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Living Standards, Inequality and Poverty: Labour's Record

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Summary

Living standards

- Living standards have grown during Labour's time in office. Between 1996–97 and 2008–09, real household disposable incomes grew by 2.0% per year on average. However, this growth has not been evenly spread over time. Real household disposable income grew by over 3% per year on average in Labour's first term, by 2% per year in its second term and by less than 1% per year in its third term.

- Much of this slowdown reflects sluggish growth in earnings from employment – a slowdown which began before the recession got underway in 2008.

- Between 1996–97 and 2007–08, average incomes grew most rapidly for pensioners, lone parents and non-working couples with children (at 2% or more a year, on average). They grew most slowly for working-age adults without children (at 1.4% or less per year, on average).

- Average incomes grew fastest in the North East of England and London (about 2.3% per year, on average) and slowest in the West Midlands (about 1.2% per year). In the latest years of data, adjusting for differences in the cost of living in different regions, average incomes were highest in the South East of England (at 110% of the national median) and lowest in the West Midlands (at 93% of the national median).

- The 'middle-class recession' predicted by some commentators did not materialise. This recession, like previous recessions, has seen low-skilled and low-educated workers bear the brunt of worsening labour market conditions.

Income inequality

- The latest data show that in 2007–08 income inequality was slightly higher than when Labour came to power and higher than in any year since at least the 1950s. However, the rise in income inequality under Labour is far smaller than the rise observed under the Conservatives during the 1980s.

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- The small increase in income inequality under Labour between 1996–97 and 2007–08 was largely driven by trends at the extremes of the income distribution: above-average growth amongst the richest 10% and below-average growth amongst the poorest 5%. Income growth was relatively even over the rest of the distribution.
- Under the Conservatives between 1979 and 1996–97, income growth increased with income right across the income distribution, with the lowest growth at the very bottom of the income distribution and the fastest growth at the very top.
- Labour's tax and benefit reforms have reduced income inequality compared with what would have happened if benefits and tax credits had simply been uprated in line with prices, the normal practice of the previous Conservative government. Labour's tax and benefit reforms thus seem to have prevented a larger rise in income inequality.
- Given that high-income individuals are more dependent on financial markets for their income, the recent financial crisis is likely to have led to lower growth or even reductions in top incomes. This may well have acted to reduce income inequality since 2007. Increases in income tax for the very rich from 2010 onwards are also likely to exert downward pressure on income inequality.
- The UK has a higher level of income inequality than the OECD average. Inequality is higher in the UK than in the likes of Sweden, France and Germany, but lower than in the likes of the US, Italy and Mexico.

Poverty

- The proportion of the population in relative poverty fell from 19.4% in 1996–97 to 18.3% in 2007–08 using incomes measured before housing costs (BHC), and from 25.3% to 22.5% after housing costs (AHC). However, poverty has increased since 2004–05 on both measures, when it was 17.0% (BHC) and 20.5 % (AHC), reversing roughly half the decline since 1996–97.
- Poverty has fallen since 1996–97 for children and pensioners, but it is higher for working-age adults without children. In part, this reflects the fact that Labour's tax and benefit changes have largely favoured the incomes of the first two, with little effect on the third.
- It is difficult to argue conclusively that severe poverty has increased since 1996–97 in a meaningful way, but the rise since 2004–05 appears to represent a more genuine increase, and mirrors the rise in the government's official measure of relative poverty.
- After adjusting for the cost of living, poverty is highest in London (21.8%) and lowest in Scotland (14.6%) in the most recent three years of data. The rate of poverty has fallen most under the present government in the North-East of England and in Yorkshire and the Humber, but it has risen in the West Midlands.
- In Budget 2010, the government as good as conceded that its relative child poverty target for 2010 would not be met, a conclusion supported by previous IFS analysis. Looking ahead to the 2020 target to eradicate child poverty, neither the government nor the main opposition parties have yet produced a credible and detailed strategy about how they will meet the now legally-binding commitment to eradicate child poverty by 2020.
- However, the most important determinant of the path of living standards, poverty and inequality over the course of the next parliament will be how the public finances are rebalanced. All are committed to tax-raising measures on the very rich and a substantial fiscal tightening. However, there is currently little detail from any of the main parties about the areas of spending that will receive the deepest cuts and how these will be achieved.

- On the basis of the limited proposals they have published to date, there is little reason to believe that the outlook for overall living standards, poverty and inequality going forwards would be dramatically different under the opposition parties from under Labour. We will revisit this question following the publication of the party manifestos.

1. Introduction

In this Briefing Note, we assess the changes to living standards that have occurred under the first 11 years of the Labour government, setting out how average incomes, income inequality and poverty have changed between 1996–97 and 2007–08 (the latest year for which data on all three are available). We compare these changes with what happened under previous governments.

Here, we mainly utilise the Households Below Average Income (HBAI) data set, which is created annually by the Department for Work and Pensions and used to measure progress against the government's targets for child poverty. It takes *current disposable household income from all sources, adjusted for family size and composition*, as a proxy for living standards; we generally refer to this measure simply as 'income' or 'net income' throughout this Briefing Note. Because figures are calculated from a sample of households, rather than from the full population, there is some uncertainty surrounding the results derived from them. In our analysis, we highlight changes that are 'statistically significant', i.e. changes outside the margins of error over time. More details about our methodology can be found in our most recent poverty and inequality report.[2]

HBAI is the most reliable source of information when looking at the entire distribution of income or the incomes of subgroups (e.g. 'the poor', 'families with children'). However, if we are interested in what has happened just to the average income (captured by the mean), then there are a number of other useful sources based on the National Accounts, which allow us to consider recent changes in average incomes up to 2008–09.

2. Living standards

Helping to raise living standards is one of the most basic ambitions of all governments. Indeed, the current government's election 'pledge card' makes this explicit, promising to 'raise family living standards'. It is worth considering, therefore, how living standards have changed under previous administrations (both on average and for specific groups) and how they might be expected to evolve as the economy emerges from recession.

We begin by considering how average living standards have changed since 1996–97, using a range of different measures. We then look at changes in average living standards by family type and by region. Finally, we consider the impact of the recession, which began in 2008 but whose full impact has yet to be reflected in measures of living standards. All monetary values in this section are expressed in 2010 prices and so are unaffected by inflation.

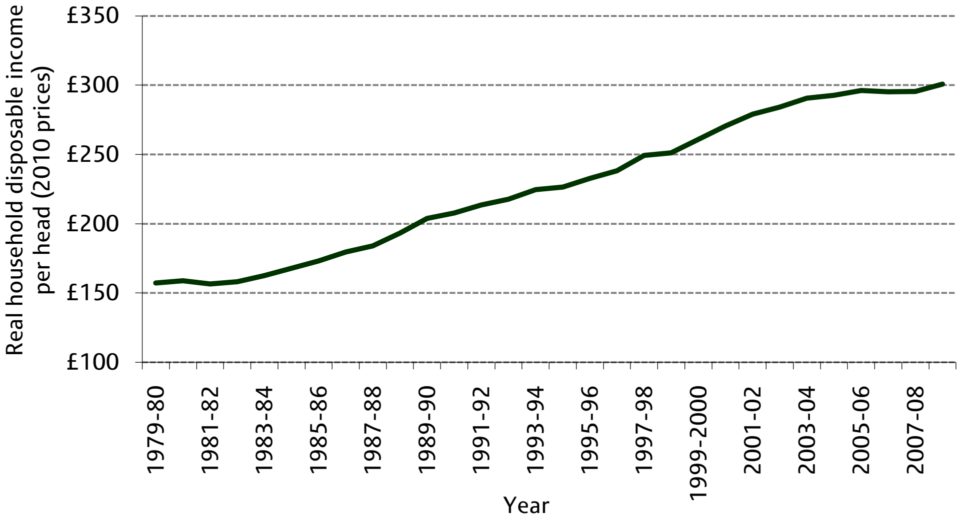
2.1 How have average living standards changed under Labour?

As Figure 2.1 shows, real household disposable income per head has grown steadily for most of the last 25 years. After a period of stagnation during the recession of the early 1980s, income growth picked up from 1983–84 onwards and remained robust even during the recession of the early

[2] M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in the UK: 2009*, Commentary no. 109, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4524).

1990s. This growth continued through to 2005–06, but income growth largely stagnated thereafter (with sluggish income growth even before the recession began in 2008).

Figure 2.1. Real household disposable income per head in weekly terms: 1979–80 to 2008–09 (UK)



Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Real Household Disposable Income per capita series from National Accounts.

Of course, real household disposable income is not the only measure of average living standards available. There are numerous different measures – some derived from the National Accounts, some from household surveys – which also give an insight into the evolution of average living standards under Labour. In Table 2.1, we therefore compare five different measures of the growth in living standards – three derived from the National Accounts (real household disposable income per head, real GDP per head and household final consumption expenditure per head) and two based on the HBAI data series described in the Introduction.

The different series measure living standards in markedly different ways.

Of the National Accounts measures, real GDP per head is a widely-used measure of economic well-being, showing the estimated market value of all final goods and services produced in the UK economy, divided by the total number of people in the UK.[3] Real household disposable income, as the name implies, focuses on the household sector,[4] and so excludes the incomes of companies and the government. Household final consumption expenditure (including the expenditure of non-profit institutions serving households) is a measure of spending, rather than income, and is also derived from the National Accounts. It captures expenditure incurred by households on consumption of goods and services.

[3] One important advantage of using GDP per head to measure living standards is that it also captures expenditure on public services and thus will not fall one-for-one with any tax increases used to pay for more public services. In contrast, household income measures will fall with such tax increases, with no account taken of the extra spending on public services or its impact on living standards.

[4] Though the household sector used for this measure also includes charities and universities.

Table 2.1. Measures of income growth compared

	Real household disposable income per head (UK)	GDP per head (UK)	Household[†] final consumption expenditure (UK)	Mean HBAI income (GB, BHC)	Median HBAI income (GB, BHC)
Labour (96–97 to 08–09*)	2.0%	2.1%	2.9%	2.0%*	1.7%*
Of which					
Labour I (96–97 to 00–01)	3.2%	3.3%	4.1%	3.1%	2.4%
Labour II (00–01 to 04–05)	2.0%	2.1%	3.8%	1.7%	2.0%
Labour III (2004–05 to 08–09*)	0.7%	0.9%	0.7%	1.1%*	0.5%*
Conservatives (79–80 to 96–97)	2.5%	1.9%	2.5%	2.1%	1.6%
Of which					
Thatcher (79–80 to 90–91)	2.6%	2.0%	2.9%	2.8%	2.1%
Major (90–91 to 96–97)	2.3%	1.8%	1.7%	0.8%	0.6%

[†] And non-profit institutions serving households.
* HBAI figures only available to 2007–08.
Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using National Accounts and Households Below Average Income data.

The HBAI measures focus on current household disposable income, adjusted for family size and composition, as discussed in the Introduction.[5] These measures allow us to look at the whole distribution of income (unlike the National Accounts measures). Table 2.1 shows income growth at both the mean and the median.[6] However, the median income measure in the final column is not directly comparable to the other three measures of average incomes, which look at mean rather than median income.

While the three directly comparable income series (real household disposable income per head, GDP per head and mean HBAI income) measure incomes in different ways, all agree that average annual income growth under Labour up to 2008–09 (or 2007–08 in the case of the HBAI measure) was around 2% per year. Growth in expenditure is slightly faster, averaging closer to 3% per year. However, all four series also show that growth has been getting steadily slower in each successive Labour term. In Labour's first term, all series show robust income growth in excess of 3% per year (4% per year in the case of expenditure). However, growth in Labour's second term was rather weaker for all the income measures – around 2% per year, on average. Expenditure growth continued to be robust during this time, however, remaining at nearly 4% per year (suggesting that expenditure growth was being partly financed by a reduced saving rate or higher debt). In Labour's third term, income growth was slower still – declining to around 1% per year. Expenditure growth also fell sharply, to less than 1% per year.

For the three series in Table 2.1 that are derived from the National Accounts (real household disposable income per head, real GDP per head and household final consumption expenditure per head), we also have data available for two additional quarters after the end of 2008–09 (Q2 and Q3 2009). These were two quarters in which GDP per head fell. In fact, real GDP per head in the latest

[5] The differences between these three income measures are discussed in more detail in M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (http://www.ifs.org.uk/publications/3328).

[6] Median income represents the income of the individual in the middle of the income distribution, with an income greater than half of the population but less than that of the other half. Mean income represents the mean average income.

quarter of data (Q3 2009) was lower than in any previous quarter since the first quarter of 2004. Household final consumption expenditure per head also fell substantially, to its lowest level since the first quarter of 2004. However, real household disposable income per head continued to grow, even during the recession, largely due to sharp falls in mortgage rates.

While the median HBAI income measure is not directly comparable to the other three measures of average incomes, it nonetheless shows similar patterns of growth – with broadly similar average growth rates under Labour and the Conservatives, taken as a whole, and with a marked slowdown in income growth seen over the course of Labour's three terms in office.

The overall average rate of income growth under Labour is broadly comparable to that seen during the preceding period of Conservative government, from 1979–80 to 1996–97, at around 2% per year (though the real household disposable income series shows slightly stronger growth under the Conservatives, at 2.5% per year).

In previous work,[7] we have attempted to uncover the causes of the slowing income growth in Labour's second and third terms. In particular, we divided households' income up into its constituent sources (earnings from employment, state benefits, pensions and so on) and examined which sources account for the slowdown in income growth in recent years. We concluded that it is earnings from employment which appear to account for most of the slowdown. From 1996–97 to 2001–02, the average income households received from earnings[8] grew by over 4% per year. From 2001–02 onwards, however, income from earnings grew far more slowly – at a rate averaging just 0.7% per year. Since earnings make up around two-thirds of household income (on average), any slowdown in earnings growth acts as a significant drag on overall income growth.

2.2 Changes in living standards by family type and region

The previous section described how average living standards have changed under Labour. In this section, we look at the average incomes of different family types and regions, as well as how these have changed in the period 1996–97 to 2007–08 (the last year for which data are available).

Family type

In Table 2.2, we split families into 12 different types according to whether or not they have children, the number of adults, the number in paid work and whether or not they are pensioners. We then show the median incomes of each of these different family types in 2007–08 relative to the median in Great Britain amongst the whole population. A number greater than 100 indicates that a group has a median income higher than the national median, whilst a value of less than 100 indicates that a group has a median income less than the national median. The table also shows the average real-terms growth in incomes for these family types between 1996–97 and 2007–08, and the median income for all households in Great Britain in 2007–08 (expressed in 2010 prices).

Three key features stand out in terms of the levels in 2007–08:

- Families containing more workers are, unsurprisingly, better off than families with no workers, on average.
- Families with children have lower incomes, on average, than equivalent families without children.
- Pensioners have below-average incomes, with pensioner couples better off, on average, than single pensioners.

[7] M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in the UK: 2009*, Commentary no. 109, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4524).

[8] Measured using the Households Below Average Income data series.

Table 2.2. Income levels and growth, by family type

Family type	Median level in 2007–08 (GB = 100)	Average growth (96–97 to 07–08)
Working-age families with children		
Lone parent, working	84.8	2.1%
Lone parent, not working	58.5	2.0%
Couple with children, two workers	115.4	1.6%
Couple with children, one worker	79.4	1.3%
Couple with children, no workers	52.8	2.0%
Working-age families without children		
Single, working	121.6	0.8%
Single, not working	67.8	1.4%
Couple, no children, two workers	152.8	1.3%
Couple, no children, one worker	103.5	0.7%
Couple, no children, no workers	66.5	0.8%
Pensioners		
Pensioner, single	77.3	2.4%
Pensioner couple	89.7	2.3%
Great Britain median (2010 prices)	***£419***	***1.7%***

Notes: Relates to Great Britain only as Northern Ireland was not included in HBAI data until 2002–03. Incomes have been measured before housing costs have been deducted and have been equivalised.
Source: Authors' calculations using Households Below Average Income data.

Of course, within each family type, there is a large degree of variation in the income levels of individual families.

Between 1996–97 and 2007–08, average incomes grew for all family types, but at different rates. Average incomes have grown less quickly for working-age families without children than for families with children and for pensioners: out of the six family types with the slowest average income growth over this period, five were working-age families without children. Average income growth has been higher for families with children, with lone parents and workless couples with children seeing average income growth above the national median, and couples with children with one or two workers seeing slightly lower growth. However, pensioners have seen the fastest average income growth of all over this period, with growth well in excess of the median. Broadly speaking, it is the family types with lowest average incomes (lone parents, pensioners and workless couples with children[9]) who saw the fastest income growth between 1996–97 and 2007–08; there is a smaller difference in income between family types than there was when Labour came to power.[10]

It is notable that those groups that have done particularly well under Labour are those that have been targeted for help from tax and benefit reforms, such as lone parents and pensioners, and those that have fared worst are those that have lost out, on average, from tax and benefit reforms to date, namely working-age families without children. A separate Election Briefing Note discusses the

[9] However, it should be noted that workless families without dependent children also have relatively low incomes and saw relatively low growth in incomes over this time.

[10] Part of the growth in pensioners' incomes may be due to new cohorts of pensioners having higher private incomes than previous cohorts. See, for example, M. Brewer, J. Browne, C. Emmerson, A. Goodman, A. Muriel and G. Tetlow, *Pensioner Poverty over the Next Decade: What Role for Tax and Benefit Reform?*, Commentary no. 103, Institute for Fiscal Studies, London, 2007 (http://www.ifs.org.uk/publications/3991).

impact of tax and benefit changes since 1997–98 in more detail.[11] However, there may be other reasons unrelated to tax and benefit reforms driving the differences in average income growth across family types. Later cohorts of pensioners, for instance, have higher private incomes (from investments and occupational and private pensions) and, as these replace earlier cohorts, the average incomes of pensioners will rise. Between 1996–97 and 2007–08, there was also a compositional shift from non-working families to working families. In particular, non-working working-age families fell from 18% to 15% of the total. Although this is likely to have been undone, at least in part, by the recession of the late 2000s, up until 2007–08 this trend is likely to have increased average income growth.

Region

Table 2.3 shows average incomes across the regions of Great Britain (nine English regions, as well as Scotland and Wales). These are averaged over the three years between 2005–06 and 2007–08 (relative to the national median); this is the government's preferred presentation of average incomes by region as presented in the annual HBAI statistics (three-year averages are used to ensure adequate sample sizes).

Table 2.3. Income levels and growth across Great Britain

Region	Median level in 05-06 to 07-08 (national prices) (GB = 100)	Median level in 05-06 to 07-08 (regional prices) (GB = 100)	Average growth (between 1996–97 to 1998–99 and 2005–06 to 2007–08)
North East	89.6	94.6	2.3%
London	112.0	101.6	2.3%
South West	100.6	98.8	2.2%
Yorkshire and Humber	93.1	98.3	2.1%
Scotland	98.6	103.8	1.9%
North West	92.8	95.3	1.8%
South East	116.3	109.9	1.7%
Wales	90.6	96.8	1.7%
East Midlands	93.7	95.7	1.6%
East of England	106.6	104.9	1.6%
West Midlands	91.7	93.3	1.2%
Great Britain median (2010 prices)	***£418***	***£418***	***1.9%***

Note: Relates to Great Britain only as Northern Ireland was not included in HBAI data until 2002–03.
Source: Authors' calculations using Households Below Average Income data.

However, the government does not adjust for differences in living costs across the country. It is difficult to do so, because the Office for National Statistics (ONS) produces no regular monthly or annual regional price indices. However, ONS did produce regional price indices for 2003–04 and 2004–05 on an experimental basis, and these showed considerable variation across the regions of Great Britain. It is unlikely that relative prices were the same in 1996–97 and 2007–08 as they were in 2004–05, but it is highly likely that this is a better approximation than assuming the cost of living is the same throughout Great Britain. Hence, in the second column of Table 2.3, we adjust incomes to account for regional price differences using the 2004–05 regional price indices. We believe that

[11] J. Browne and D. Phillips, *Tax and Benefit Changes under Labour*, IFS 2010 Election Briefing Note.

adjusting for the differences in price levels across the country is important and that figures that do not account for them are a poor guide to differences in living standards across the country.

Accounting for regional price differences reduces the apparent differences in median incomes between regions. In the three years between 2005–06 and 2007–08, the median income of the 'richest' region (the South East of England) was 16% higher than the GB median using national prices but only 10% higher using regional prices. Similarly, for one of the 'poorest' regions (the North East) the median income was 10% below the GB median using national prices but only 5% lower using regional prices. There was greater variation across regions for mean incomes, and the order is different (for instance, London performs better when looking at mean as opposed to median income, because the incomes of the richest people in the region outstrip the incomes of those in the middle of the distribution by more than in other regions).[12]

The North East of England and London saw the largest increases in median income under the first 11 years of Labour government, of 2.3% per annum (increasing from 91% to 95%, and from 98% to 102%, of the national median respectively). The West Midlands saw the slowest growth, of 1.2% per annum on average, and hence the largest relative fall, from 99% to 93% of the national median.

2.3 The effect of the recession on living standards

The recession that began in the first quarter of 2008 will clearly have had a profound effect on living standards on average and across different groups, but this impact has yet to be fully reflected in official statistics. HBAI statistics are only available up to 2007–08 at the time of writing, so only reflect the very first quarter of the recession. Although the National Accounts measures are available up to Q3 2009, these cannot tell us which groups have felt the strongest impact of the recession on their living standards.

In the absence of completely up-to-date and definitive information on living standards, we can turn instead to historical precedent. In previous work,[13] we examined the impact of the UK's three previous recessions (1973–75, 1979–81 and 1990–92) on the living standards of different groups. We found that it is groups most strongly attached to the labour force (in particular, working-age couples, and single people without children) whose living standards tend to fall most during recessions – a fact which is not surprising, given the slowdown in business activity and increasing unemployment associated with periods of economic contraction.

In contrast, groups such as lone parents and pensioners, whose incomes tend to be more reliant on state benefits and pensions, are less directly affected by recessions. In the longer term, however, the fiscal tightening that is often necessary in the aftermath of a recession is likely to affect these groups, as benefit and state pension increases become less generous.[14]

The recession will have affected individuals' stocks of wealth, as well as their flows of income, since both the housing market and the stock market fell substantially as the economy entered recession. Individuals who receive a substantial portion of their income from investments (who tend to be

[12] For a brief discussion about mean income by region up until 2006–07, see chapter 2 of M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in Britain: 2008*, Commentary no. 105, Institute for Fiscal Studies, London, 2008 (http://www.ifs.org.uk/publications/4258).

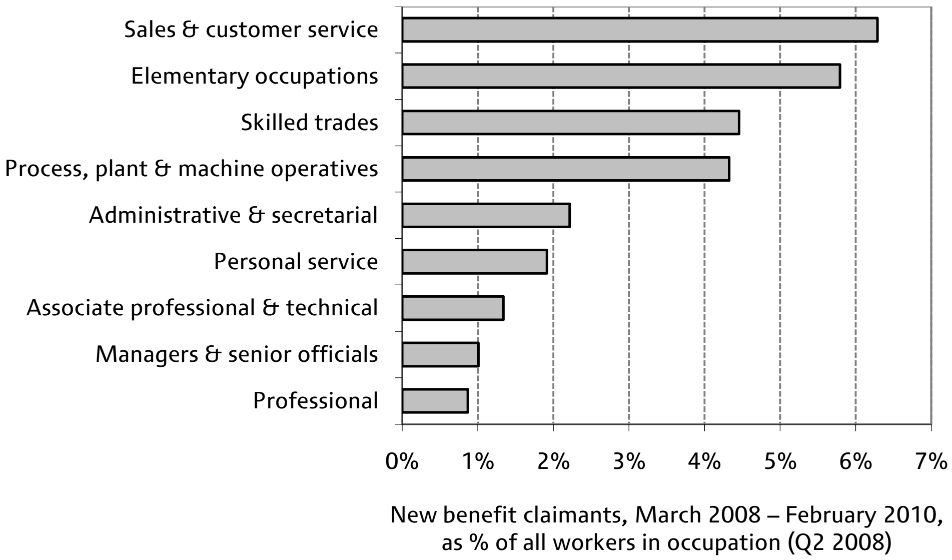
[13] A. Muriel and L. Sibieta, *Living Standards during Previous Recessions*, Briefing Note no. 85, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4525).

[14] J. Hines, H. Hoynes and A. Krueger, 'Another look at whether a rising tide lifts all boats', NBER Working Paper no. 8412, 2001 (http://www.nber.org/papers/w8412).

towards the top of the income distribution) are therefore likely to see a substantial decline in income from these during recessions.[15]

In terms of unemployment, previous recessions have seen low-skilled and low-educated workers bear the brunt of layoffs and worsening labour market prospects. However, in the early stages of the latest recession, it was suggested by some commentators[16] that we might be entering a 'middle-class' or 'white-collar' recession, unlike anything seen in the past. Because the recession started in the financial sector, it was argued that skilled, university-educated workers would suffer more than their lower-skilled counterparts. These predictions are not borne out by the latest unemployment data. Figure 2.2 shows unemployment growth by occupation, between March 2008 (around the low point of unemployment, going into the recession) and February 2010 (the latest month for which data are available). We can see that low-skilled 'elementary' workers (such as shelf-fillers and cleaners) and sales and customer service workers (such as shop assistants and call-centre workers) have been hit hardest since 2008, with an increase in unemployment amounting to around 6 percentage points of the 2008 workforce in these occupations.

Figure 2.2. Unemployment growth (claimant count) by occupation, March 2008 to February 2010



Note: Denominator for each occupation is the number of individuals working in that occupation in 2008Q2.
Source: Authors' calculations using claimant count data and the Annual Population Survey data made available by the Office for National Statistics (NOMIS).

Skilled trades (such as plumbers and motor mechanics) and process, plant and machine operatives have also suffered, with their unemployment rate rising by around 4 percentage points. In contrast, 'white-collar' managers, senior officials and professionals have seen an unemployment increase of just 1 percentage point.

We might worry that the claimant count unemployment measure used in Figure 2.2 may understate unemployment among white-collar workers, since they are less likely to claim unemployment benefits, but a similar pattern is seen in wider measures of unemployment that do not suffer from

[15] M. Brewer, L. Sibieta and L. Wren-Lewis, *Racing Away? Income Inequality and the Evolution of High Incomes*, Briefing Note no. 76, Institute for Fiscal Studies, London, 2008 (http://www.ifs.org.uk/publications/4108).

[16] See, for example, '"Middle class recession" to hit Britain's white-collar workers, top economist warns', 23 October 2008, http://www.dailymail.co.uk/news/article-1079754/Middle-class-recession-hit-Britains-white-collar-workers-economist-warns.html.

this potential bias.[17] In summary, the 'middle-class recession' does not appear to have materialised, and it is the low-skilled and low-educated workers whose labour market prospects have suffered most.

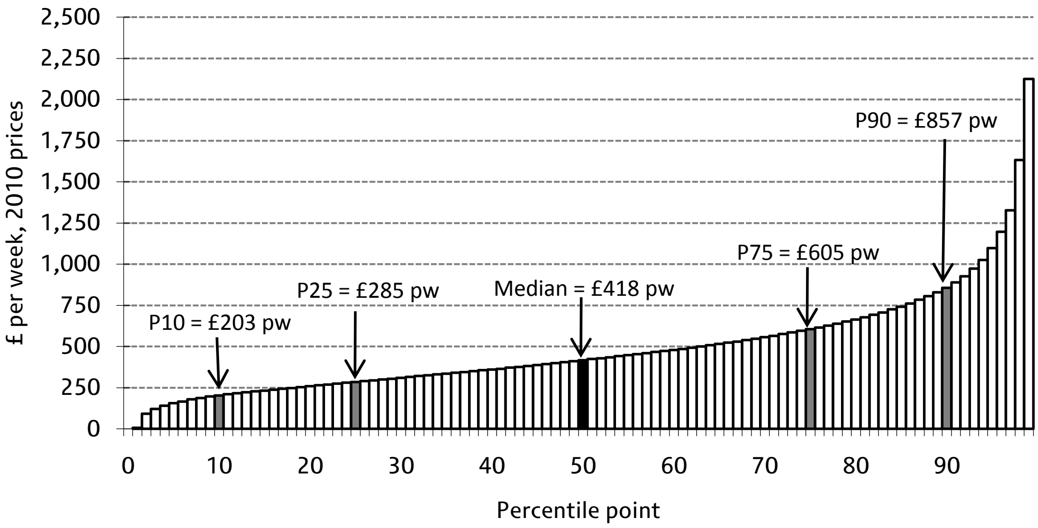
3. Inequality

In this section, we examine how unevenly incomes are distributed in the UK, and how and why the degree of income inequality has changed under the first 11 years of Labour's time in government. We also look at the prospects for income inequality and compare the level of income inequality with that seen in other OECD countries. As in the rest of this Briefing Note, the main income measure under consideration is equivalised household disposable income per week.

3.1 How unevenly are incomes distributed?

Figure 3.1 illustrates the UK income distribution in 2007–08 – the most recent year for which data are available. We divide all individuals into 100 equally-sized groups (called percentiles) according to their position in the income distribution, showing the income level of each percentile on the left-hand axis. For example, the median is the 50th percentile (shaded in black), which was £418 for the UK in 2007–08.

Figure 3.1. The income distribution in 2007–08 (UK)



Note: Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using the Family Resources Survey, 2007–08.

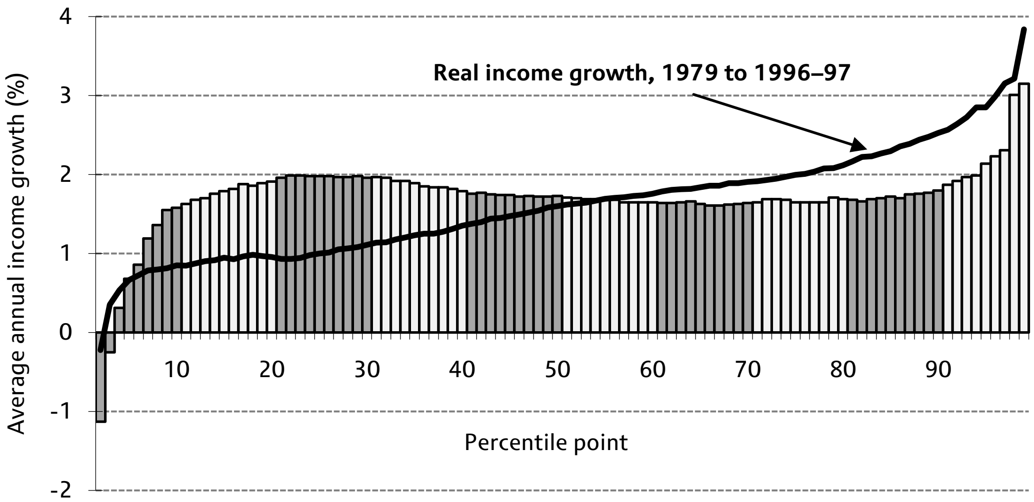
The graph shows that the bulk of incomes are concentrated in a relatively narrow range: half of all individuals live in households with incomes between £285 and £605 per week (the 25th and 75th percentile points respectively). However, there is a long tail of households with very high incomes. In 2007–08, the 90th percentile was about £857 per week, over twice the value of the median. At the very top of the income distribution, the 99th percentile was over £2,100 per week, more than five times the value of the median. At the bottom of the income distribution, 10% of individuals had incomes less than £203 per week, about half the value of the median.

[17] See A. Muriel and L. Sibieta, *Living Standards during Previous Recessions*, Briefing Note no. 85, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4525).

3.2 How has income inequality changed under Labour?

Figure 3.2 shows how incomes have changed across the income distribution over the period of Labour government from 1996–97 to 2007–08.[18] Between the 20th and 85th percentile points, incomes have grown fairly evenly, though it is generally the lower parts of the distribution that have gained most over this period. By itself, this would be consistent with falling inequality. Below the 20th percentile point, however, the lower the income percentile, the lower the growth experienced, with real income falling in the very lowest part of the income distribution (the 2nd and 3rd percentiles). Beyond the 85th percentile point, income growth is generally increasing in income, with a spike at the 98th and 99th percentile points. In other work we have pointed to above-average growth in top incomes as a driver of income inequality during this period.[19]

Figure 3.2. Real income growth by percentile point, 1996–97 to 2007–08, compared with 1979 to 1996–97 (GB)



Notes: The change in income at the 1st percentile is not shown on this graph. Incomes have been measured before housing costs have been deducted. The differently-shaded bars refer to decile groups.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

To place these figures in a historical context, the black line shows income growth under the previous period of Conservative government (between 1979 and 1996–97). Over this period, income growth was increasing in the level of income. Comparing income growth under Labour to date with that seen under the last period of Conservative government, we see that the bottom half of the income distribution saw stronger annual average income growth under Labour, whilst income growth in the top half of the income distribution was higher under the Conservatives.

Figure 3.3 shows income growth separately for the three Labour parliaments since 1996–97. For the bulk of the income distribution, income growth was fastest in Labour's first term of office, between 1996–97 and 2000–01. Growth over this period is also inequality-reducing across most of the distribution, with the highest growth around the 20th percentile. However, the tails of the distribution are a different matter, with very fast growth for the top 5% and lower growth for the bottom 10%. Labour's second term in office (2000–01 to 2004–05) saw income growth that was unambiguously inequality-reducing, though generally lower than during Labour's first term.

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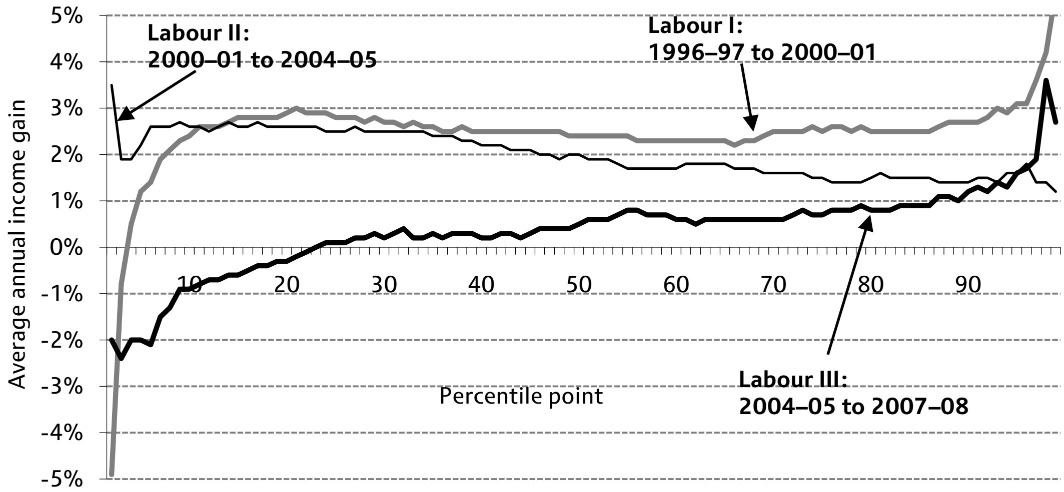
[18] Since data on Northern Ireland are only available from 2002–03 onwards, we only look at changes in income inequality across Great Britain over time.

[19] M. Brewer, L. Sibieta and L. Wren-Lewis, *Racing Away? Income Inequality and the Evolution of High Incomes*, Briefing Note no. 76, Institute for Fiscal Studies, London, 2008 (http://www.ifs.org.uk/publications/4108).

However, income growth between 2004–05 and 2007–08 has been lower than during previous parliaments for most of the income distribution (all bar the top 5% and bottom 2%) and almost uniformly inequality-increasing. That is, for most points of the income distribution since 2004–05, the higher up the income distribution we go, the higher the annual growth in incomes. Income growth has been negative for the bottom 20% of the income distribution over this time period, and below 1% everywhere except in the top 15%.

Figure 3.3. Percentile-point real income growth by parliament, 1996–97 to 2007–08 (GB)



Notes: The change in income at the 1st percentile is not shown on this graph. Incomes have been measured before housing costs have been deducted.
Source: Authors' calculations using Family Resources Survey, various years.

It can also be useful to construct summary measures of how inequality has evolved over time. The Gini coefficient is a commonly-used measure of income inequality that condenses the entire income distribution into a single number between 0 and 1: the higher the number, the greater the degree of income inequality.[20] Figure 3.4 shows the evolution of the Gini coefficient since 1979.[21] Inequality rose dramatically over the 1980s, with the Gini rising from a value of around 0.25 in 1979 and reaching a peak in the early 1990s of around 0.34. The scale of this rise in inequality has been shown elsewhere to be unparalleled both historically and compared with the changes taking place at the same time in most other developed countries.[22]

Since the early 1990s, the changes in income inequality have been less dramatic. Having fallen slightly over the early to mid-1990s, inequality rose during Labour's first term, with the Gini coefficient reaching a new peak of 0.35 in 2000–01. During Labour's second term, the Gini fell back again, with the level of inequality in 2003–04 returning to that last seen in 1997–98. However, over the first three years of Labour's third term, income inequality rose to a new high of 0.36, the highest level since our comparable time series began in 1961. The level of inequality in 2007–08 is higher (0.36 compared with 0.33) than when Labour came to power in 1996–97, and this increase is

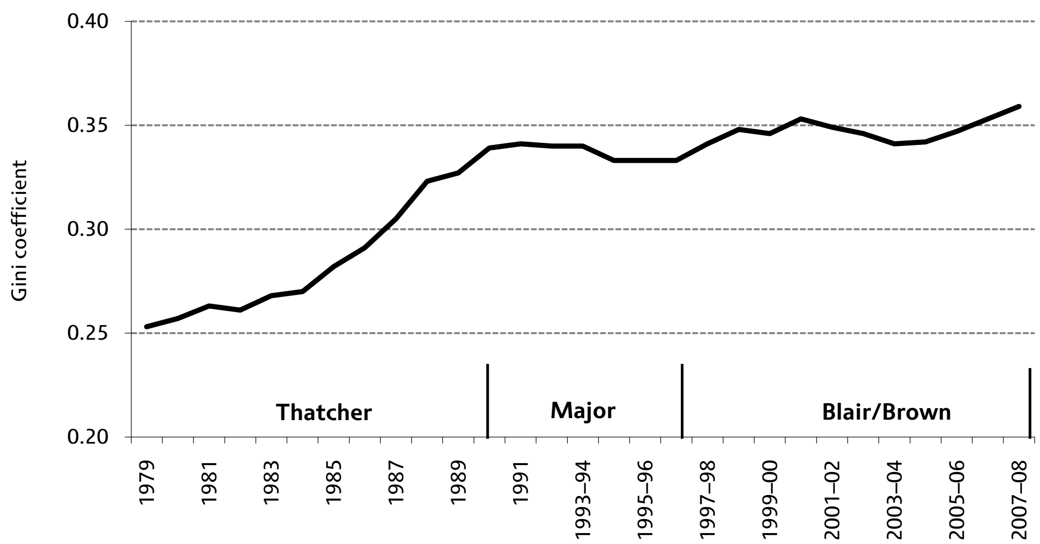
[20] A value of 0 corresponds to the absence of inequality, so that having adjusted for household size and composition, all individuals have the same household income. In contrast, a value of 1 corresponds to inequality in its most extreme form, with a single individual having command over the entire income in the economy.

[21] All income inequality statistics in this section use incomes measured before housing costs have been deducted.

[22] See: A. Goodman, P. Johnson and S. Webb, S., *Inequality in the UK*, Oxford University Press, Oxford, 1997; P. Gottschalk and T. M. Smeeding, 'Cross-national comparisons of earnings and income inequality', *Journal of Economic Literature*, 1997, vol. 35, pp. 633–8; and A. Atkinson, 'The distribution of income in the UK and OECD countries in the twentieth century', *Oxford Review of Economic Policy*, 1999, vol. 15, no. 4, pp. 56–75.

statistically significant. In previous work,[23] we have shown that other measures of income inequality have shown similar trends, except for the ratio of the 90th percentile to the 10th percentile point (the '90:10 ratio'), which fell up to 2004–05 but has since risen and was very slightly higher in 2007–08 than when Labour came to power.

Figure 3.4. The Gini coefficient, 1979 to 2007–08 (GB)



Note: The Gini coefficient has been calculated using incomes before housing costs have been deducted.
Source: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

3.3 Factors influencing recent changes to income inequality

In other work,[24] we have shown that Labour's tax and benefit reforms have tended to benefit poorer households at the expense of richer ones. It might thus seem surprising that income inequality is now slightly higher than when Labour came to power. The explanation is that income inequality would have been even higher in the absence of such reforms – in other words, if the alternative was a situation in which all tax thresholds, benefits and tax credits were uprated in line with prices (the standard uprating practice followed by the Conservatives between 1979 and 1997).[25] However, it should be noted that the impact of Labour's tax and benefit reforms on income inequality is lower if we consider a baseline where all tax thresholds, benefits and tax credits are uprated in line with national income instead.

In late March, the Conservatives released a poster with a picture of Gordon Brown along with the text 'I increased the gap between rich and poor'. Based on our analysis, it would be more accurate to say that the gap between rich and poor increased slightly under Labour and that Labour's tax and benefit reforms have probably muted the growth in income inequality.

The recent report by the National Equality Panel[26] examined inequalities across a wide range of dimensions and over time. For this report, IFS researchers decomposed changes in income

[23] M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in the UK: 2009*, Commentary no. 109, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4524).

[24] J. Browne and D. Phillips, *Tax and Benefit Changes under Labour*, IFS 2010 Election Briefing Note.

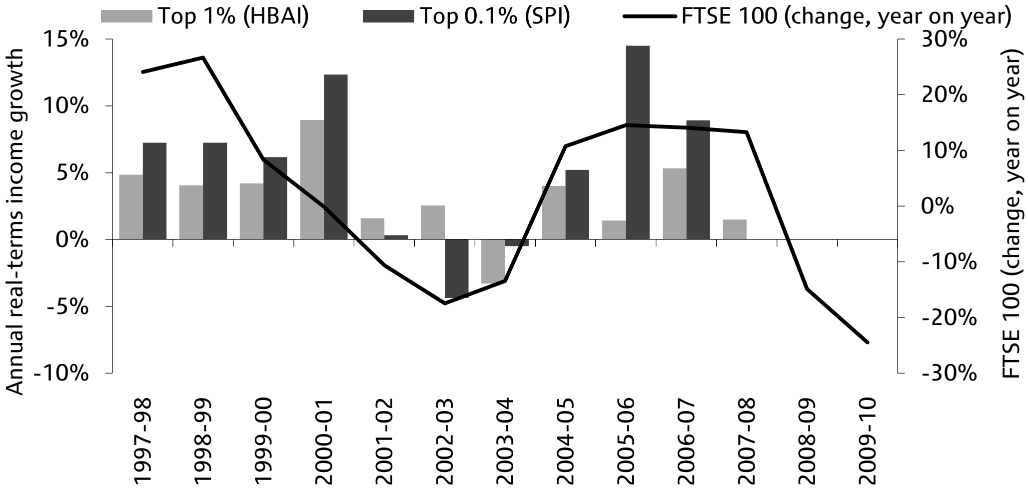
[25] S. Adam and J. Browne, 'Redistribution, work incentives and thirty years of tax and benefit reform in the UK', Institute for Fiscal Studies, Working Paper, forthcoming.

[26] National Equality Panel, *An Anatomy of Economic Inequality in the UK: Report of the National Equality Panel*, CASEreport no. 60, Government Equalities Office and Centre for Analysis of Social Exclusion, London, 2010 (http://www.equalities.gov.uk/national_equality_panel/publications.aspx).

inequality since the mid-1990s by different characteristics and income sources.[27] They found that earnings inequality amongst full-time workers continued to rise from the mid-1990s to the mid-2000s, though inequalities in other income sources, such as investment income and pensions, were largely unchanged. They also found that increases in the relative incomes of some low-income groups, such as pensioners and families with children, made a significant contribution to the fall in income inequality observed during Labour's second term.

As seen in Figure 3.2, above-average growth in top incomes has also been an important driver of income inequality in recent years. Between 1996–97 and 2007–08, the incomes of the richest 1% have grown by about 3.1% per year on average, or by about 40% in total – the highest level of growth across the income distribution. In Figure 3.5, we show the year-on-year real-terms growth of the richest 1% and the richest 0.1% (those with the very highest incomes). Note that the latter makes use of a different source of data and relates to individuals' after-tax incomes instead.[28] The graph makes clear that growth gets even higher the further up the income distribution you go. The incomes of the richest 0.1% grew by a total amount of 72% between 1996–97 and 2006–07 (the latest year of data available for these individuals), or by about 5.6% on average per year over this period. Although changes in the measurement of these top incomes are likely to mean that the growth in such incomes over time is overstated, particularly in 2005–06, it seems unlikely that this has affected the qualitative conclusion that it is the very highest high incomes that grew fastest of all between 1996–97 and 2007–08.[29]

Figure 3.5. Growth in top incomes and the change in the FTSE 100 index



Notes: Incomes have been measured before housing costs have been deducted. Top incomes figures relate to Great Britain only. Methodological improvements to the Survey of Personal Incomes are likely to have overstated growth over this period, particularly in 2005–06.
Source: Google Finance; authors' calculations using Family Resources Survey and Survey of Personal Incomes, various years.

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[27] M. Brewer, A. Muriel and L. Wren-Lewis, 'Accounting for changes in inequality since 1968: decomposition analyses for Great Britain', report prepared for the National Equality Panel, Institute for Fiscal Studies, London, 2009.

[28] The series for the top 0.1% is an update of the series created by M. Brewer, L. Sibieta and L. Wren-Lewis, *Racing Away? Income Inequality and the Evolution of High Incomes*, Briefing Note no. 76, Institute for Fiscal Studies, London, 2008 (http://www.ifs.org.uk/publications/4108).. It makes use of the Survey of Personal Incomes constructed by HMRC, the most reliable source of information for top incomes. However, this data source is only available up to 2006–07 and it has also undergone a number of methodological improvements in recent years. In particular, in 2005–06, methodological improvements to self-assessment cases where individuals are yet to submit a tax return are likely to have overstated total income growth in this year. We present changes in income levels of the richest 0.1% over time, but note these important caveats. For more information, please see http://www.hmrc.gov.uk/stats/income_distribution/menu-by-year.htm.

[29] Even up to 2004–05, the incomes of the richest 0.1% had grown by a total real-terms amount of 38%. The incomes of this group would need to have grown by just 0.7% per year, on average, between 2004–05 and 2007–08 in order for them to have seen income growth equal to that of the richest 1% or richest 2%.

Growth in top incomes has not been consistent over this period. It tends to be correlated with rises (and falls) in financial markets. For example, Figure 3.5 shows that the changes in top incomes from year to year are highly correlated with changes in the FTSE 100 index from year to year. This is not surprising, given that people in this group receive a larger fraction of their income from savings and investments than individuals further down the income distribution, and that a significant fraction of top earners work in the financial sector.[30]

3.4 Prospects for income inequality

Given the significant falls in financial markets observed since 2007, we might well suspect that top income growth slowed (or perhaps even turned negative) between 2007 and 2010, which may well have acted to reduce income inequality. Furthermore, a recent IFS Briefing Note[31] shows that during past recessions, income differences in the lower part of the income distribution have tended to shrink, though there appears to be no single trend for the direction of overall income inequality during past recessions. However, a number of planned tax policy changes do seem likely to reduce income inequality from 2010 onwards, other things being equal – for instance, the introduction of a new higher tax rate of 50% on incomes above £150,000, the withdrawal of the personal allowance on incomes above £100,000 and the reduction in the tax relief on pensions contributions for individuals with incomes over £130,000 whose income, plus the estimated value of any employer pension contributions, exceeds £150,000. In the 2010 Budget, the government estimated that these measures will raise £7.6 billion in extra revenue by 2012–13, after taking into account likely behavioural responses (e.g. choosing to work less or adjust pension contributions over a lifetime). IFS researchers[32] have estimated that approximately 830,000 adults will be affected by such measures in 2012-13 – the richest 2% of adults. Therefore, we estimate that affected individuals will be paying around £9,200 more in tax, on average, as a result of these measures. Two qualifications are worth noting, however. Firstly, this is an average figure and there will be a large amount of variation around this average, with some individuals paying much more than this and some a lot less. Secondly, this is probably an underestimate of the effect of these measures on the welfare of the individuals concerned as it assumes some behavioural response and it is costly to change behaviour[33].

In the recent Ask the Chancellors debate on Channel 4, Alistair Darling, George Osborne and Vince Cable all agreed that reducing the gap between rich and poor should be a policy priority for the government. Labour has already announced plans to increase taxes on the richest 2% of individuals, which seems likely to reduce income inequality. The Liberal Democrats have supported this change and the Conservatives have said that they have no plans to reverse it. Although of less significance for the very rich, all parties are also committed to increasing National Insurance rates on the rich in April 2011. In the 2005 election, only the Liberal Democrats said that they proposed to increase taxes on high-income individuals (a 50% tax rate on incomes above £100,000). This

[30] At the very top of the earnings distribution (the top 0.1%), 30% of individuals work in 'financial intermediation' – see M. Brewer, L. Sibieta and L. Wren-Lewis, *Racing Away? Income Inequality and the Evolution of High Incomes*, Briefing Note no. 76, Institute for Fiscal Studies, London, 2008 (http://www.ifs.org.uk/publications/4108).

[31] A. Muriel and L. Sibieta, *Living Standards during Previous Recessions*, Briefing Note no. 85, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4525).

[32] See Box 2.1 in R. Chote, R. Crawford, C. Emmerson and G.Tetlow 'Fiscal tightening: why and how', in R. Chote, C. Emmerson and J. Shaw (eds), *The IFS Green Budget: February 2010*, Commentary no. 112, Institute for Fiscal Studies, London, 2010 (http://www.ifs.org.uk/budgets/gb2010/10chap2.pdf).

[33] For more details on using changes in net income before and after accounting for behavioural response as indicators of changes in welfare, please see the Appendix of J. Browne and D. Phillips, *Tax and Benefit Changes under Labour*, IFS 2010 Election Briefing Note.

time round, all three main parties are committed to the planned increase in tax rates on high-income individuals, at least in the short run.

All three main parties are committed to roughly the same size of fiscal tightening over the course of the next parliament, though they disagree about when it should start. The recent National Equality Panel report stated that 'How [the public finances are rebalanced] will probably be the most important influence on how the inequalities both within and between groups evolve [in the near future]'.[34] Although all main parties have announced some measures that are likely to reduce the deficit, such as restrictions to the growth in public sector pay, there is currently little detail from any of the main parties about the areas of spending that will receive the deepest cuts and how these will be achieved.

There are some further differences between the parties in terms of tax and benefit proposals. The Conservatives have recently announced plans to partially reverse the planned increase in National Insurance contributions for 2011–12 for those on low to middle incomes. The Liberal Democrats have announced plans to increase the personal allowance to £10,000, increase capital gains tax rates and impose further tax rises on wealthy individuals (e.g. the mansion tax).

Future Election Briefing Notes will analyse the distributional effect of the tax and benefit policies proposed by the main parties in their manifestos. We also plan to examine which areas of public spending are likely to receive the deepest cuts over the course of the next parliament.

3.5 International comparisons

How does the level of income inequality in the UK compare with that observed across other countries, and have other countries observed similar trends? In the latest OECD statistics, income inequality in the UK remained above the OECD average, as shown in Figure 3.6.[35] Looking at levels of inequality in the mid-2000s, Nordic countries such as Sweden stand out for their very low inequality; France also has a Gini coefficient below the OECD average, though less dramatically so.

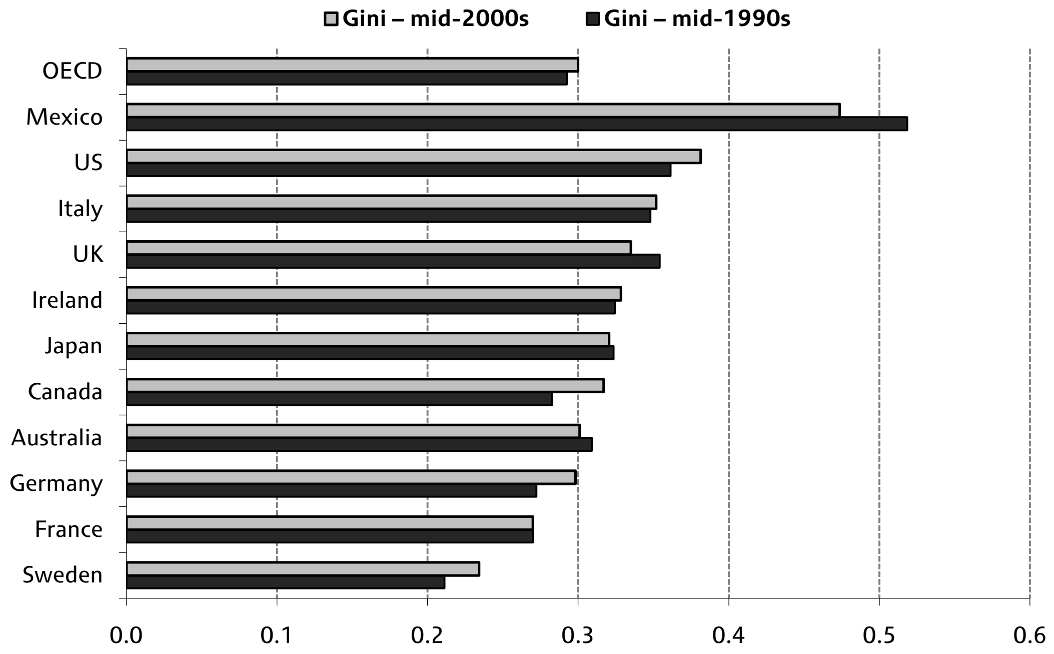
Countries such as Japan, Ireland and the UK have income inequality just above the OECD average, while Italy, the US and Mexico have Gini coefficients exceeding the OECD average by a much greater degree.

Although the UK's level of income inequality was higher than the OECD average in the mid-2000s, the UK was somewhat unusual among OECD nations in having falling income inequality between the mid-1990s and mid-2000s according to these data: only Australia, Mexico, Greece and the UK experienced statistically significant falls in inequality. The OECD's choice of years somewhat flatters the UK, however. As Figure 3.4 shows, the mid-2000s saw the lowest level of income inequality since the mid-1990s. Inequality has risen since then and was higher in 2007–08 than it was in the mid-1990s.

[34] Page 402 of National Equality Panel, *An Anatomy of Economic Inequality in the UK: Report of the National Equality Panel*, CASEreport no. 60, Government Equalities Office and Centre for Analysis of Social Exclusion, London, 2010 (http://www.equalities.gov.uk/national_equality_panel/publications.aspx).

[35] Note that the measure of income used by the OECD is somewhat different from that used in this Briefing Note, so the Gini coefficient in Figure 3.6 is not directly comparable to that shown in Figure 3.4. For more details, see box 3.1 in M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in the UK: 2009*, Commentary no. 109, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4524).

Figure 3.6. The Gini coefficient, selected OECD countries



Source: OECD, *Growing Unequal? Income Distribution and Poverty in OECD Countries*, Paris, 2008 (http://www.oecd.org/document/53/0,3343,en_2649_33933_41460917_1_1_1_1,00.html).

4. Poverty

In this section, we begin by examining trends in overall poverty, before looking at trends amongst different family types and across different regions and constituent countries of the UK. Lastly, we examine trends in child poverty in more detail and discuss the 2020 target to eradicate child poverty.

4.1 Poverty across the whole population

In the UK in 2007–08, there were 13.5 million individuals in relative poverty measuring incomes after housing costs (AHC) and 11.0 million measuring them before housing costs (BHC), using a poverty line equal to 60% of median income. On both these indicators, between 1998–99 and 2004–05, Labour oversaw the longest decline in poverty since the start of our consistent time series in 1961. However, this decline came to an end in 2004–05, and poverty rose every year between 2004–05 and 2007–08.

To give more perspective, Figure 4.1 shows the proportion of individuals living in relative poverty in Great Britain between 1979 and 2001–02 and in the UK from 2002–03, measuring incomes AHC (4.1a) and BHC (4.1b), and under a range of poverty lines. The government's child poverty targets are based on 60% of median BHC income.

Poverty rates increased dramatically during the mid- to late 1980s (under Thatcher) and more slowly in the early 1990s, and then stabilised or fell from the mid-1990s onwards, about the same time that the current Labour government came to power. To be more specific and using a poverty line of 60% of median income, in Labour's first term, overall poverty fell by 2.1 percentage points (AHC) and by 1.0 percentage points (BHC); it then fell slightly faster during the second term, falling by a further 2.6 percentage points (AHC) and 1.4 percentage points (BHC). All of these declines are statistically significant. The last three years of data put an end to this continuous decline in relative poverty, with cumulative rises between 2004–05 and 2007–08 of 2.0 and 1.3 percentage points, for AHC and BHC income respectively. Although the rise in relative poverty between 2004–05 and 2007–08 has not completely undone the reductions in poverty that occurred in Labour's first two terms, poverty is now higher than it was in 2002–03.

When we look at trends using other poverty lines (40%, 50% and 70% of the median income), we see that poverty rates also increased during the 1980s using these poverty lines. Poverty has fallen or stabilised since the mid-1990s using the 50% and 70% thresholds. However, when we consider the 40% poverty line, we see that this measure of poverty has actually risen by 0.8 percentage points since 1996–97 measuring incomes AHC and by 1.7 percentage points measuring incomes BHC. These rises are both statistically significantly different from zero. Box 4.1 discusses other research, which assesses whether severe poverty has risen since 1997.

Figure 4.1a. Relative poverty: percentage of individuals in households with incomes below various fractions of median income (AHC)

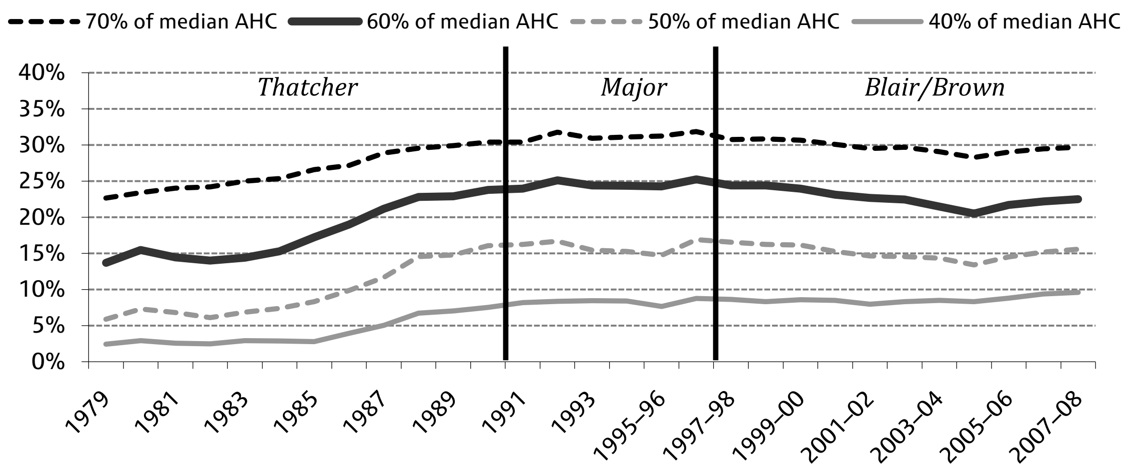
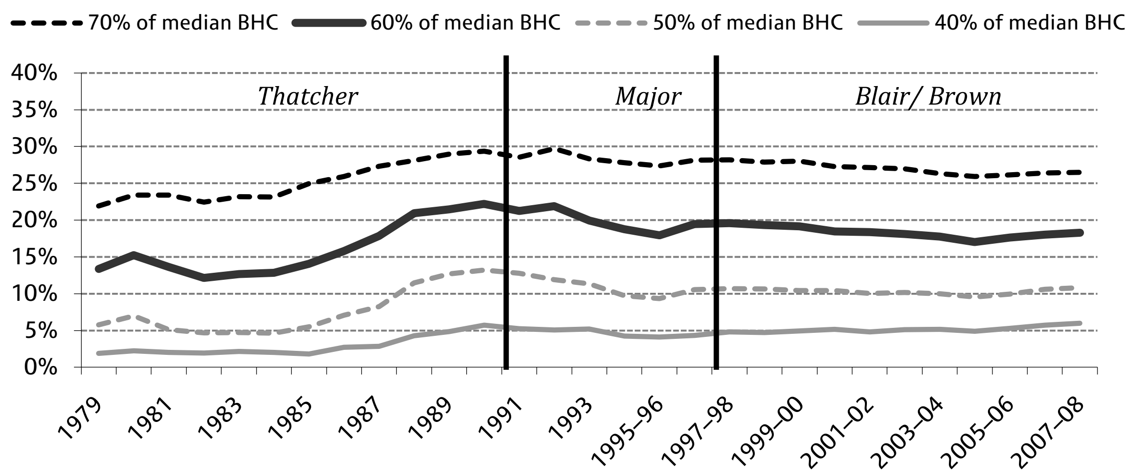


Figure 4.1b. Relative poverty: percentage of individuals in households with incomes below various fractions of median income (BHC)



Note: Figures are presented for GB up until 2001–02 and for the whole of the UK from 2002–03 onwards.
Source: Authors' calculations based on Family Expenditure Survey and Family Resources Survey, various years.

Box 4.1. Has 'severe poverty' risen under Labour?

In contrast to other poverty lines, the number of people with incomes below 40% of the median has increased by a statistically significant amount since Labour came to power in 1997. A number of commentators have used this fact to argue that 'severe' poverty has increased under Labour.[a] Another Election Briefing Note released alongside this one, 'What has happened to severe poverty under Labour?', shows that there are at least two fundamental issues we should consider when trying to assess this claim; the answers suggest that one cannot convincingly prove that severe poverty has increased since 1996–97.[b]

First, we should recognise that we can measure severe poverty in a number of ways. For instance, it could be based on very low relative income, very low absolute income, very low expenditure or some measure of persistent poverty. For the period since 1996–97, there is significant disagreement between these different measures, with some showing falls and others increases. However, relative and absolute measures of very low income, and measures of severe material deprivation (for families with children), have all increased since 2004–05, mirroring an increase in the government's official measures of relative poverty (based on a poverty line equal to 60% of median income).

Second, does the increase in the fraction of people with very low levels of relative income reflect a genuine increase in those with very low living standards? Importantly, the rise between 1996–97 and 2000–01 was accounted for largely by a rise in the proportion of the population living in households with either zero measured income or an income below 20% of the median, groups for which we have evidence (based on the material deprivation scores of families with children) that living standards are not as low as their incomes would suggest. Furthermore, some of this increase seems to be the result of increased deductions from income, some of an unrealistic level, such as student loan contributions (which explain about one-third of the rise in the fraction of people with an income less than 40% of the median between 1996–97 and 2004–05). It is therefore difficult to support the idea that severe poverty rose during this period in a meaningful sense. However, the rise in the proportion of people living in households with incomes below 60% since 2004–05 was driven mainly by those with incomes between 20% and 40% of the median, for whom living standards are very low on average, and so this probably does reflect an increase in the fraction of people with very low living standards.

Claims that severe poverty has increased since 1996–97 are therefore difficult to sustain convincingly. However, there is considerably stronger evidence that severe poverty has risen since 2004–05, mirroring an increase in the government's preferred measure of poverty.

a. For an implicit use of this definition of severe poverty, see the Conservative Party's Draft Manifesto, chapter 2 (Mending Our Broken Society), 2010 (available at http://www.conservatives.com/Policy/Where_we_stand/Schools.aspx)
b. For more details, see M. Brewer, D. Phillips and L. Sibieta, *What has happened to 'Severe Poverty' under Labour*, IFS 2010 Election Briefing Note.

4.2 Poverty amongst different family types and regions

Table 4.1 shows how relative poverty has changed for different types of people during the period 1996–97 to 2007–08 for the BHC income measure, and Table 4.2 repeats the analysis for the AHC measure.

There were substantial falls in relative poverty amongst children, parents and pensioners between 1996–97 and 2004–05. However, three years of increasing poverty have now reversed about one-quarter of the fall in child poverty between 1996–97 and 2004–05 when measured using BHC income and almost half of the fall using incomes measured AHC.

The increase in pensioner poverty in 2006–07 means that pensioner poverty (measured BHC) is about 1.9 percentage points above its recent low in 2005–06. However, this has only undone half of the fall in pensioner poverty since 1996–97, with the level in 2007–08 still being 1.9 percentage points below its 1996–97 level. However, measuring incomes AHC, pensioner poverty has fallen much more rapidly, from 29.1% in 1996–97 to 18.1% in 2007–08, a fall of 11.0 percentage points.

By 2007–08, about 70% of pensioners owned their homes outright and thus had minimal housing costs. This outright ownership of their homes explains why there are fewer pensioners in poverty on an AHC basis (18.1% in 2007–08) than on a BHC basis (22.7% in 2007–08). Moreover, poverty measured AHC is likely to have fallen much faster than poverty on a BHC basis, in part because the proportion of pensioners who own their homes outright has risen substantially as earlier cohorts (who often rented) are replaced by newer ones.[36]

Table 4.1. Relative poverty: percentage and number of individuals in households with incomes below 60% of median BHC income

	Children		*Pensioners*		*Working-age parents*		*Working-age non-parents*		*All*	
	%	Million	%	Million	%	Million	%	Million	%	Million
1996–97 (GB)	26.7	3.4	24.6	2.4	20.2	2.5	12.0	2.5	19.4	10.8
1997–98 (GB)	26.9	3.4	25.3	2.5	20.4	2.5	11.9	2.5	19.6	10.9
1998–99 (GB)	26.0	3.3	26.8	2.7	19.6	2.4	11.5	2.4	19.3	10.8
1999–00 (GB)	25.6	3.3	25.1	2.5	19.8	2.4	12.1	2.6	19.2	10.7
2000–01 (GB)	23.3	3.0	24.8	2.5	18.1	2.2	12.8	2.7	18.4	10.4
2001–02 (GB)	23.1	2.9	25.1	2.5	18.3	2.2	12.5	2.7	18.4	10.4
2002–03 (UK)	22.6	2.9	24.4	2.5	18.0	2.2	12.7	2.8	18.1	10.6
2003–04 (UK)	22.1	2.9	22.9	2.4	17.9	2.2	12.8	2.9	17.8	10.4
2004–05 (UK)	21.3	2.7	21.3	2.3	16.9	2.1	12.6	2.9	17.0	10.0
2005–06 (UK)	22.0	2.8	20.8	2.2	18.2	2.3	13.4	3.1	17.6	10.4
2006–07 (UK)	22.3	2.9	23.2	2.5	17.9	2.3	13.2	3.0	18.0	10.7
2007–08 (UK)	22.5	2.9	22.7	2.5	18.1	2.3	14.0	3.2	18.3	11.0
Changes										
1996–97 to 2000–01	−3.4		0.1		−2.0		0.7		−1.0	
2000–01 to 2004–05	−2.0		−3.5		−1.2		−0.2		−1.4	
2004–05 to 2007–08	(1.2)	(0.2)	(1.4)	(0.2)	(1.2)	(0.2)	1.4	0.4	1.3	1.0

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Changes in parentheses are not significantly different from zero at the 5% level. Because of the discontinuity in the series due to the inclusion of Northern Ireland from 2002–03, changes in the number of people in poverty since 1996–97 are not available. However, due to Northern Ireland's small population and similar poverty rates, the changes in poverty rate reported should be accurate.
Source: Authors' calculations based on Family Resources Survey, various years.

Whilst other groups have seen falls in poverty rates since 1996–97, poverty has risen amongst working-age adults without dependent children, a group who have lost out, on average, from tax and benefit reforms under Labour to date. Although this group has a lower-than-average risk of poverty, the 1996–97 level of relative poverty has been exceeded in every year since 2005–06 (AHC) or 1999–2000 (BHC).

It is also interesting to ask how the level of and trends in poverty vary across the country. Table 4.3 shows poverty rates for each of the 12 regions and constituent countries of the UK using averages

[36] For discussion of advantages and disadvantages of different treatments of housing costs, see appendix A of M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in the UK: 2009*, Commentary no. 109, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4524).

over three-year periods and the regional price indices discussed in Section 2.2. In the three years to 2007–08, the rate of poverty measured BHC was highest in London and lowest in Scotland, having adjusted for differences in the cost of living. Poverty has fallen since the period 1996–97 to 1998–99 in most regions, most notably in the North East, Yorkshire and Humber, the South West and Scotland, where it has fallen by more than 3 percentage points. However, poverty has risen by 1.3 percentage points in the West Midlands, which, in the period 2005–06 to 2007–08, had the second highest rate of poverty in the country, as opposed to the sixth highest in the period 1996–97 to 1998–99.

Table 4.2. Relative poverty: percentage and number of individuals in households with incomes below 60% of median AHC income

	Children		*Pensioners*		*Working-age parents*		*Working-age non-parents*		*All*	
	%	**Million**	**%**	**Million**	**%**	**Million**	**%**	**Million**	**%**	**Million**
1996–97 (GB)	34.1	4.3	29.1	2.9	26.6	3.3	17.2	3.5	25.3	14.0
1997–98 (GB)	33.2	4.2	29.1	2.9	25.9	3.2	15.9	3.3	24.4	13.6
1998–99 (GB)	33.9	4.3	28.6	2.9	26.3	3.2	15.5	3.2	24.4	13.6
1999–00 (GB)	32.7	4.2	27.6	2.8	25.5	3.1	16.1	3.4	24.0	13.4
2000–01 (GB)	31.1	3.9	25.9	2.6	24.7	3.0	16.2	3.4	23.1	13.0
2001–02 (GB)	30.8	3.9	25.6	2.6	24.5	3.0	15.6	3.4	22.7	12.8
2002–03 (UK)	29.8	3.9	24.2	2.5	24.1	3.0	16.5	3.7	22.4	13.1
2003–04 (UK)	28.7	3.7	20.6	2.2	23.5	2.9	16.6	3.7	21.5	12.6
2004–05 (UK)	28.4	3.6	17.6	1.9	23.0	2.9	16.1	3.6	20.5	12.1
2005–06 (UK)	29.8	3.8	17.0	1.8	24.9	3.1	17.6	4.0	21.7	12.8
2006–07 (UK)	30.5	3.9	18.9	2.1	25.2	3.2	17.6	4.0	22.2	13.2
2007–08 (UK)	31.1	4.0	18.1	2.0	25.6	3.3	18.1	4.2	22.5	13.5
Changes										
1996–97 to 2000–01	–3.0		–3.2		–1.9		–1.0		–2.1	
2000–01 to 2004–05	–2.8		–8.3		–1.6		–0.1		–2.6	
2004–05 to 2007–08	2.7	0.3	(0.5)	(0.1)	2.6	0.4	2.0	0.5	2.0	1.4

Notes: See Table 4.1

Table 4.3. Relative poverty across the United Kingdom (BHC)

	1996–97 to 1998–99	**2005–06 to 2007–08**	**Change (ppt)**
London	23.6%	21.8% (1)	– 1.7
North West	21.2%	19.2% (4)	–1.9
North East	21.2%	17.7% (7)	–3.5
Yorkshire and Humber	20.5%	16.9% (8)	–3.5
South West	19.8%	16.6% (9)	–3.3
West Midlands	19.4%	20.7% (2)	+1.3
East Midlands	19.2%	19.3% (3)	+0.0
Wales	19.0%	18.1% (5)	–0.9
Scotland	17.8%	14.6% (12)	–3.2
East of England	16.5%	14.8% (11)	–1.7
South East	15.6%	15.7% (10)	+0.0
Northern Ireland	–	17.8% (6)	–

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. Please note that Northern Ireland was not included in the FRS until 2002–03 onwards. Rankings in 2005–06 to 2007–08 are given in parentheses.

Source: Authors' calculations based on Family Resources Survey, various years.

4.3 Child poverty

Reducing child poverty has been a priority of the current Labour government. In 1999, the then Prime Minister Tony Blair made a pledge to 'abolish child poverty within a generation'.[37]

On the way to meeting this pledge, the government set a number of intermediate targets. The first of these was for child poverty in 2004–05 to be one-quarter lower than its rate in 1998–99. Despite sharp falls in the numbers in child poverty, this target was narrowly missed by 100,000 measuring incomes BHC and by 300,000 measuring incomes AHC.[38]

The government also set a target for child poverty in the UK in 2010–11 to be one-half its 1998–99 level. Progress is to be assessed against three definitions of poverty, including an absolute low income indicator and a combined relative low income and material deprivation indicator, but the most-watched measure is the pure relative poverty target based on a poverty line of 60% of median BHC income. With relative child poverty at 2.9 million in 2007–08, it has fallen by 500,000 (or 17%) in the nine years since 1998–99 and therefore needs to fall by another 1.2 million in the remaining three years before 2010–11 to meet this element of the target. Table 4.4 shows the progress on each of the three measures of child poverty.

Table 4.4. Progress towards halving child poverty in the UK by 2010–11

	Relative poverty, UK, modified OECD (BHC)		*Absolute poverty, UK, modified OECD (BHC)*		*Material deprivation and relative low income*	
	%	**Million**	**%**	**Million**	**%**	**Million**
1998–99	26.1	3.4	26.1	3.4	20.8	2.6
1999–00	25.7	3.4	23.4	3.1		
2000–01	23.4	3.1	19.1	2.5		
2001–02	23.2	3.0	15.2	2.0		
2002–03	22.6	2.9	14.1	1.8		
2003–04	22.1	2.9	13.7	1.8		
2004–05	21.3	2.7	12.9	1.7	17.1	2.2
2005–06	22.0	2.8	12.7	1.6	16.3	2.1
2006–07	22.3	2.9	13.1	1.7	15.6	2.0
2007–08	22.5	2.9	13.4	1.7	17.1	2.2
Change since 1998–99	–3.6	–0.5	–12.7	–1.7	–3.7	–0.4
Target for 2010–11		1.7		1.7		1.3

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding. For the purposes of the child poverty target in 2010–11, the DWP has had to estimate the level of child poverty in the UK in 1998–99 (Northern Ireland was first included in the official HBAI series in 2002–03); see HM Treasury (2007), as in the Sources. We have followed a similar imputation process for intervening years.
Sources: Authors' calculations based on Family Resources Survey, various years; HM Treasury, *PSA Delivery Agreement 9: Halve the Number of Children in Poverty by 2010–11, on the Way to Eradicating Child Poverty by 2020*, TSO, London, 2007 (http://www.hm-treasury.gov.uk/d/pbr_csr07_psa9.pdf).

[37] Tony Blair, Beveridge Lecture, Toynbee Hall, London, 18 March 1999.

[38] See M. Brewer, A. Goodman, J. Shaw and L. Sibieta, *Poverty and Inequality in Britain: 2006*, Commentary no. 101, Institute for Fiscal Studies, London, 2006 (http://www.ifs.org.uk/publications/3575). Note that, for this target, incomes were adjusted using the McClements equivalence scale, rather than the modified OECD equivalence scale now used, so that the numbers presented in this paragraph differ from those in the rest of this chapter, and are not directly comparable to future targets in 2010 and 2020.

The government published a policy report on child poverty alongside Budget 2010.[39] It set out simulations (by the Child Poverty Unit) of the level of child poverty in 2010–11, drawing on methods previously used by researchers at IFS and ISER.[40] These simulations probably come as near as we will get to an explicit admission that the government has not done enough to hit its target for child poverty in 2010–11. Despite the expected falls between 2007–08 and 2010–11, which have not yet been reflected in official statistics, the government expects child poverty to reach 2.3 million in 2010–11, 600,000 short of the 1.7 million target (the same shortfall as was estimated by researchers at IFS and ISER).

The eradication of child poverty by 2020

We now look further ahead to the government's target to eradicate child poverty by 2020. The recently passed Child Poverty Act (2010) gives this target new significance and makes the eradication of child poverty by 2020 a legal requirement. The Act was passed with cross-party support.

The Child Poverty Act sets four UK-wide targets that define the eradication of child poverty in 2020. The most-watched measure is likely to be the relative income poverty indicator, which must be amongst the lowest in Europe. The Act defines this as a rate of relative income poverty less than 10%. A target of zero would be impractical due to fluctuations in incomes and the potential for incomes to be misreported by survey respondents, and because there will always be a small number of people who, for whatever reason, fall through the safety net. As well as a relative income poverty target, the government has proposed targets based on persistent poverty, a combined relative low income and material deprivation indicator, and an absolute poverty measure.[41] It is notable that the measures in the Act are almost exclusively income-based. A focus on income-based measures may skew the policy response towards reforms that have immediate and predictable impacts on household incomes – such as tax and benefit changes – rather than those that most cost-effectively improve children's quality of life or those that reduce the risk of poverty being transmitted across generations – such as improvements to early years education. We believe it would be sensible to make use of information about other aspects of children's and parents' lives, such as health, educational attainment, access to services, experiences of crime, and mental and social well-being. This is similar to suggestions by the Conservative Party that a broader strategy for tackling poverty that targets 'causes' is required. On the other hand, there is clearly a risk that with too many targets and measures, potentially moving in different directions, progress is difficult to identify and measure, reducing accountability and allowing a dilution of the commitment to the policy.

Perhaps more important than how to measure child poverty are the policies one would use in order to reduce child poverty. The Child Poverty Act requires the next government to publish a National Strategy setting out how it will eradicate child poverty by 2020. The policy report accompanying Budget 2010[42] gives more detail on Labour's strategy. It discusses promoting work as the best route out of poverty, the need to improve children's lives and life chances through early childhood development, narrowing the gap in educational outcomes, smoothing the transition from

[39] HM Treasury, DCSF and DWP, *Ending Child Poverty: Mapping the Route to 2020*, London, 2010 (http://www.hm-treasury.gov.uk/d/budget2010_childpoverty.pdf).

[40] M. Brewer, J. Browne, R. Joyce and H. Sutherland, *Micro-Simulating Child Poverty in 2010 and 2020*, Commentary no. 108, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4434).

[41] For more details, see M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in the UK: 2009*, Commentary no. 109, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4524).

[42] HM Treasury, DCSF and DWP, *Ending Child Poverty: Mapping the Route to 2020*, London, 2010 (http://www.hm-treasury.gov.uk/d/budget2010_childpoverty.pdf).

adolescence to adulthood, reducing deprivation in local areas, and improving public service delivery.

The report also provides simulations of the level of child poverty in 2020–21. These simulations are actually more pessimistic than those previously published by IFS researchers,[43] but confirm the general conclusion of that work that, if there are no major economic or demographic changes, and if tax credits and benefits are not comprehensively uprated in line with average earnings, then child poverty will rise considerably. The government's simulations show a shortfall of 2.1 million children in 2020–21. Commendably, the report tries to show how some of this projected deficit might be closed. A set of very ambitious assumptions about parental employment and the decline in teenage pregnancies might reduce the simulated shortfall by 1 million children. But the document is much less clear on how the remaining 1.1 million children might be lifted out of poverty: it suggests that improved take-up of benefits, and a reduction in in-work poverty, would both help, but the first is hard to achieve in practice, and the second is a leap of faith, and this still leaves a residual 200,000 children to be lifted out of poverty by 'other' policies. Therefore, it is still unclear how the current government will be able to meet the 2020 target. Furthermore, it is also unclear what resources will be available to implement such policies, given the necessary fiscal tightening planned over the next few years.

The Conservative Party Shadow Work and Pensions spokesman, Lord Freud, has identified four key areas the Conservatives would target:[44] family breakdown; addiction to drugs and alcohol; education and skills; and work strategy. They have also announced a number of specific policies that they claim will help to reduce child poverty – for example, ending the couple penalty in the tax credits system, introducing a pupil premium to the school funding system and increasing conditionality in the welfare system. However, the impact of such policies on child poverty in 2020 is highly uncertain, and it is unlikely that these measures alone would be enough to meet the 2020 child poverty targets.

The Liberal Democrats supported the Child Poverty Bill as it was going through parliament. They have announced policies that will affect child poverty, such as an increase in the personal allowance to £10,000 and cuts in tax credits for above-average-income families, and they have also announced plans for the introduction of a pupil premium into the school funding system, which may help to reduce inequalities in child outcomes in the longer run. However, the impact these policies will have on child poverty both in the near term and in 2020 is highly uncertain, and it is unlikely that these measures alone would be enough to meet the 2020 child poverty targets.

Hence, neither the government nor the main opposition parties have yet produced a credible and detailed strategy about how they will meet this now legally-binding commitment.

5. Conclusion

This Election Briefing Note has charted the course of living standards, poverty and inequality during Labour's period of government. Taking the period since 1997 as a whole, average living standards have risen. However, this growth has slowed from an average of more than 3% a year in Labour's first term, to 2% a year in its second and to less than 1% in its third. Average income growth has also been varied by family type: families with children and pensioners saw the fastest growth; working-age adults without children have seen the slowest growth. Across regions, the

[43] M. Brewer, J. Browne, R. Joyce and H. Sutherland, *Micro-Simulating Child Poverty in 2010 and 2020*, Commentary no. 108, Institute for Fiscal Studies, London, 2009 (http://www.ifs.org.uk/publications/4434).

[44] See House of Lords Daily Hansard, 5 January 2010, Column 23 to Column 27.

North East of England and London saw the fastest growth, and the West Midlands saw the slowest growth, on average. The recession is also likely to have had a significant impact on living standards. However, the 'middle-class recession' predicted by some commentators did not materialise. This recession, like previous recessions, has seen low-skilled and low-educated workers bear the brunt of worsening labour market conditions.

The latest data show that in 2007–08, income inequality was slightly higher than when Labour came to power and higher than in any year since at least the 1950s. However, the rise in income inequality under Labour is far smaller than the rise observed under the Conservatives during the 1980s. Furthermore, Labour's tax and benefit reforms have reduced income inequality compared with the normal practice of the previous Conservative government of increasing all benefits and tax credits broadly in line with prices. In other words, Labour's tax and benefit reforms seem to have prevented a larger rise in income inequality.

The overall rate of relative poverty has declined since Labour came to power, having risen strongly during the 1980s. However, since 2004–05, about half of the fall observed during Labour's first two terms of office has been reversed. Since 1996–97, poverty has fallen most strongly for children and pensioners, but it is higher for working-age adults without dependent children. The government has now in effect conceded that it will miss the child poverty target it set itself for 2010–11, having earlier missed the one it set itself for 2004–05. Furthermore, neither the government nor the main opposition parties have yet produced a credible and detailed strategy about how they will meet the now legally-binding commitment to eradicate child poverty by 2020.

Finally, the most important determinant of the path of living standards, poverty and inequality over the course of the next parliament will be how the public finances are rebalanced. All the main parties are committed to a similar-sized fiscal tightening over this period and all are committed to tax-raising measures on the very rich. However, there is currently little detail from any of the main parties about the areas of spending that will receive the deepest cuts and how these will be achieved. Therefore, on the basis of the limited proposals they have published to date, there is little reason to believe that the outlook for overall living standards, poverty and inequality going forwards would be dramatically different under the opposition parties from under Labour. We will revisit this question following the publication of the party manifestos.