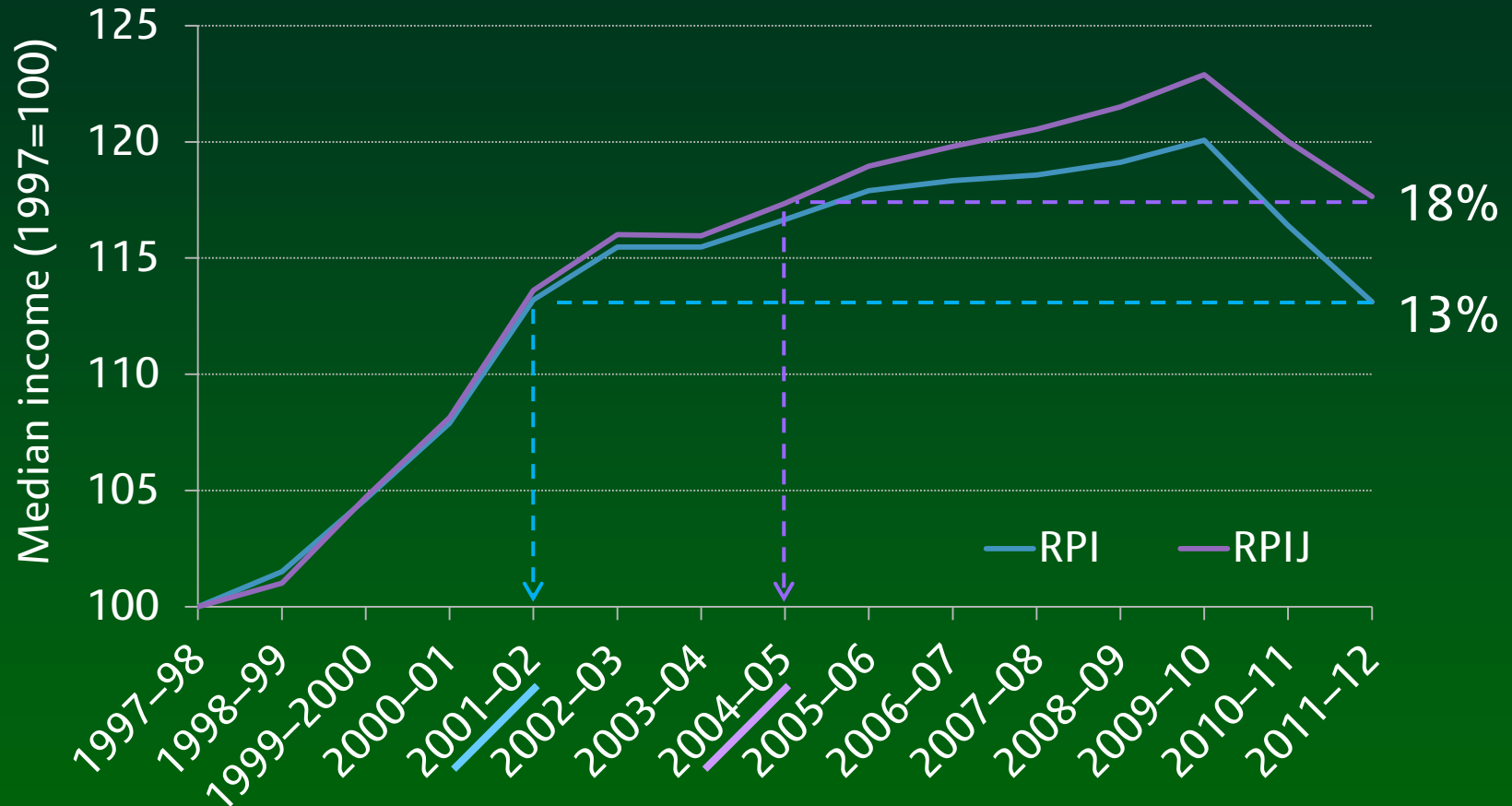
Prospects for living standards

- 2012–13 : a mixed outlook
 - Real earnings fell (only 1.5% nominal growth), but employment rose
 - Further discretionary cuts to benefits, but falling inflation meant default uprating (5.2%) increased real benefit rates
- 2013–14 and beyond: a weak outlook
 - OBR predicts real earnings will keep falling into 2014–15
 - Lots more real benefit cuts (including 3 years of 1% uprating)
- Recent IFS work projected further falls in median income in 2013–14 and 2014–15, before a weak recovery in 2015–16

Inflation and living standards

- Past incomes are adjusted to take account of inflation
 - Change in “real” living standards depends on the measure used
 - HBAI uses a series based on the Retail Prices Index (RPI)
- The ONS acknowledges that the RPI *overstates* inflation...
 - RPI methodology is “no longer justifiable”
- ... so HBAI *understates* the growth in real living standards
- New RPIJ index is an improved version of the RPI

Inflation and living standards: RPI vs. RPIJ



Source: Figure 2.4 of *Living Standards, Poverty and Inequality: 2013*

Notes: The RPI line is in fact RPI minus council tax, the inflation measure currently used to adjust HBAI incomes

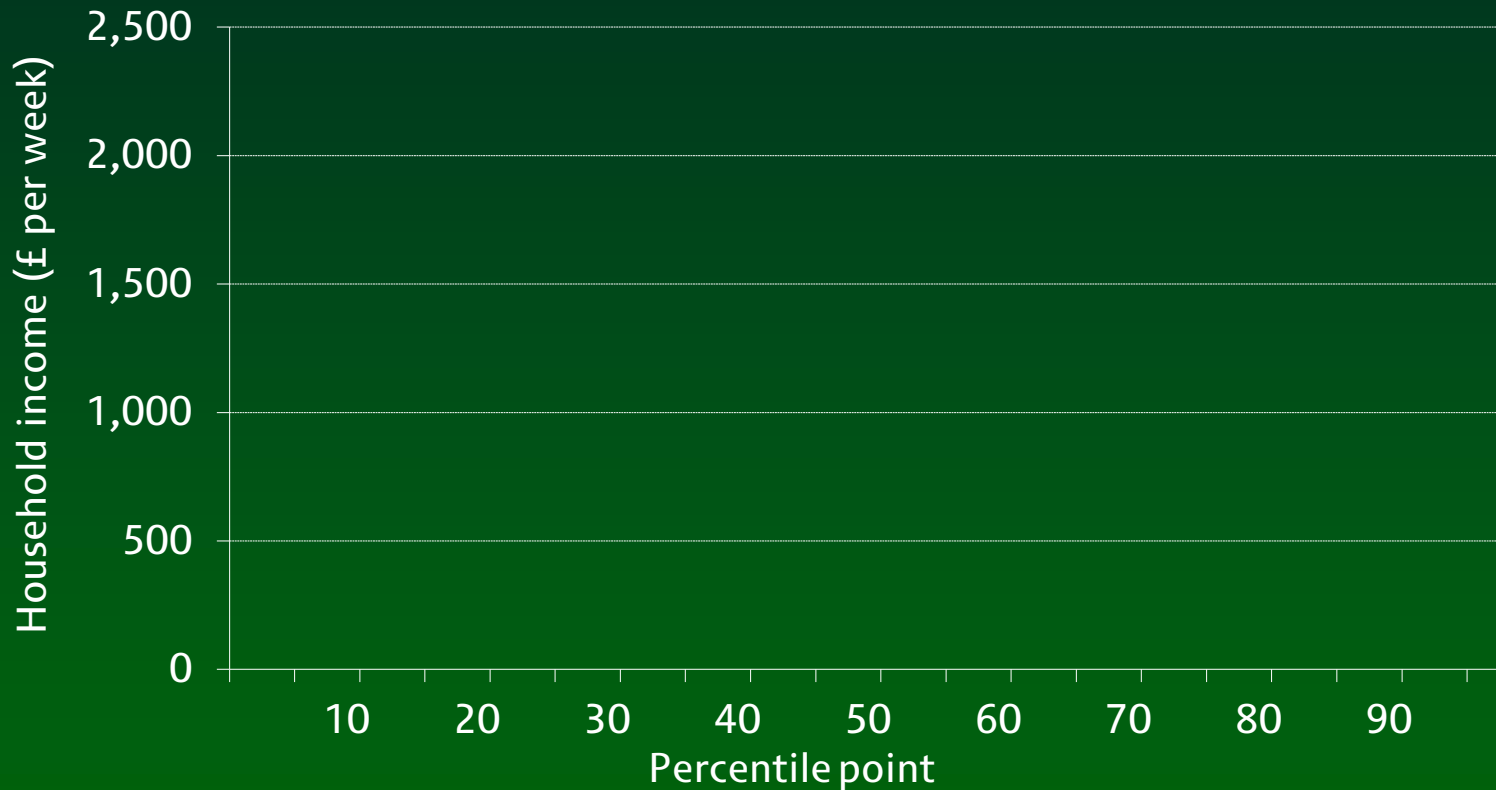
Inflation and living standards

- Past incomes are adjusted to take account of inflation
 - Change in “real” living standards depends on the measure used
 - HBAI uses a series based on the Retail Prices Index (RPI)
- The ONS acknowledges that the RPI *overstates* inflation...
 - RPI methodology is “no longer justifiable”
- ... so HBAI *understates* the growth in living standards
- New RPIJ index is an improved version of the RPI
- We recommend moving to using the RPIJ to adjust past incomes
 - providing a more accurate picture of changes in living standards

Inequality

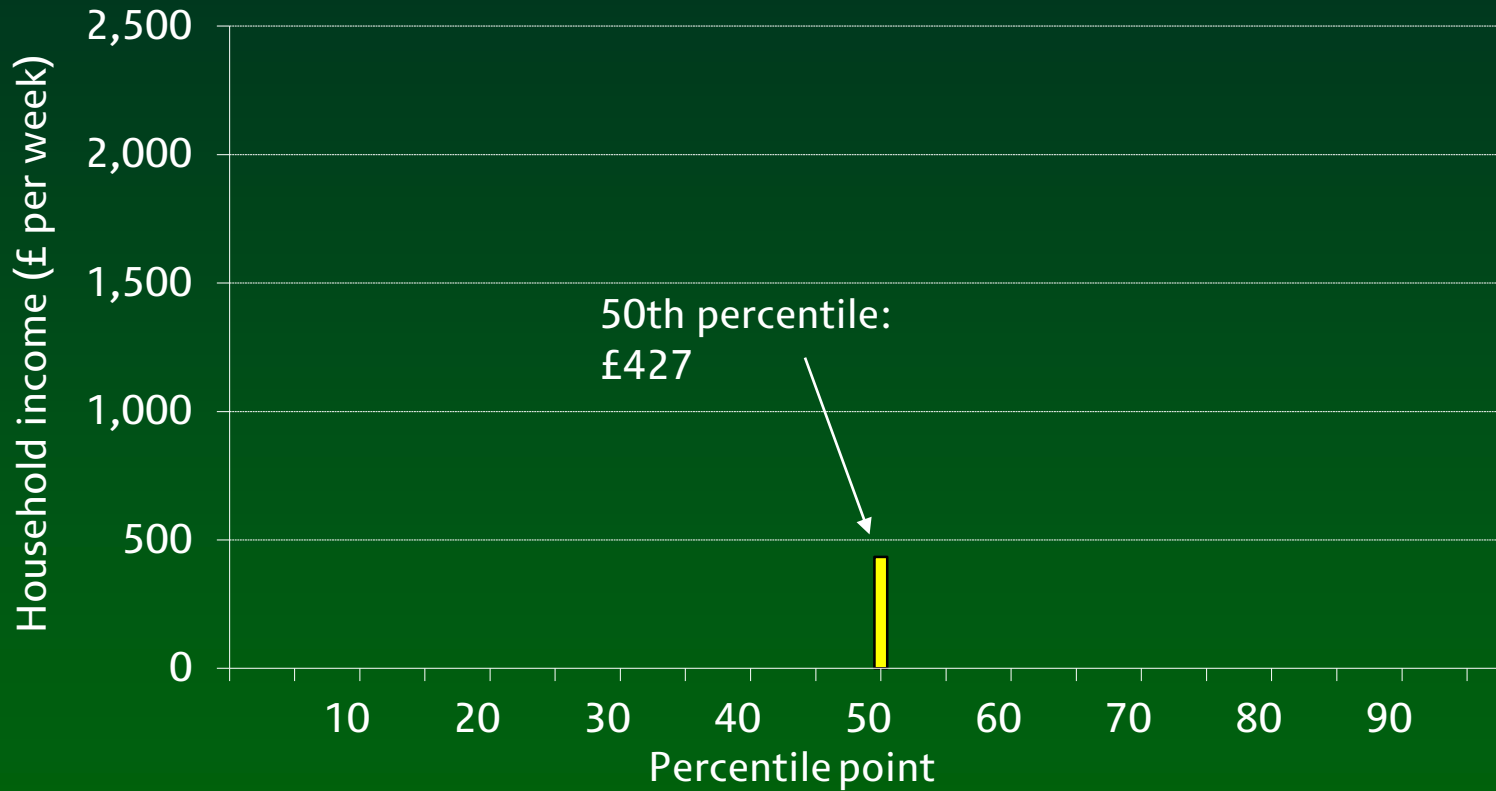


The UK income distribution in 2011–12



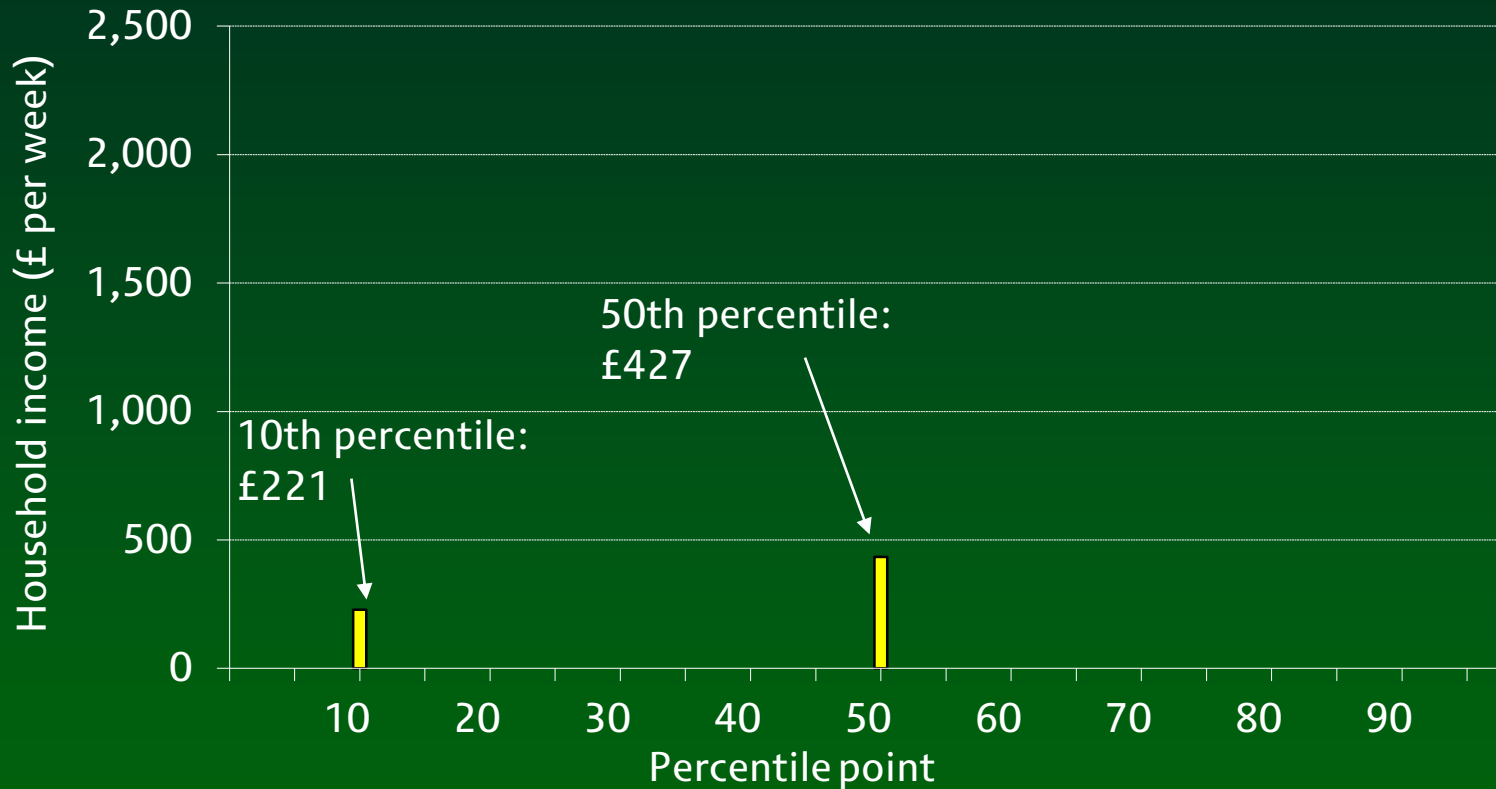
Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2013*

The UK income distribution in 2011–12



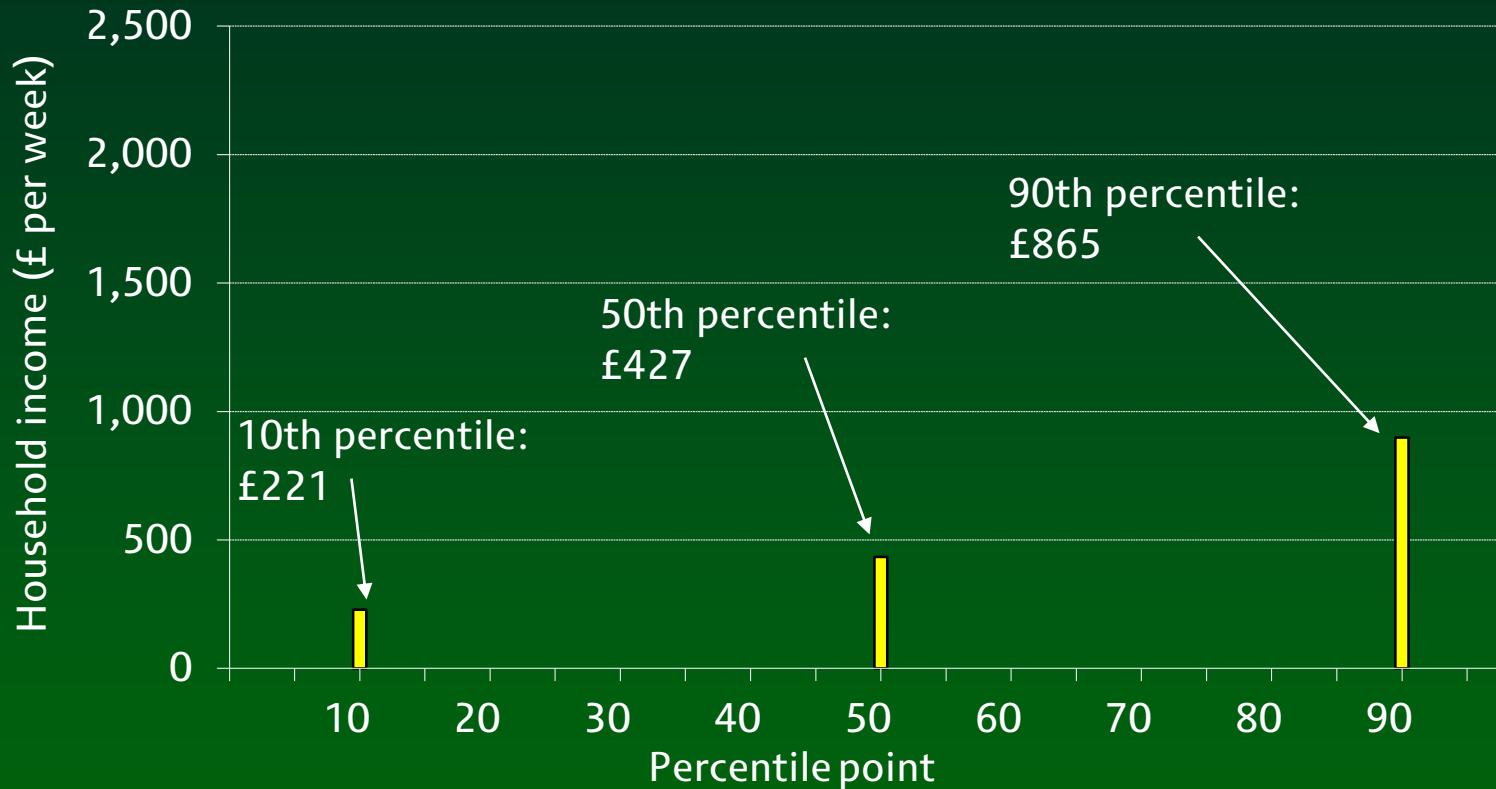
Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2013*

The UK income distribution in 2011–12



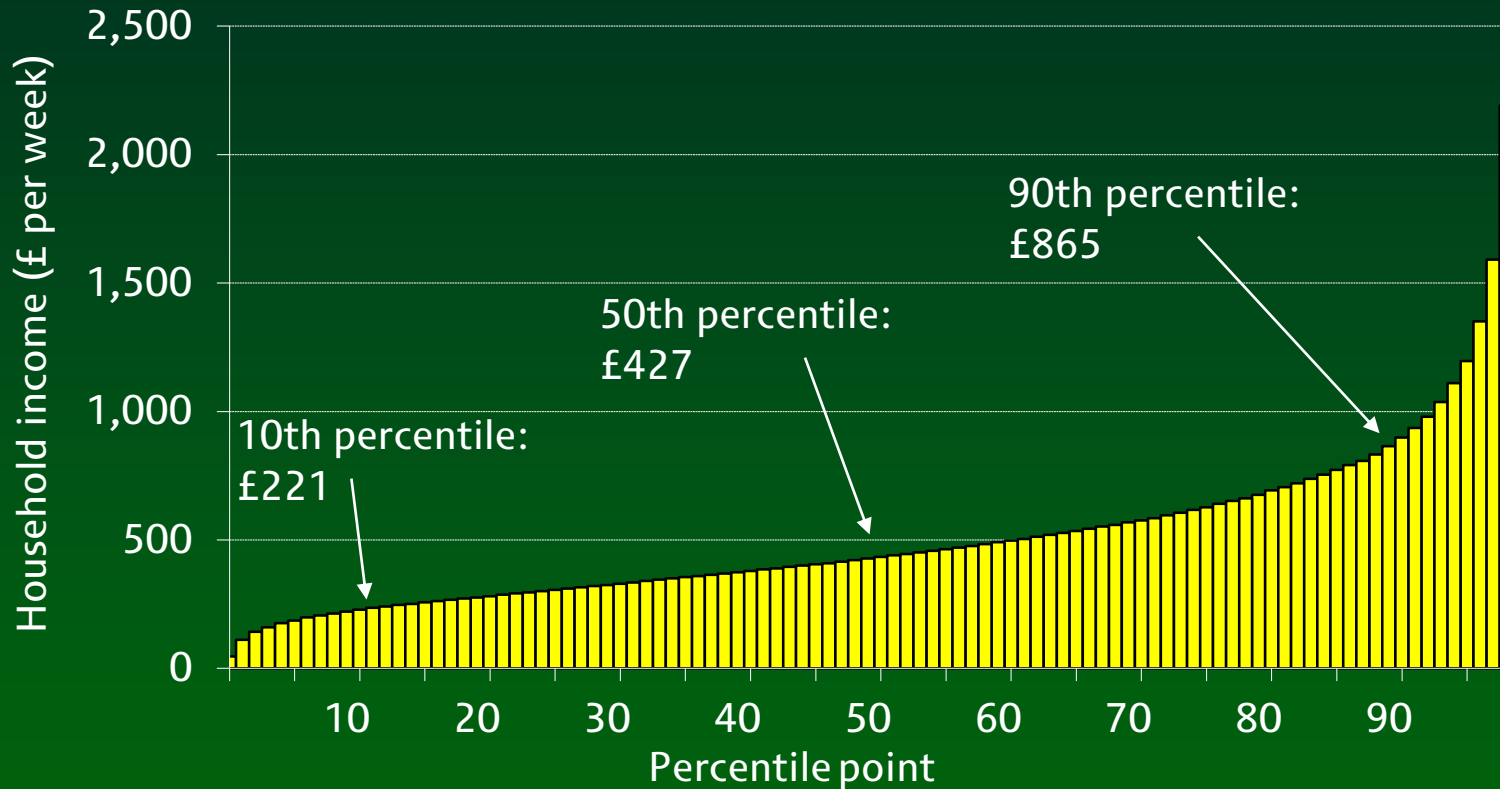
Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2013*

The UK income distribution in 2011–12



Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2013*

The UK income distribution in 2011–12



Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2013*

Gini coefficient: 1979 to 2011–12



- Gini rose dramatically in the 1980s (0.25 in 1979 to 0.34 in 1990)
- Big fall in recent years (0.36 in 2007–08 to 0.34 in 2010–11)
- Unchanged in 2011–12

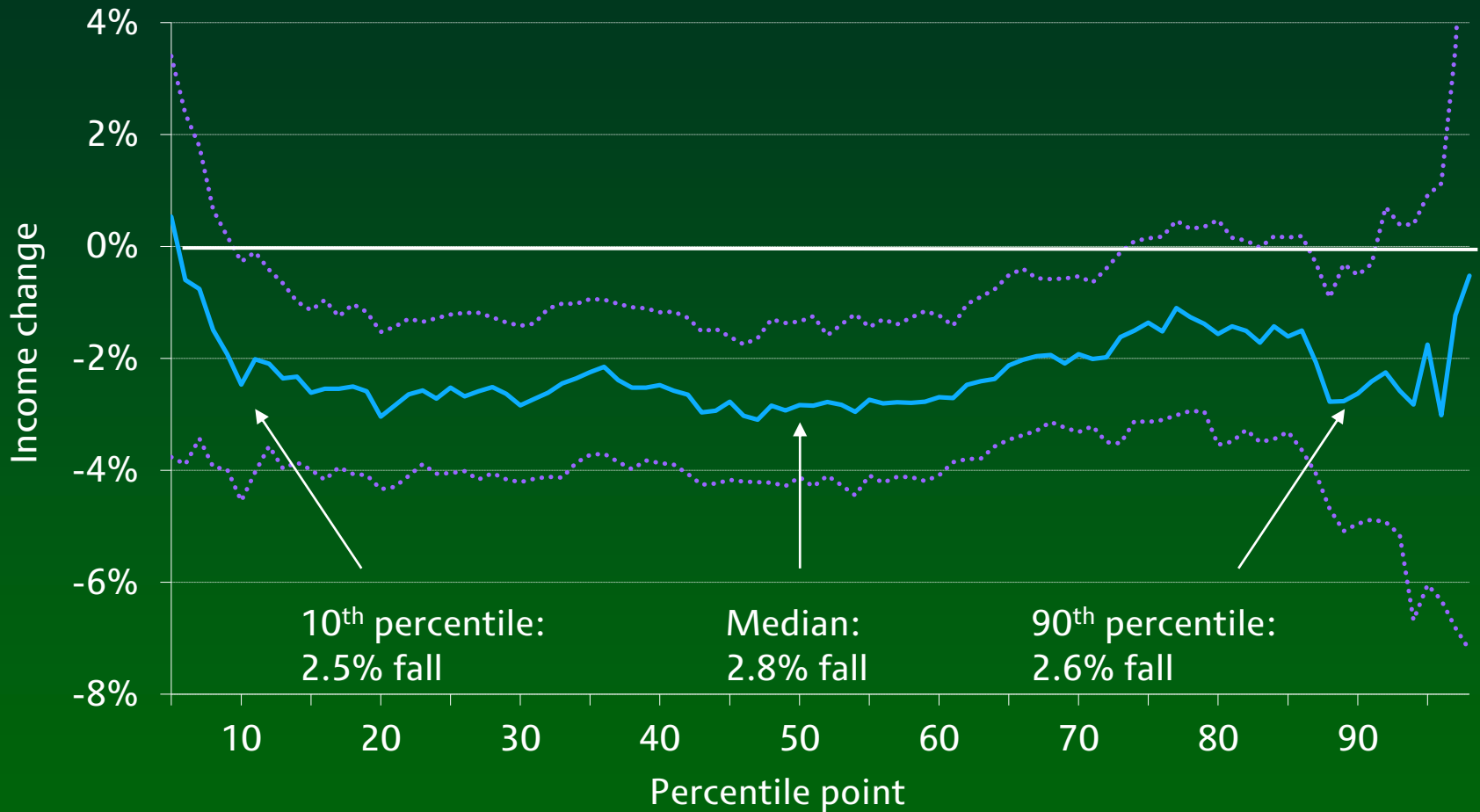
Source: Figure 3.8 of *Living Standards, Poverty and Inequality: 2013*



Income inequality

- Inequality was unchanged in 2011–12
 - Similar falls in incomes across the distribution

Income changes by percentile point in 2011–12

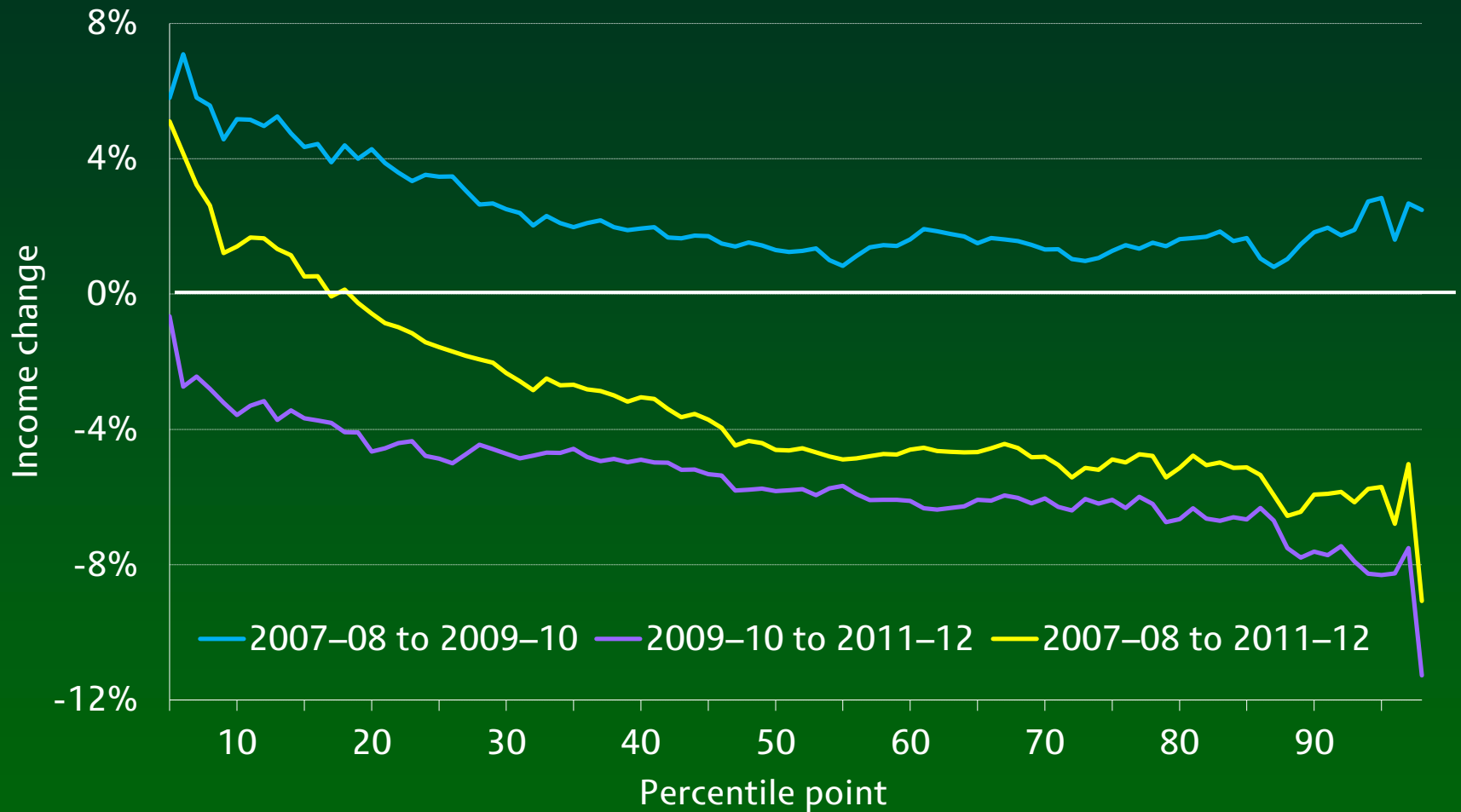


Source: Figure 3.3 of *Living Standards, Poverty and Inequality: 2013*

Income inequality

- Inequality was unchanged in 2011–12
 - Similar falls in incomes across the distribution
- However, income inequality fell substantially between 2007–08 and 2011–12...
- ...despite a rise in labour earnings inequality among workers
- Why?
 - Falls in labour earnings matter more for high-income households
 - Increased benefits matter more for low-income households

Income changes : 2007–08 to 2011–12

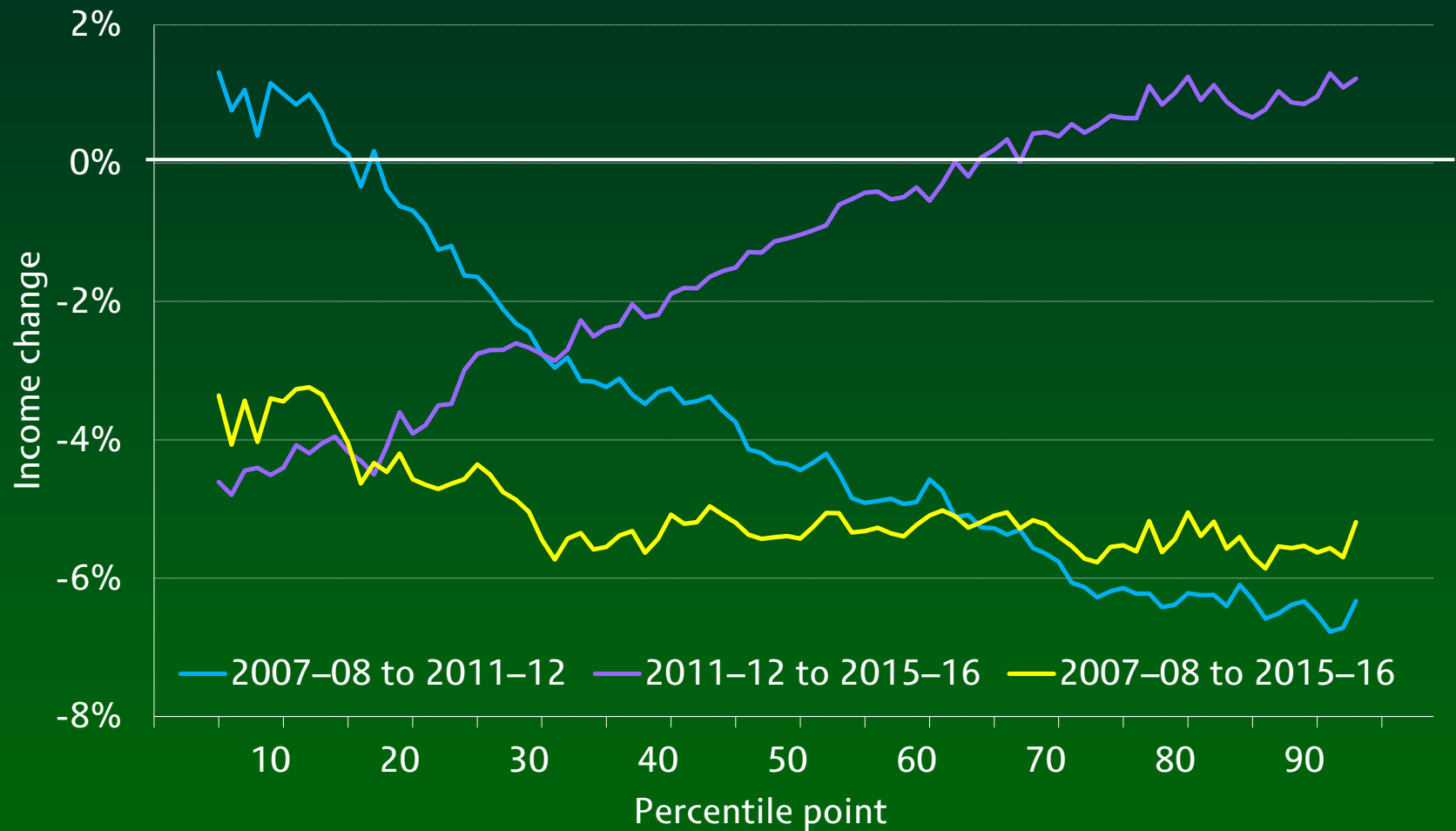


Source: Figure 3.5 of *Living Standards, Poverty and Inequality: 2013*

Prospects for inequality

- The return of earnings growth in 2014–15 will benefit higher income households more
- Substantial welfare cuts will hit lower income households proportionately more
 - £21 billion p/a of cuts by 2017–18
 - of which only £2 billion in place in 2011–12
- Decrease in top rate of tax from April 2013 likely to have increased top household incomes

Inequality simulations: 2007–08 to 2015–16



Note: Figure taken from Brewer et. al. (2013), published before the latest HBAI release. The 2011–12 income distribution is therefore a simulation, but is extremely similar to the actual data.

Summary

- Average incomes fell sharply between 2009–10 and 2011–12
 - After slow growth throughout the 2000s
- Median income was probably roughly the same in 2012–13, with further falls in 2013–14 and 2014–15 likely
- Inequality fell significantly between 2007–08 and 2011–12
 - Income from benefits grew, real earnings fell sharply
 - Welfare cuts mean pattern likely to be reversed by 2015–16