



Institute for
Fiscal Studies

Poverty and Inequality in the UK

Rob Joyce

Overview

1. Introduction

2. Poverty

- i. Definitions
- ii. What's been happening over the last 3 decades, and why?

3. Inequality

- i. Definitions
- ii. What's been happening over the last 3 decades, and why?

4. Summary and final thoughts

Disclaimer

- This talk is narrow.
- Clearly there are lots of ways to think about well-being, and many have little/nothing to do with material living standards.
- But we focus on things we can count!
- Even after imposing that restriction, choices remain...

Income

- Transitory, not reliable measure of material living standards in short run
- Easier to measure
- Largest UK survey ~25,000 households

Consumption

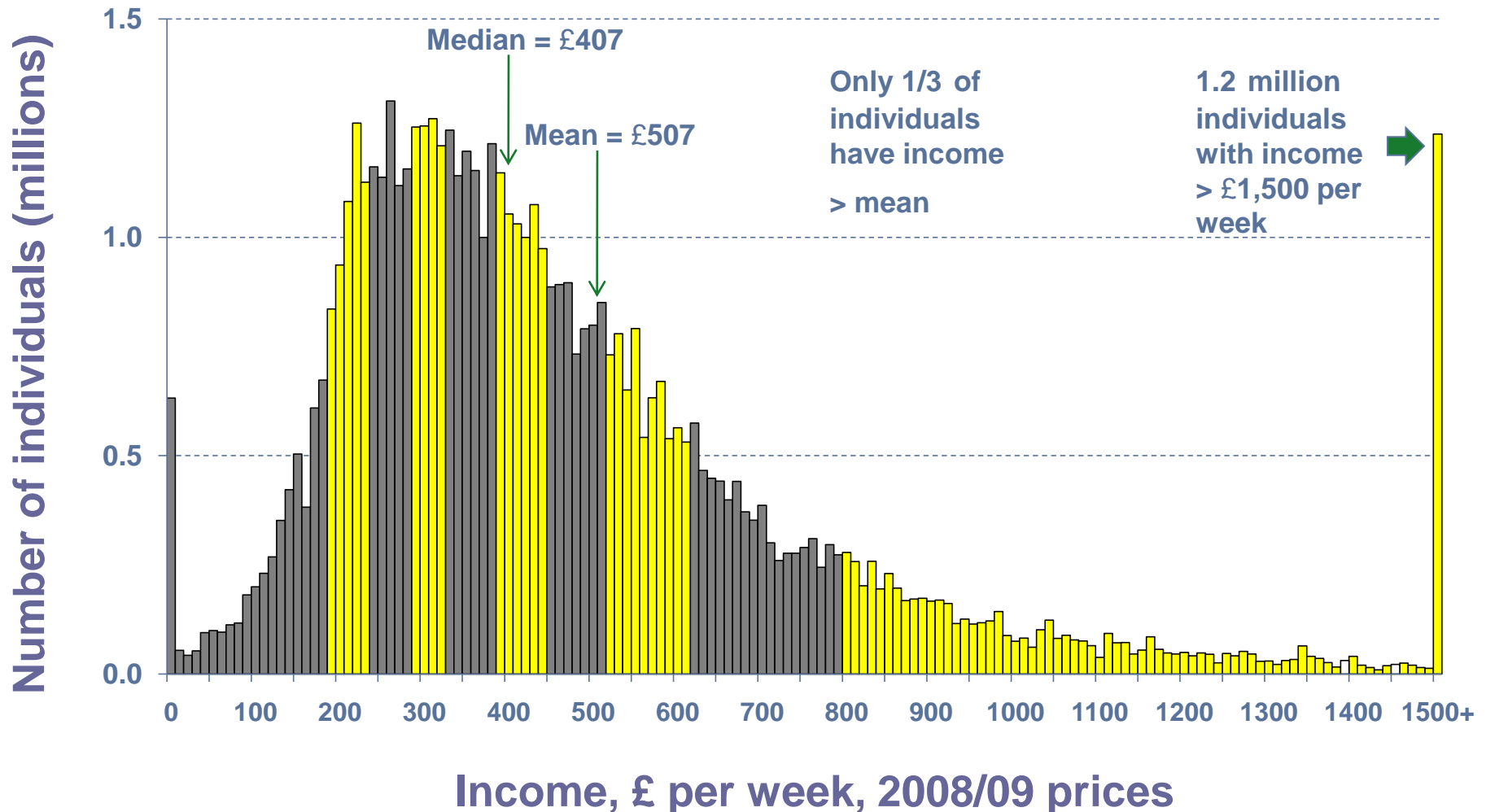
- Conceptually better measure of living standards
- Difficult/expensive to measure
- Largest UK survey ~ 7,000 households

If interested in link between consumption inequality and income inequality, see Blundell, Pistaferri and Preston (2008) and Blundell and Preston (1998)

So we will focus on income...

- Data from annual Households Below Average Income series (HBAI), based on Family Resources Survey (FRS)
- Incomes are measured:
 - Net (private incomes + benefits/tax credits – taxes)
 - At household level
 - Equivalised (accounting for different family structures)
 - Both before and after subtracting housing costs (BHC and AHC incomes)

UK income distribution in 2008/09 (1st full financial year since start of recession)



Source: HBAI data

POVERTY

What exactly do we care about?

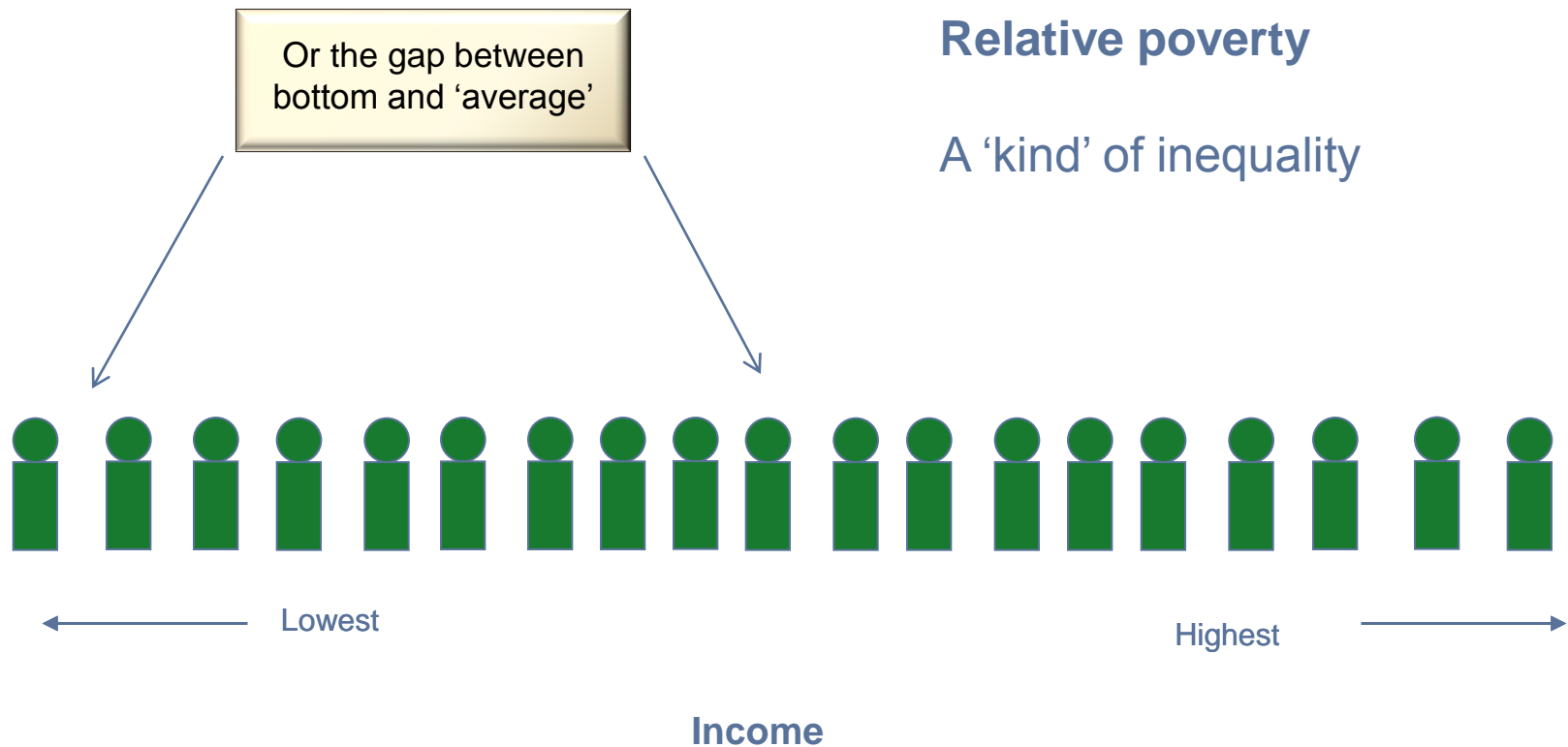
Could focus on those at the bottom in isolation

Absolute living standards:

Food/nutrition
Clothing
Heating/electricity



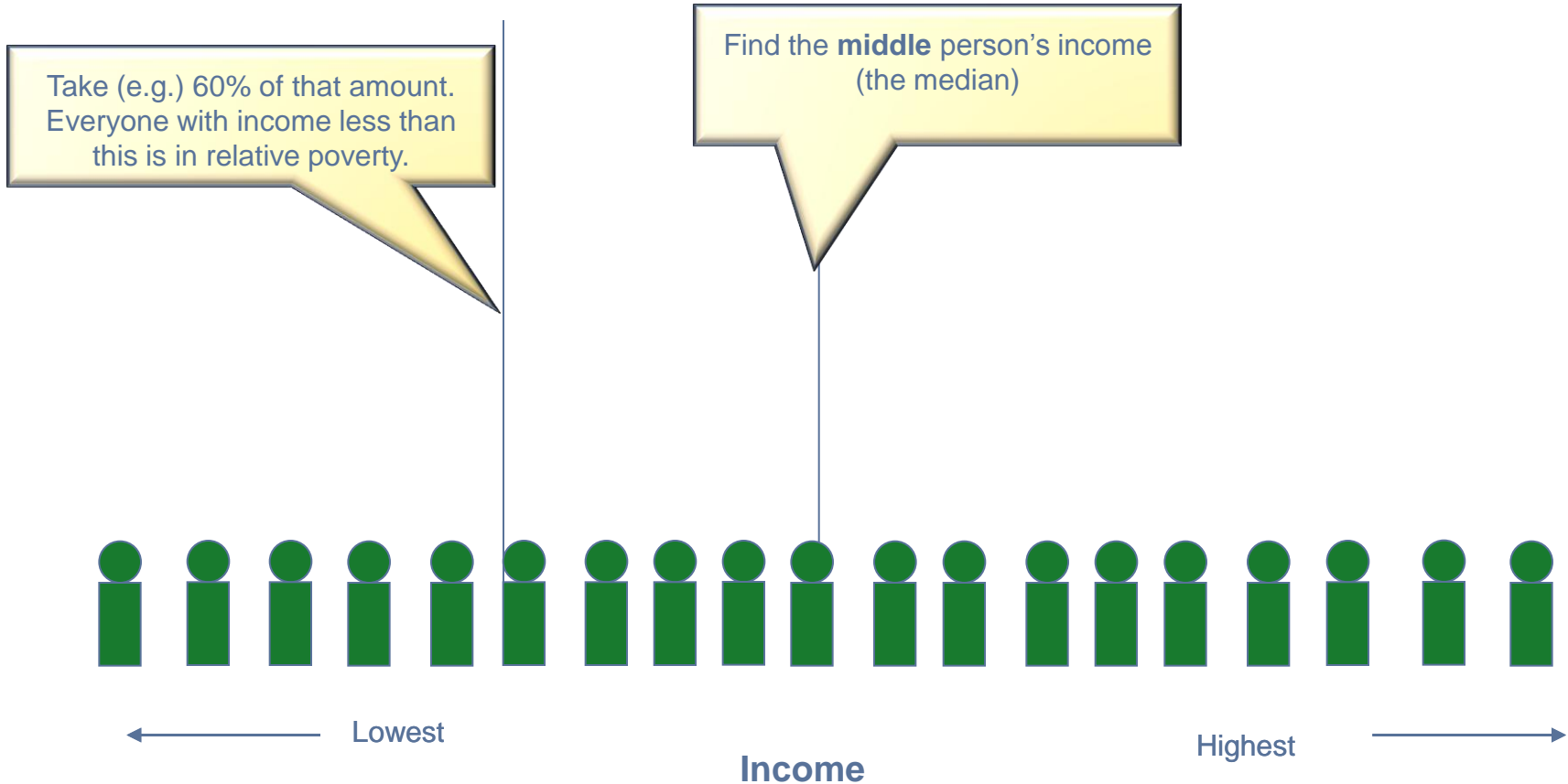
What exactly do we care about?



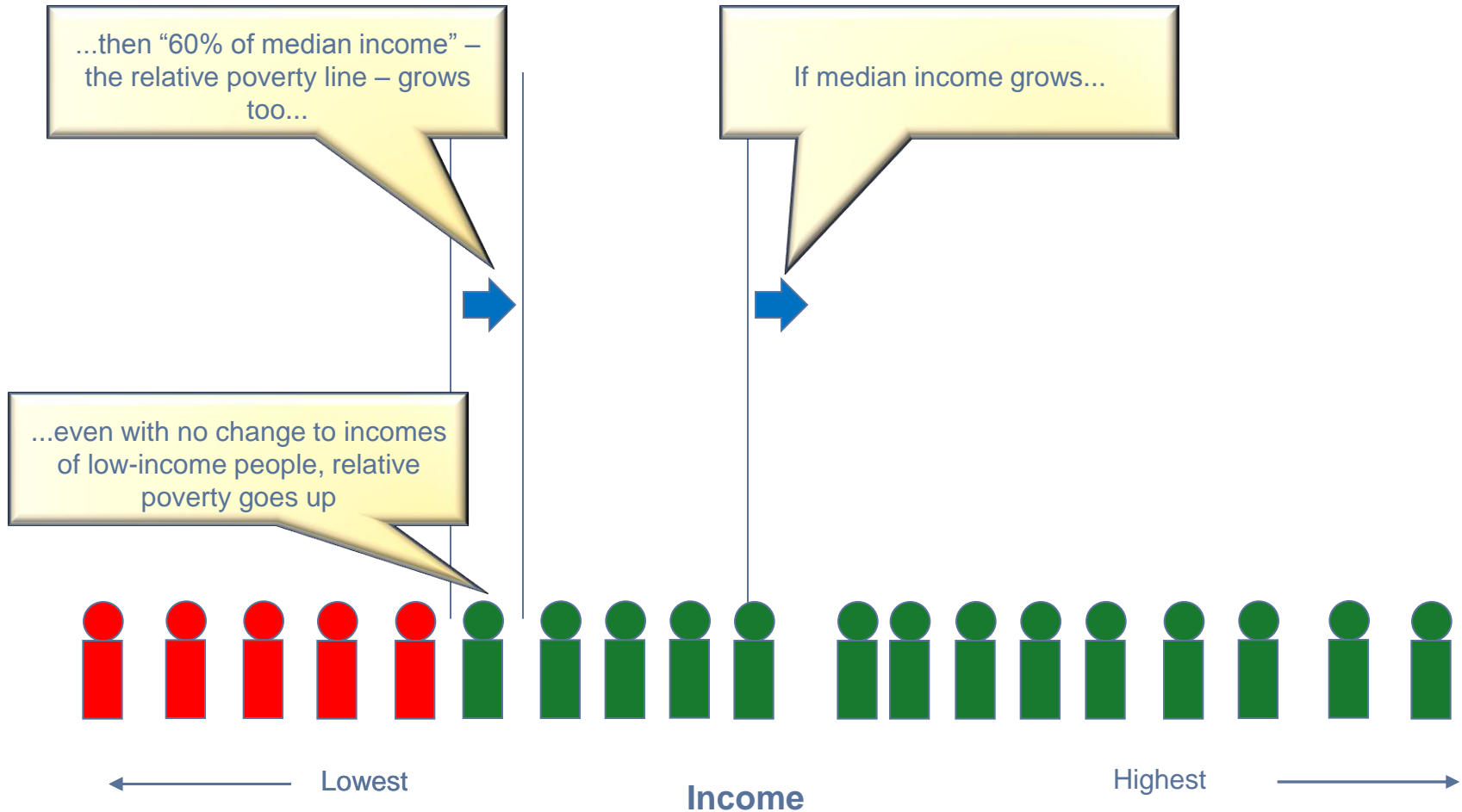
Absolute vs relative poverty

- Absolute poverty \neq destitution!
- Key difference between absolute/relative poverty: what happens to poverty line over time
- Absolute poverty line constant (in real terms)
 - Should society get more ambitious (i.e. have lower tolerance for low living standards) as it gets better off? Are 'needs' fixed?
 - Could just raise absolute poverty line now and then...
 - ...but hard to rationalise this discontinuity.
 - If raising poverty line, do it smoothly – a relative poverty line.

Calculating relative poverty



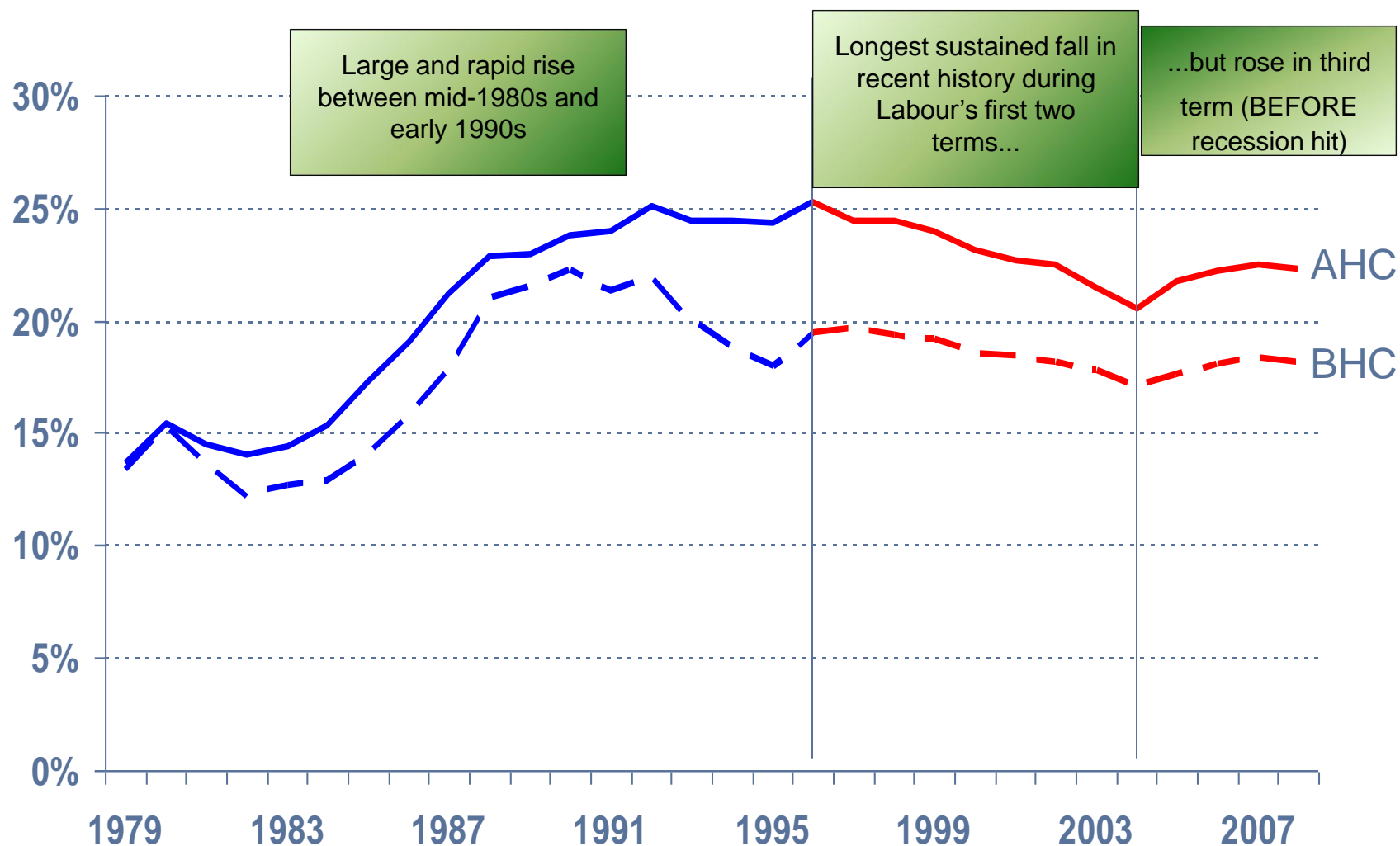
Relative poverty over time – a moving target



The moving target, continued...

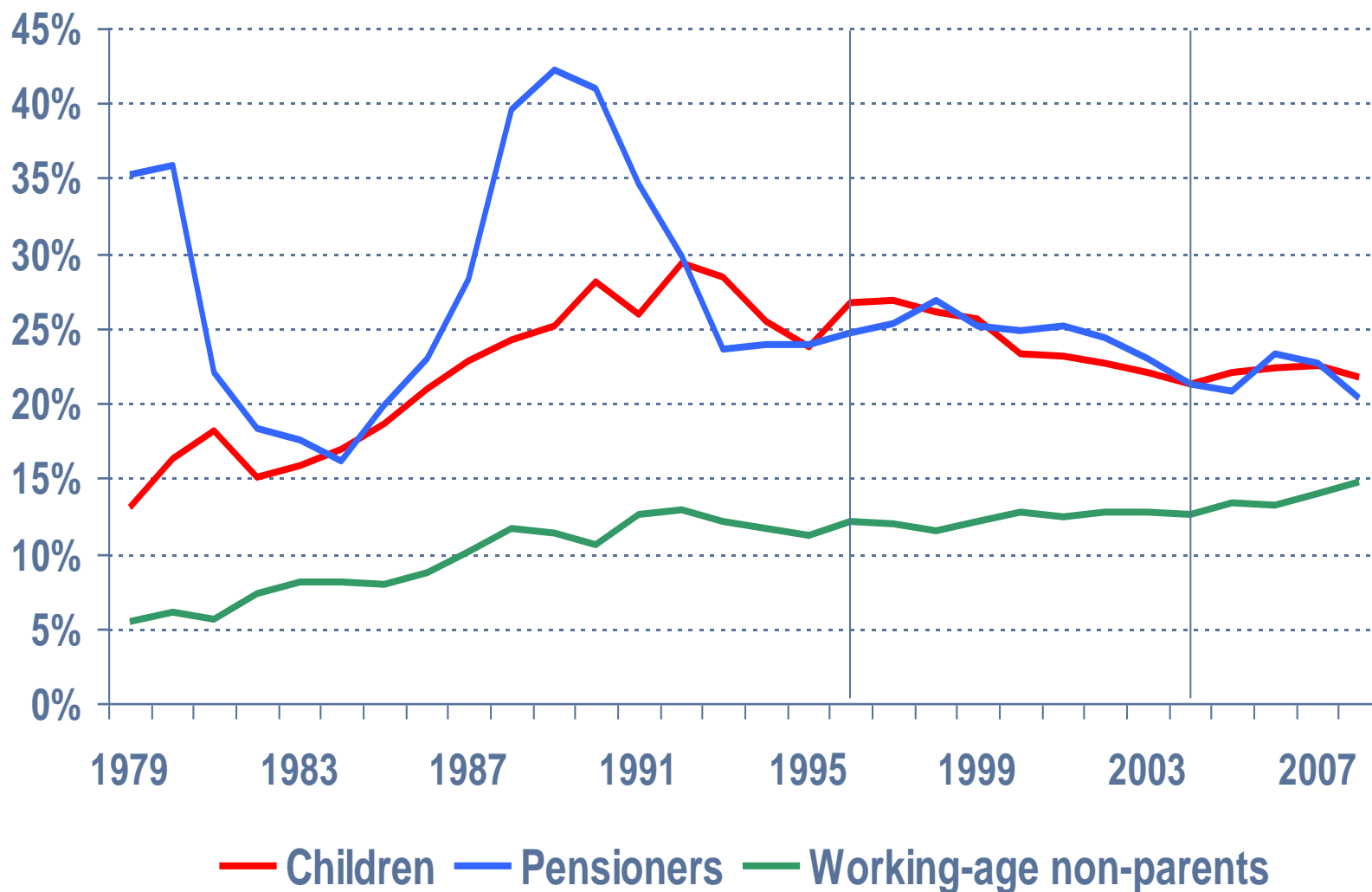
- Earnings growth between 1998-99 and 2008-09 acted to increase relative child poverty by 4 ppts (Brewer, Browne, Joyce, Sibieta, 2010), by increasing the median.
- Conversely, relative poverty can fall when poor get poorer, if median household fares even worse.
- Indeed, it fell in previous 3 recessions (Muriel and Sibieta (2009)). Not something to celebrate!
- Imagine policy implications of ONLY worrying about relative poverty.

(Relative) poverty from 1979/80 to 2008/09



Source: HBAI data

Poverty from 1979/80 to 2008/09 : subgroups



Source: HBAI data

Note: Only BHC incomes shown.

(Relative) poverty under Labour: subgroups

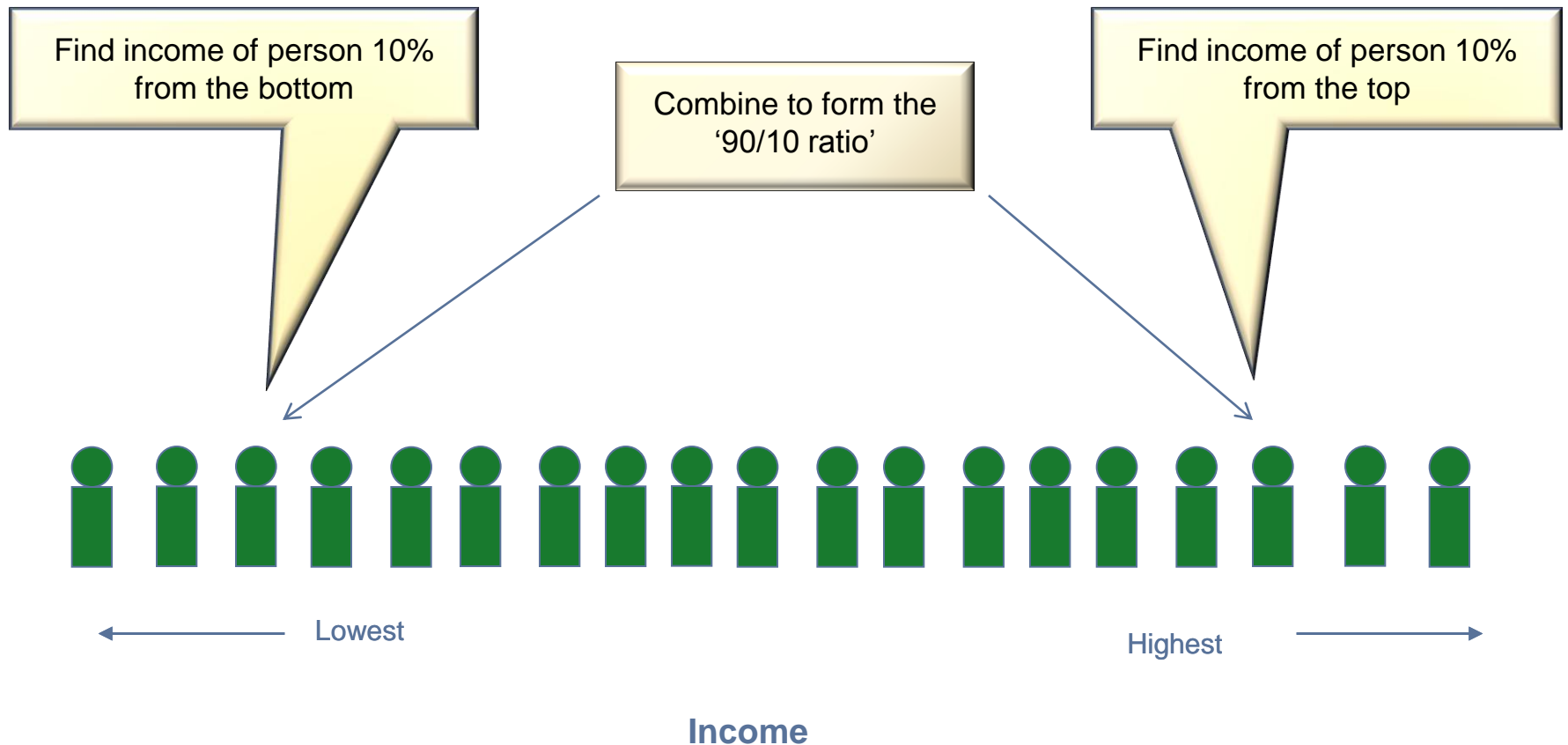
- Biggest drivers of falling poverty during Labour's first two terms: pensioners, families with children.
 - Child tax credit, pension credit, winter fuel allowances introduced
- Poverty up amongst working age adults without children between 1996/97 – 2008/09.
 - Not the focus of tax and benefit reforms under Labour (e.g. under-25s ineligible for tax credits).
 - Current levels of 'youth' unemployment suggests the position of this group may have continued to worsen.

INEQUALITY

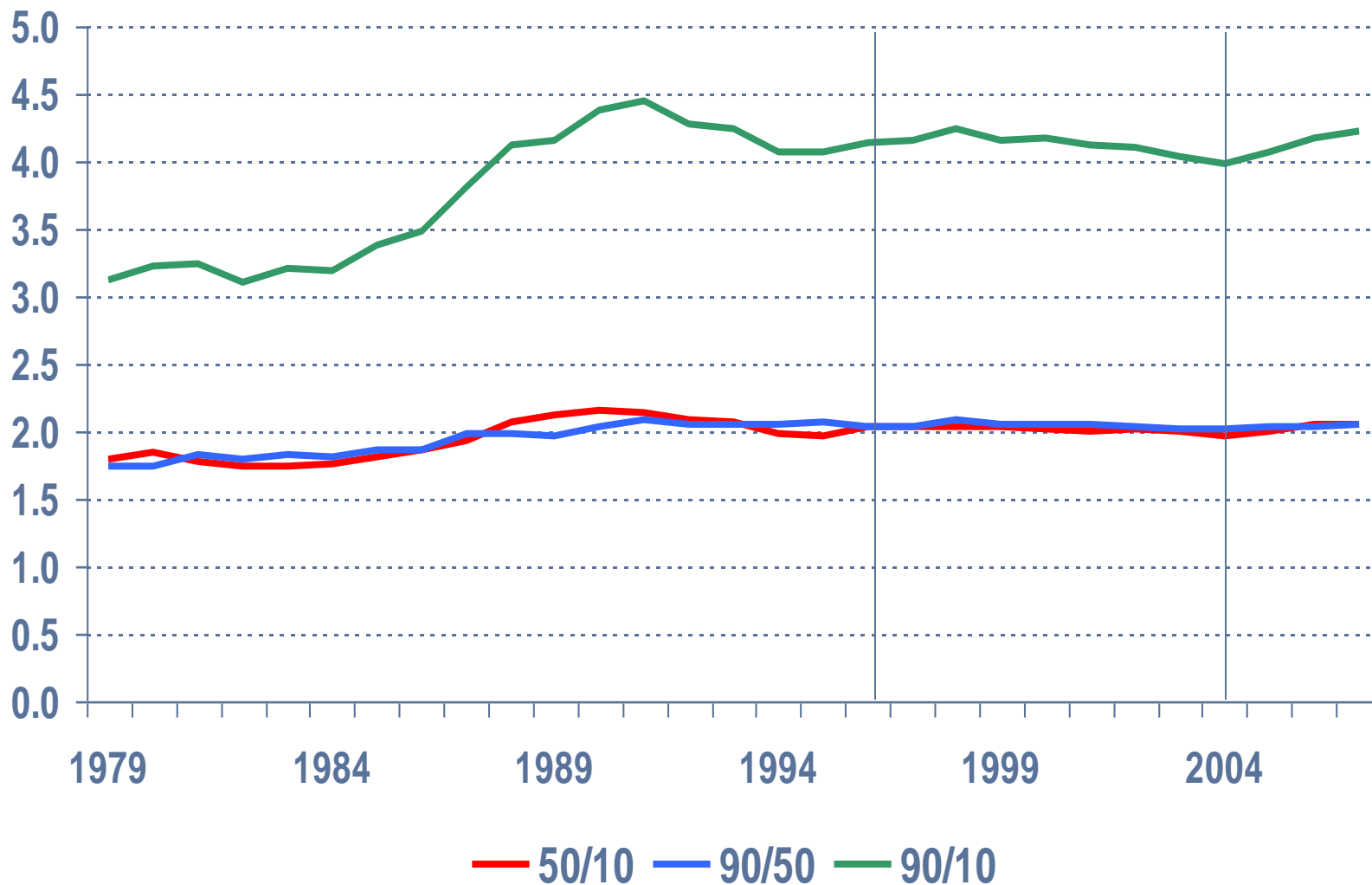
Inequality between whom?

- Maybe we're interested in gap between bottom and top, or bottom and middle, or middle and top?
- Simple ratios give you this information by comparing just two points of the distribution...

Simple inequality measures: calculation



Inequality ratios since 1979



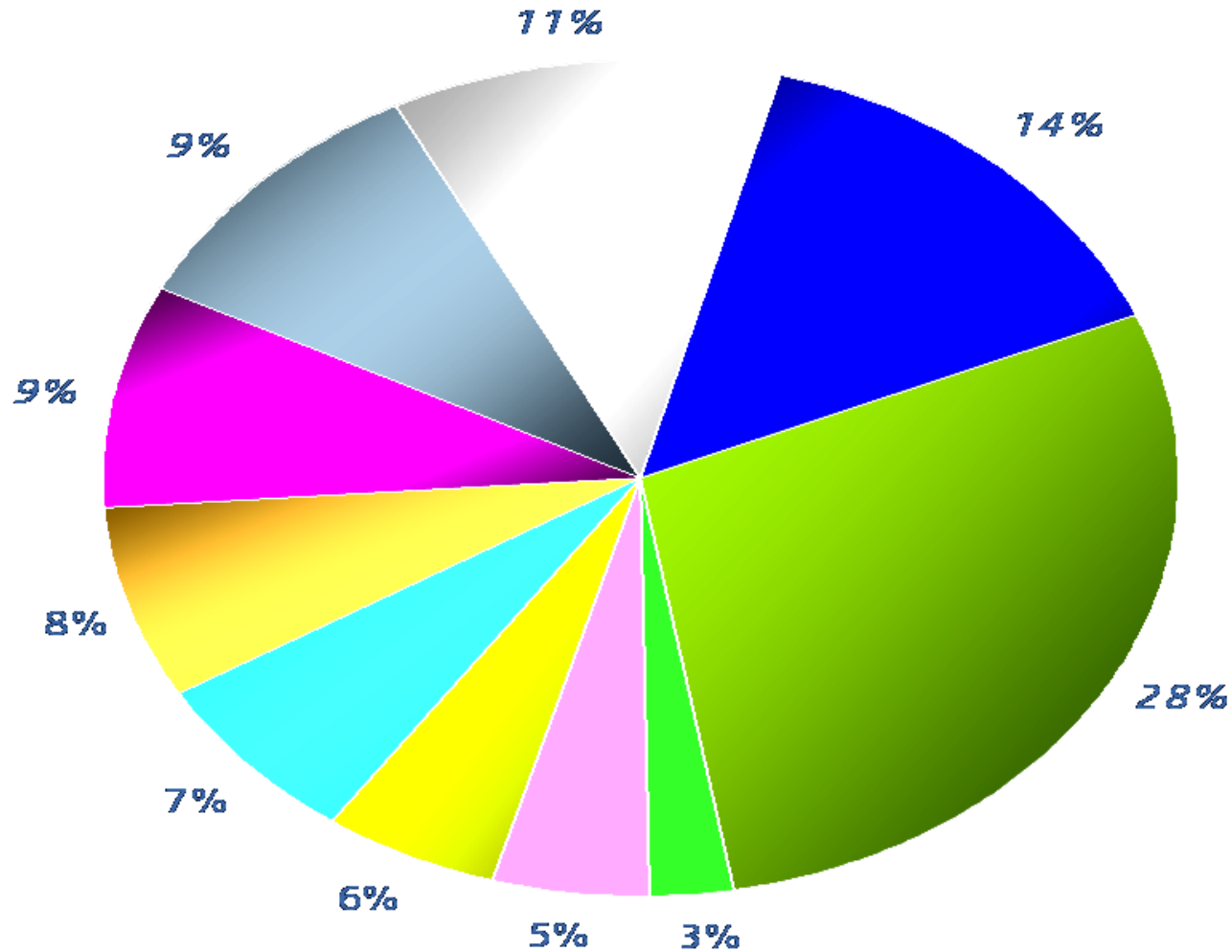
Source: HBAI data

Note: Only BHC incomes shown.

More complex inequality measures

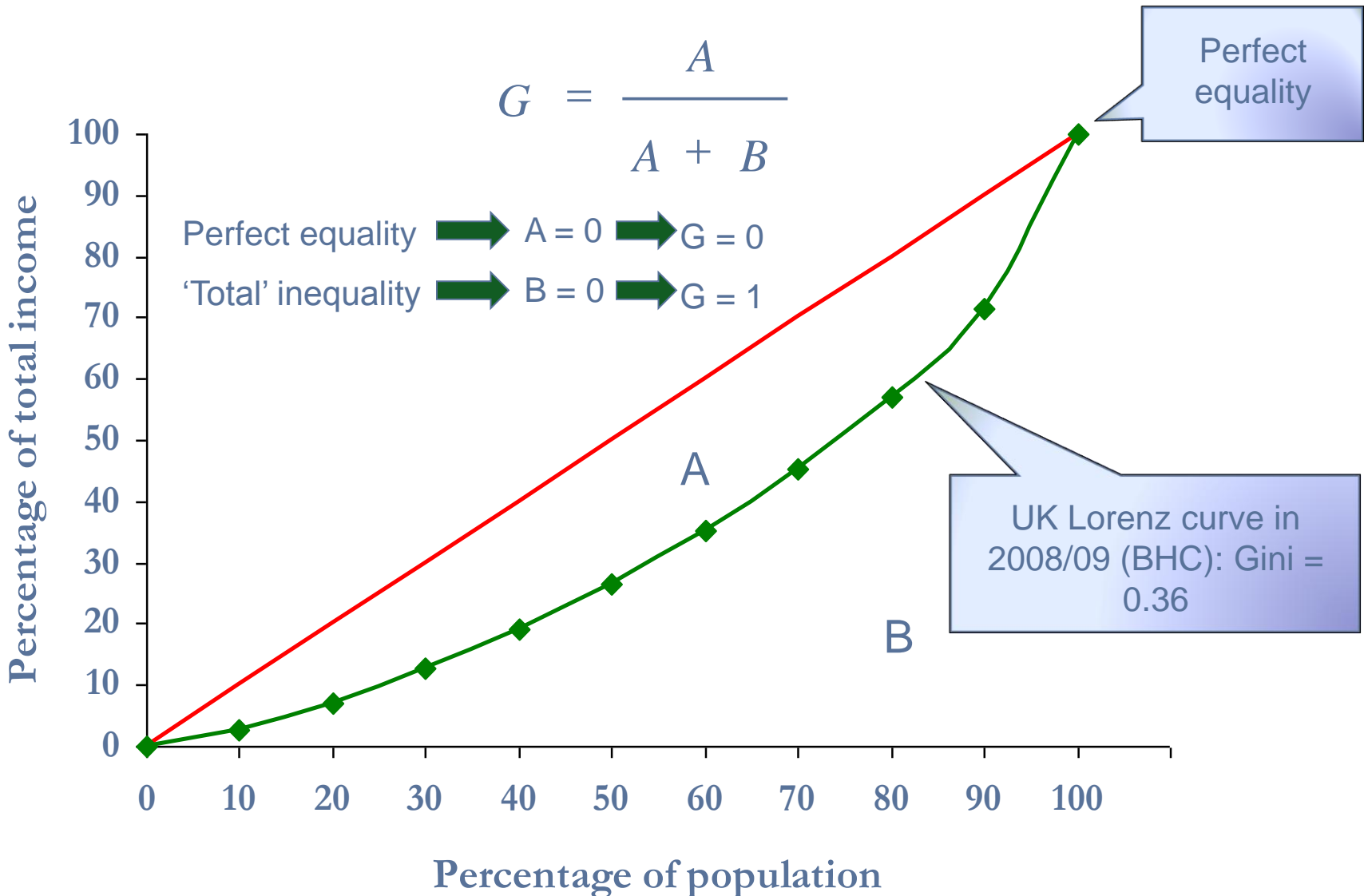
- Ratio measures great for detailed picture of small parts of income distribution
- But they also 'throw away' lots of information about rest of distribution
- We also want single statistic to tell us how unequal the distribution 'as a whole' is. Many possibilities...
 - Mean log deviation
 - Gini coefficient (most commonly cited)

UK income shares (BHC) by decile group: 2008/09



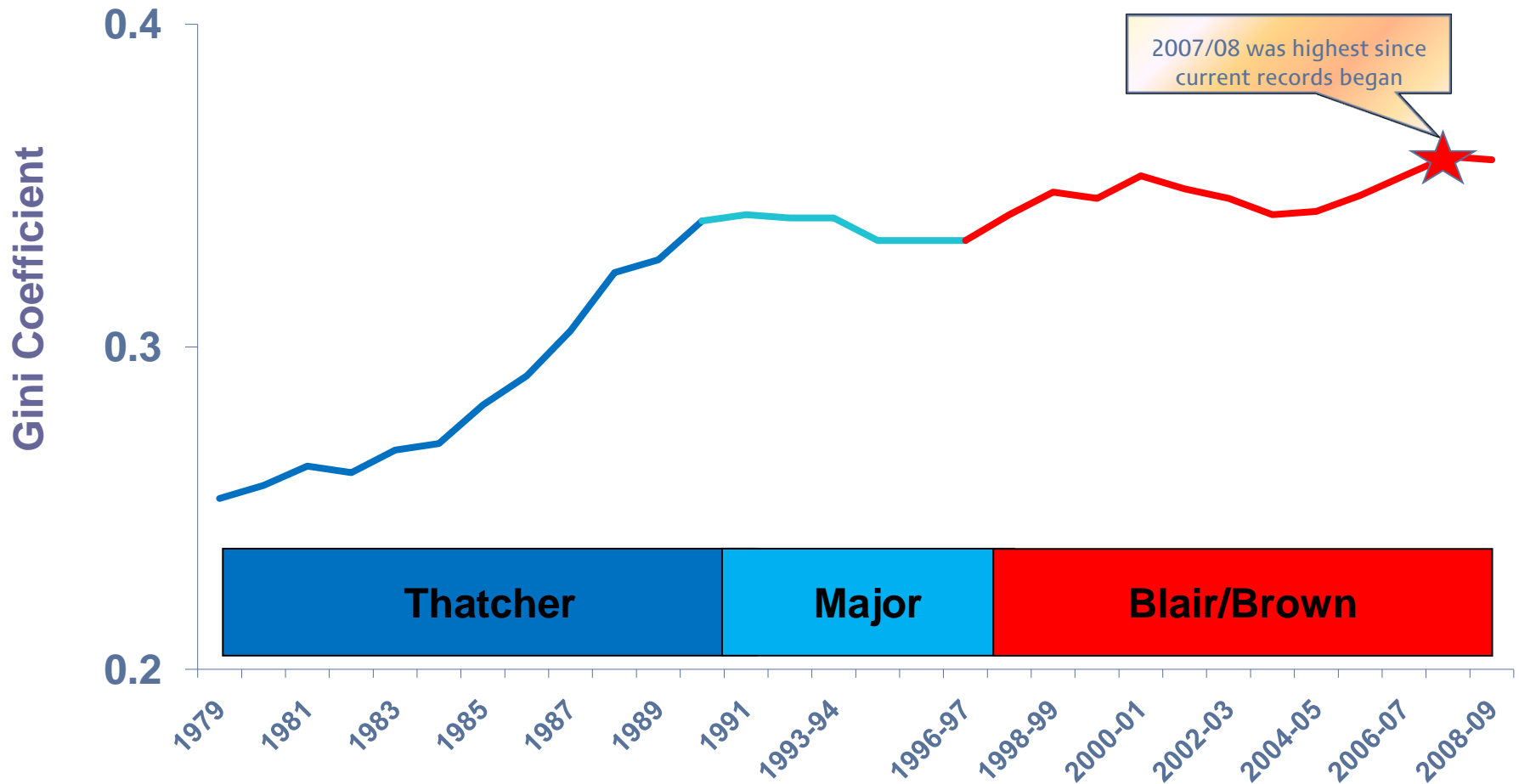
Source: HBAI data

The Gini coefficient: a 'summary' of income shares



Source of data: HBAI data

The Gini coefficient: 1979/80–2008/09 (Great Britain)

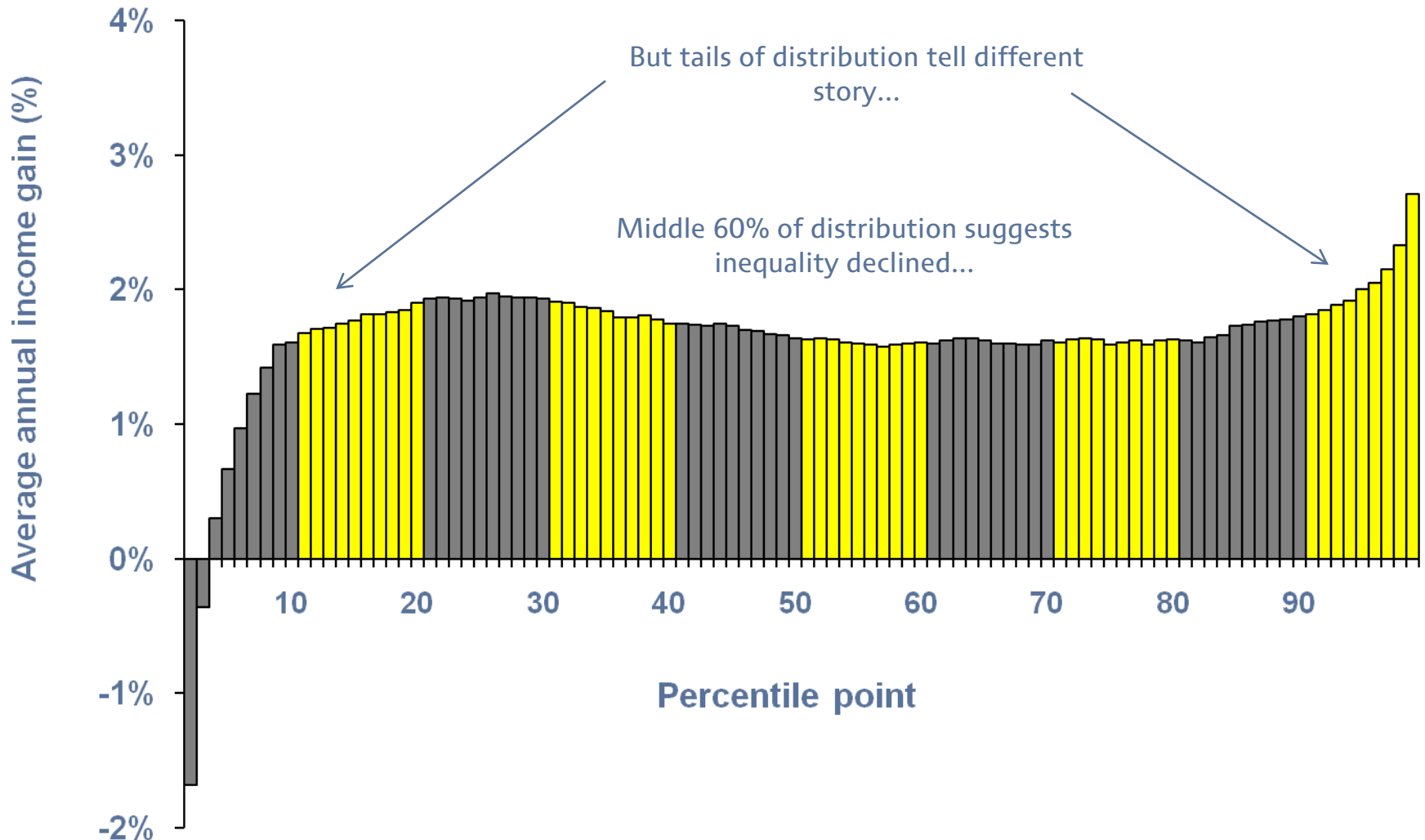


Source: HBAI data

Inequality under Labour

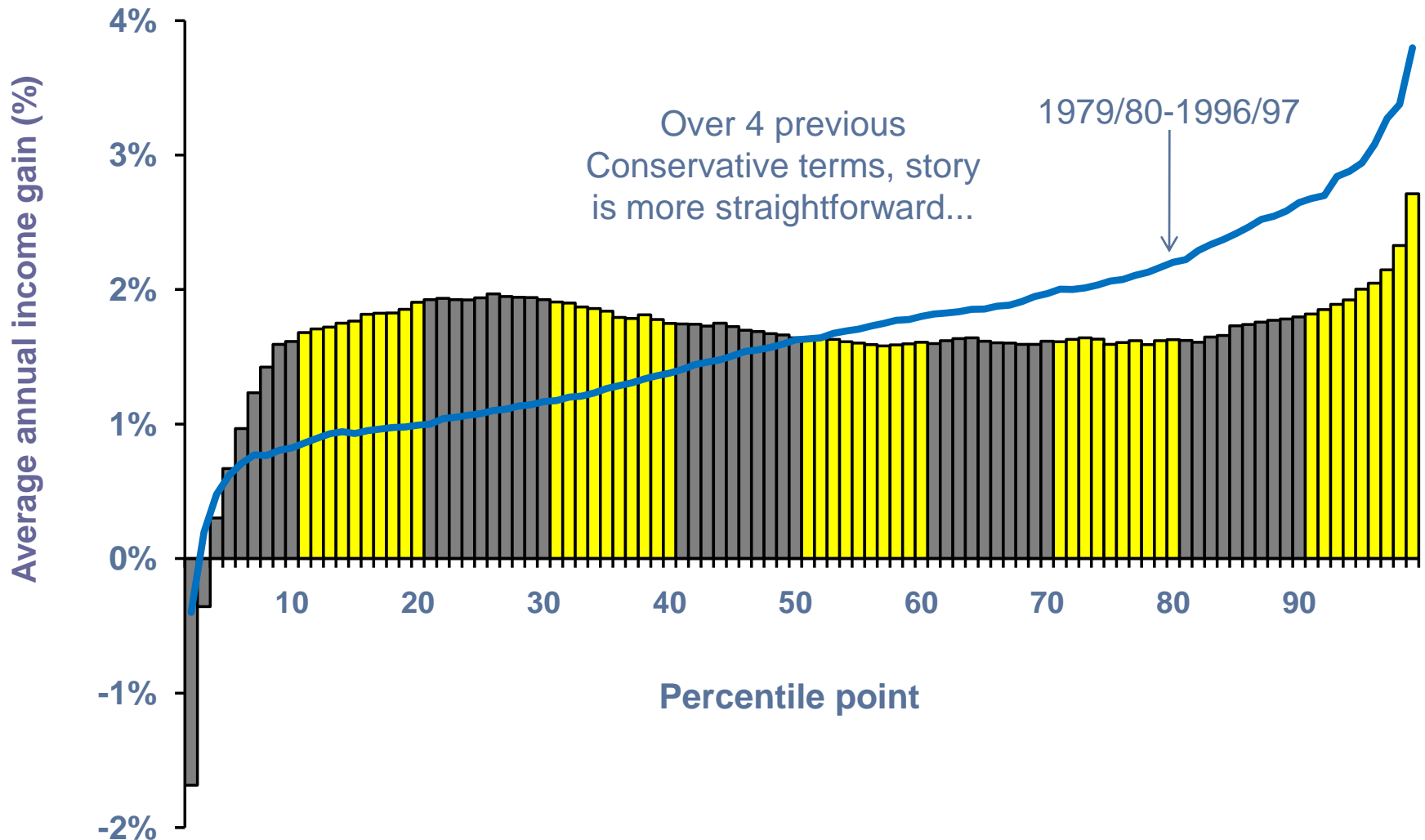
- So the Gini has risen under Labour, even though...
- 1) Labour's tax and benefit changes have been inequality-reducing.
 - Tax and benefit reforms since 1997 had roughly same effect on inequality as raising all benefits in line with GDP (Adam and Browne (2010)).
 - 2) Relative poverty has *fallen*
 - 'Net' increase in inequality driven by small groups at top and bottom of distribution...

Income changes by percentile group: 1996/97 – 2008/09 (Great Britain)



Source: HBAI data

Income changes by percentile group: 1996/97 – 2008/09 (Great Britain)



Source: HBAI data

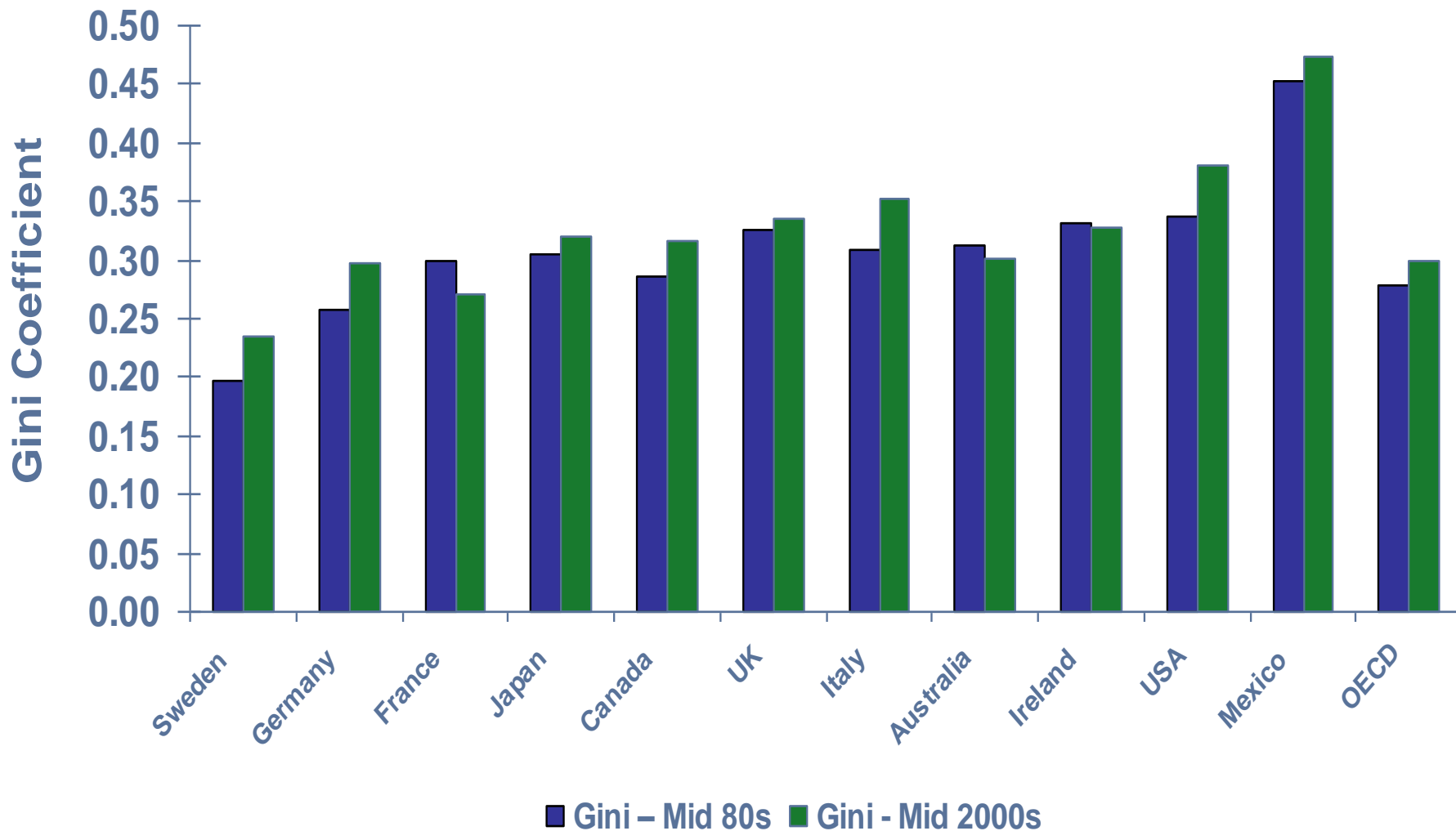
Income dynamics and re-ranking

- An inequality-reducing pattern of income growth is not equivalent to a 'pro-poor' pattern (and vice versa).
- That would require a rank preservation assumption: the poorest people remain the poorest and vice versa.
- Most good income data comes from repeated cross-sections (i.e. doesn't track the same people over time), so can't get at this.
- See Jenkins and Van Kerm (2008) for an exception. Comparing early nineties with a decade later, they conclude that income growth has not unambiguously become more pro-poor, but specific groups (children, pensioners) have improved their relative position.

Why has inequality been rising in last 30 years?

- Note the UK is not alone...
- Earnings are important (about 70% of income in UK)
- Possible drivers of higher earnings inequality:
 - 1) Increasing returns to education (Machin (2001), Acemoglu (2002)). Wage gap between occupations has been rising in UK and this is important for explaining rising inequality (Brewer, Muriel and Wren-Lewis, 2010).
 - 2) Globalisation (more competition means less rent for unions to bargain over)
 - 3) Weaker trade unions
 - 4) Decline of collective bargaining – wage policies and wage councils removed

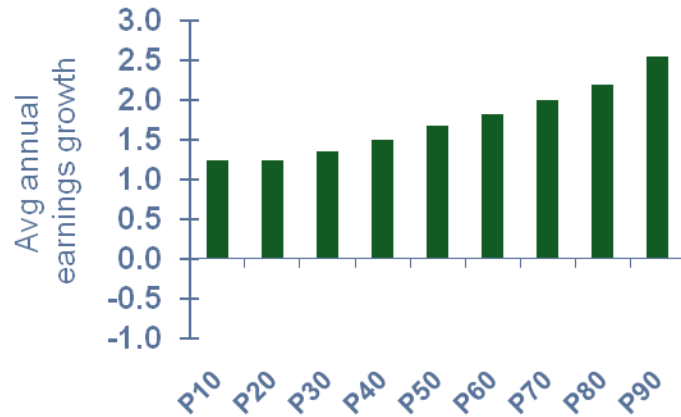
The Gini: international comparisons



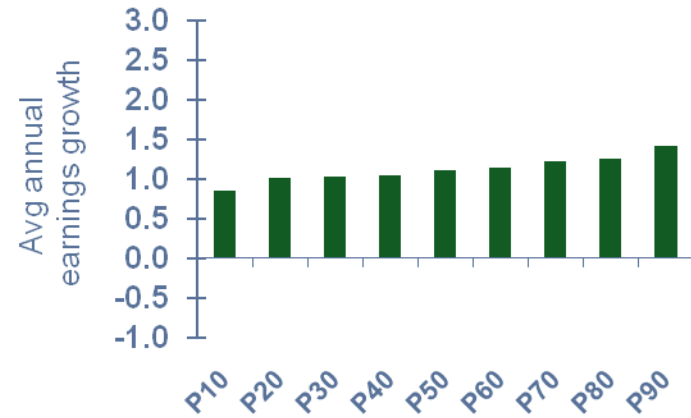
Source: OECD. Figures not directly comparable with those on other slides. Mid 80s Germany refers to West Germany.

Real earnings growth

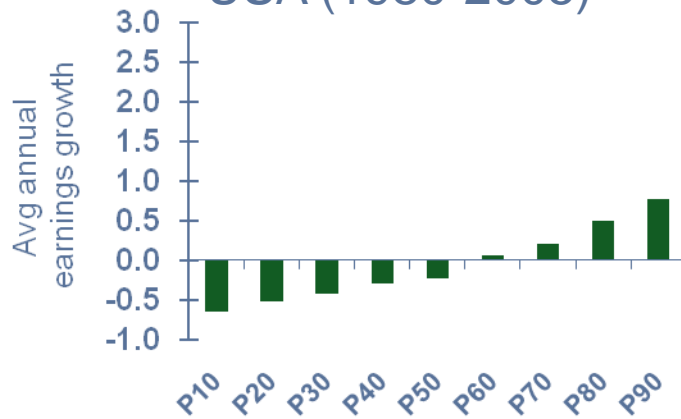
UK (1980-2005)



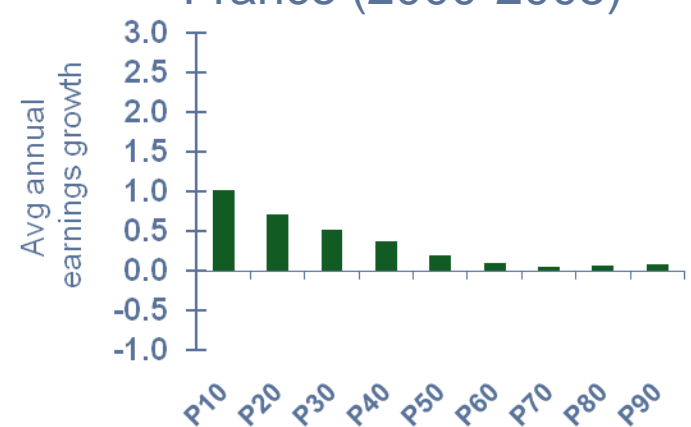
Sweden (1980-2005)



USA (1980-2005)



France (2000-2005)



Source: OECD

Notes: Full-time male workers only

Why has inequality been rising in last 30 years? (2)

➤ Demographics

- More inequality in employment status across households (Gregg and Wadsworth, 2008).
- More pensioners (but quantitatively not that important for explaining higher inequality in UK – Brewer, Muriel and Wren-Lewis, 2010)

➤ Regressive tax and benefit reforms?

- Most gainers from 1980s income tax cuts were on high incomes.
- Precise impact of changes depends on counter-factual (what would 'no reform' have meant?)...
- Conservative tax and benefit reforms had roughly same effect on inequality as if all benefits had been raised annually in line with prices (Adam and Browne(2010)).

Why has inequality been rising in last 30 years? (3)

- There is much we do not understand!
- The 'unexplained' component of inequality has been rising in the UK (Brewer, Muriel, Wren-Lewis, 2010).
- Has some factor which we can not observe been becoming more unevenly distributed? Job/career preferences?
- Maybe preference heterogeneity translates into wage inequalities more when societies become more educated – education might increase the extent to which career preferences actually determine careers.

How much can government affect inequality?

- Tax and benefit system clearly makes a difference (and quickly...).
- But can be very costly to just rely on fiscal redistribution.
- Countries with low inequality (e.g. Scandinavia) tend to have low '*pre tax and benefit*' inequality.
- So how much can govt affect distribution of *private* incomes? Depends what drives it (e.g. educational outcomes vs technological change vs trade union influence).
- Policies that target private incomes tend to have less immediate impacts than tax and benefit changes.

A summary of recent history (!)

- Pattern of income growth in 1980s was unambiguously inequality-increasing.
- Inequality and relative poverty grew rapidly, then stabilised in early 1990s.
- During Labour's first 2 terms relative poverty experienced secular decline. Particular gainers: pensioners, families with children.
- Relative poverty has since ticked up. Poverty rate for working-age non-parents now higher than in 1996/97.
- Inequality remained stubbornly high throughout 1990s and 2000s, and is (essentially) at highest since current series began in 1961/62.

References (1)

- Acemoglu, “Technical Change, Inequality and the Labor Market”, *Journal of Economic Literature* 40 (1), 2002.
- Adam and Browne, “Redistribution, work incentives and thirty years of UK tax and benefit reform”, IFS Working Paper 10/24, 2010.
- Blundell, Pistaferri and Preston, “Consumption Inequality and Partial Insurance”, *American Economic Review* 98(5), pp. 1887-1921, 2008.
- Blundell and Preston, “Consumption inequality and income uncertainty“, *Quarterly Journal of Economics* 113, pp. 603-640, 1998.
- Brewer, Browne, Joyce and Sibieta, “Child poverty in the UK since 1998-99: lessons from the past decade ”, IFS Working Paper 10/23, 2010, <http://www.ifs.org.uk/publications/5303>
- Brewer, Muriel and Wren-Lewis, “Accounting for changes in inequality since 1968: decomposition analyses for Great Britain”, report for the National Equality Panel, 2009, http://www.equalities.gov.uk/national_equality_panel/publications/research_reports.aspx
- Gregg and Wadsworth, “Two Sides to Every Story: Measuring Polarization and Inequality in the Distribution of Work”, *Journal of the Royal Statistical Society Series A*, 2008.

References (2)

- Jenkins and Van Kerm, “Has Income Growth in Britain become more pro-poor?”, Conference Paper, 2008, <http://www.iariw.org/papers/2008/vankerm.pdf>
- Joyce, Muriel, Phillips and Sibieta, “Poverty and Inequality in the UK: 2010”, IFS Commentary 116, 2010, <http://www.ifs.org.uk/publications/4877>
- Machin, “The Changing Nature of Labour Demand in the New Economy and Skill-Biased Technology Change”, Oxford Bulletin of Economics and Statistics 63 (S1), 2001.
- Muriel and Sibieta, “Living Standards During Previous Recessions”, IFS Briefing Note 85, 2009, <http://www.ifs.org.uk/publications/4525>.