Living Standards and Inequality

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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

- Earnings
- Benefits and tax credits
- Savings and private pension income
- Self-employment income
- Other
- Taxes and other deductions
- Total income

Contribution to income growth between 2007–08 to 2009–10 (in percentage points)

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

Contribution to income growth between 2007–08 to 2009–10 (in percentage points)

- Earnings: -0.1
- Benefits and tax credits: 2.2
- Savings and private pension income: -0.7
- Self-employment income: 0.4
- Other: 0.3
- Taxes and other deductions: 0.2
- Total income: 2.4

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

Contribution to income growth between 2009–10 to 2011–12 (in percentage points)

- Earnings: -5.7
- Benefits and tax credits: -1.0
- Savings and private pension income: -2.0
- Self-employment income: -0.7
- Other: -0.4
- Taxes and other deductions: 2.4
- Total income: -7.5

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

- **Earnings**: -5.9
- **Benefits and tax credits**: 1.2
- **Savings and private pension income**: -1.5
- **Self-employment income**: -1.6
- **Other**: -0.1
- **Taxes and other deductions**: 2.7
- **Total income**: -5.3

Contribution to income growth between 2007–08 to 2011–12 (in percentage points)

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
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  – 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

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The UK income distribution in 2011–12

10th percentile: £221
50th percentile: £427

Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2013*
The UK income distribution in 2011–12

- 10th percentile: £221
- 50th percentile: £427
- 90th percentile: £865

Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2013*
The UK income distribution in 2011–12

- **50th percentile:** £427
- **10th percentile:** £221
- **90th percentile:** £865

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

Income change

Percentile point

Median: 2.8% fall

10th percentile: 2.5% fall

90th percentile: 2.6% fall

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