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Five years of recovery in living standards: middle incomes rise by more than for higher or lower income households

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Five years of recovery in living standards: middle incomes rise by more than for higher or lower income households

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Introduction

In the aftermath of the Great Recession, average (median) household incomes fell by 3.5% from 2009–10 to 2011–12 after adjusting for inflation. Since then, incomes have gradually recovered. Today (Thursday 22nd March 2018) the Department for Work and Pensions (DWP) has published the latest official statistics on household incomes covering the financial year 2016–17.

This short briefing note summarises what the newly released data tell us about how living standards have changed after five years of recovery from the Great Recession, how this differs between different groups, and the implications for inequality and poverty.

The new data reveals growth in median income of 1.9% in 2016–17 after adjusting for inflation. This brings median income growth across the first five years of the recovery in household living standards to 8.1%. However, income growth during the recovery has not been even across the income distribution. High and low income households have seen incomes grow only about half as fast as those around the middle. This has led to little change in income inequality over the period. Since 2011–12, absolute poverty has declined as the incomes of poorer households have continued to (slowly) rise, though there have been very slight increases in relative poverty measured after housing costs are deducted (AHC).

For precise definitions of how incomes are measured, and what different measures of poverty are, please see the short note on methodology at the end of this briefing note.

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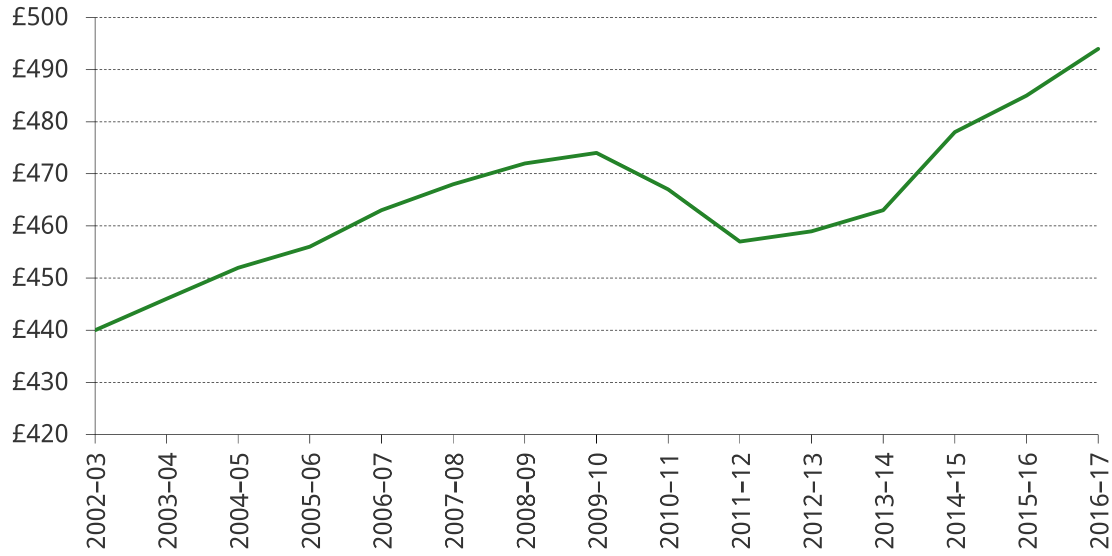
[1] This analysis is based on the Department for Work and Pensions (2018) release "Households below Average Income: 1994/95 to 2016/17", and on IFS analysis of the Family Resources Survey and Family Expenditure Survey. We would like to thank the Joseph Rowntree Foundation for continued support in our research into poverty and inequality in the UK. Any errors and all views expressed are those of the authors.

Median household income grew by 8.1% between 2011–12 and 2016–17, leaving it 5.6% above its 2007–08 level

Figure 1. Median net household income (before housing costs) since 2002–03, (UK)



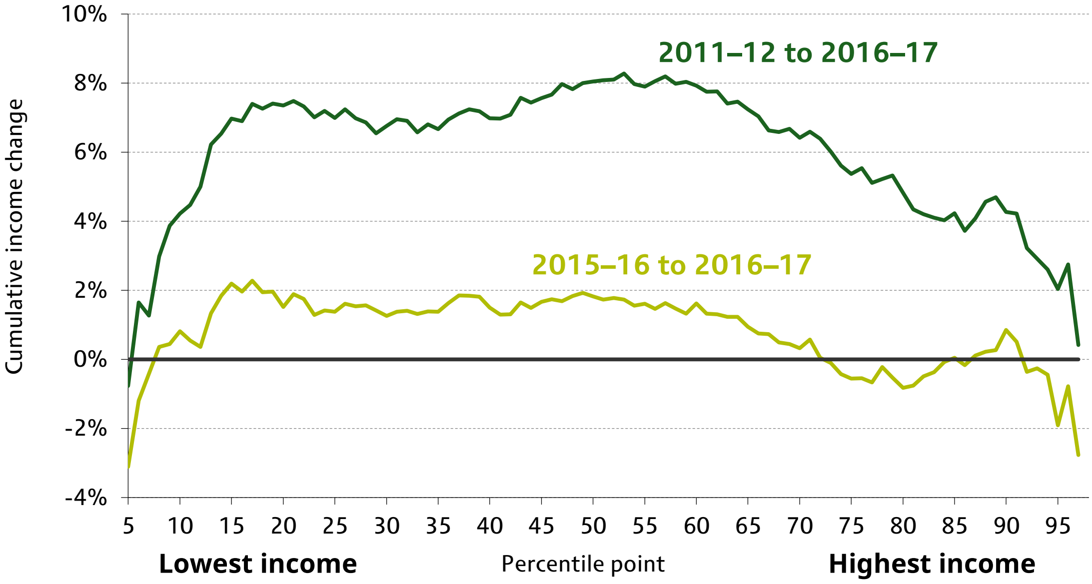
Note: Incomes have been measured net of taxes and benefits but before housing costs have been deducted and are expressed in 2016–17 prices. All incomes have been equivalised using the modified OECD equivalence scale and are expressed in terms of equivalent amounts for a childless couple. Source: Department for Work and Pensions (2018) "Households below average income: 1994/95 to 2016/17".

With median income growth of 1.9%, 2016–17 was the fifth year of recovery in household incomes since their post-recession low in 2011–12. This represents an average annual growth rate between 2011–12 and 2016–17 of 1.6%: faster than the 1.2% average recorded in the five years before the recession, though still slower than the 2.0% average seen over four decades preceding the Great Recession.

While median income grew in 2016–17, mean income fell. However, the Department for Work and Pensions noted that this fall was due to large falls in dividend income that HM Revenue and Customs have projected between 2015–16 and 2016–17. This was in part driven by individuals shifting their dividend income in response to increases in dividend taxation in April 2016. As a result, this shifting boosts incomes in 2015–16, and reduces them in 2016–17. This means we should be wary about drawing firm conclusions regarding changes in mean incomes in the last few years.

Pattern of income growth in recovery: better growth for the middle than for low or high income households

Figure 2. Real income growth by percentile point, 2011–12 to 2016–17 (UK)



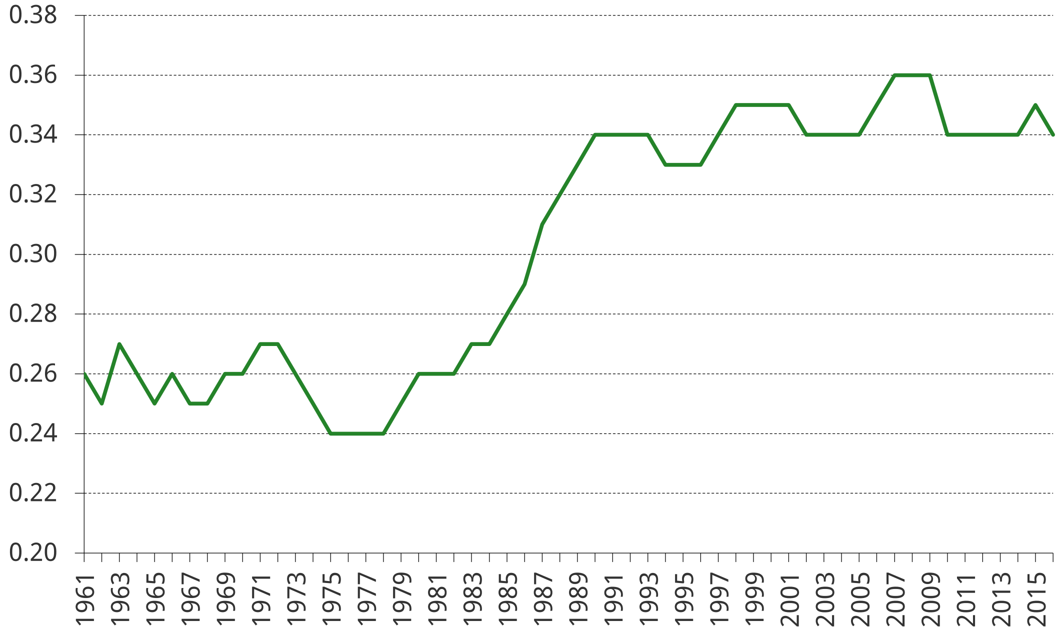
Note: Incomes have been measured net of taxes and benefits but before housing costs have been deducted and have been equivalised using the modified OECD equivalence scale. Percentiles 1–4 and 98-99 are excluded because of large statistical uncertainty.
Source: Department for Work and Pensions (2018) and IFS calculations using the Family Resources Survey.

Income growth in 2016–17 was stronger for those on middle incomes than for high income households or those on the lowest incomes. This continues the pattern seen during the recovery. Between 2011–12 and 2016–17 incomes between the 15th and 65th percentiles grew by around 6½ to 8%, but growth was lower in the top third of the distribution, as well as at the very bottom. The net effect is very little change in inequality between high and low income people: the ratio between incomes at the 90th and 10th percentiles in 2016–17 remains at 3.9.

Disentangling precisely all the reasons for this pattern will require detailed analysis of the underlying data, which we will be conducting and publishing in the summer. However, it is likely that three trends will have been driving these changes. First, over this period lower earning employees (many of whom are in middle income households) have seen much faster earnings growth than higher earning ones. Second, there have been big increases in the proportion of people in paid work (increasing by 4.2 percentage points). This tends to benefit low-and-middle income households more than high income households, although those who remain at the very bottom of the distribution are disproportionately likely to be out of work. Third, slower growth seen at the bottom of the income distribution is likely to be partly be caused by reductions in average working age benefit incomes, which fell by 8.5% between 2011–12 and 2015–16 according to previous IFS analysis.

Income inequality (measured by the Gini coefficient) flat during the recovery and at similar level to early 1990s

Figure 3. The Gini coefficient of income inequality, 1961 to 2016–17



Note: Incomes have been measured net of taxes and benefits but before housing costs have been deducted and have been equivalised using the modified OECD equivalence scale. Years refer to calendar years up to and including 1992 and to financial years from 1993–94 onwards. Figures relate to UK households from 2002–03 onwards and to GB households for earlier years.
Source: Department for Work and Pensions (2018) and IFS calculations using the Family Resources Survey and the Family Expenditure Survey.

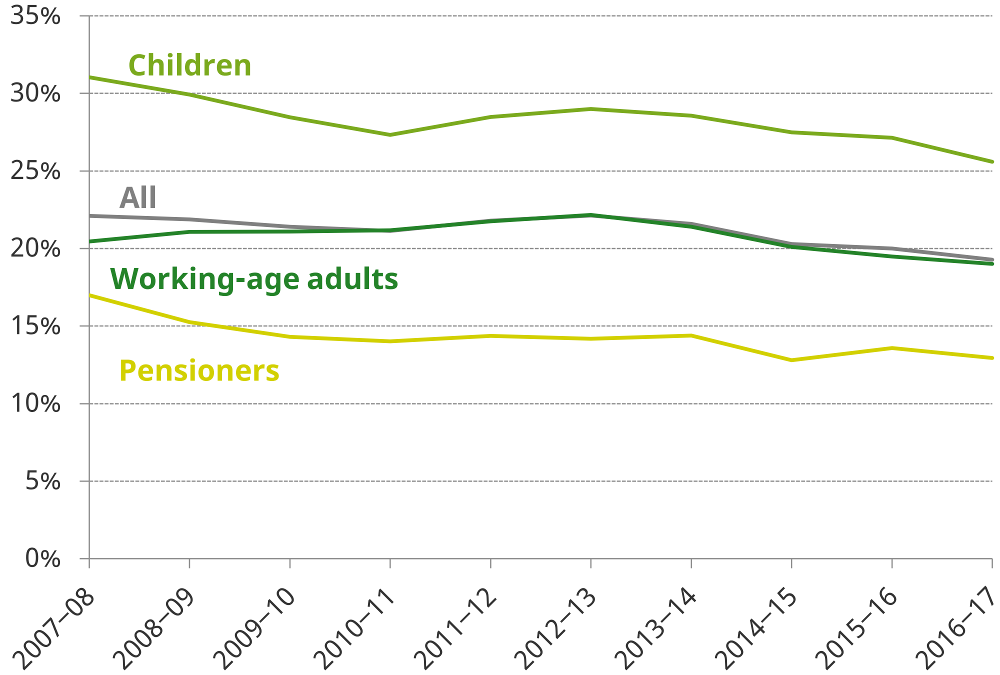
The Gini coefficient is a summary measure of income inequality across the whole income distribution. The latest data show that, at 0.34, this measure of inequality in 2016–17 was at the same level as at the start of the recovery in 2011–12, lower than it was just before the recession (it was 0.36 in 2007–08) and at the same level as seen in the early 1990s.

Previous IFS research[2] has shown that, compared to the early 1990s, income inequality is lower across most of the income distribution, but income inequality at the very top (for example measured by the share of income going to the top 1%) has increased markedly compared to the early 1990s. However, income inequality as measured by the Gini coefficient is much higher than it was in the 1960s and 1970s, as the substantial increases in inequality in the 1980s have not been reversed.

[2] See Belfield et al (2017) "Two Decades of Income Inequality in Britain: the roles of wages, household earnings and redistribution", *Economica,* 84(334), pp. 157-179

Absolute income poverty declined between 2011–12 and 2016–17, albeit at a relatively slow rate

Figure 4. Absolute poverty rate (AHC) by demographic group



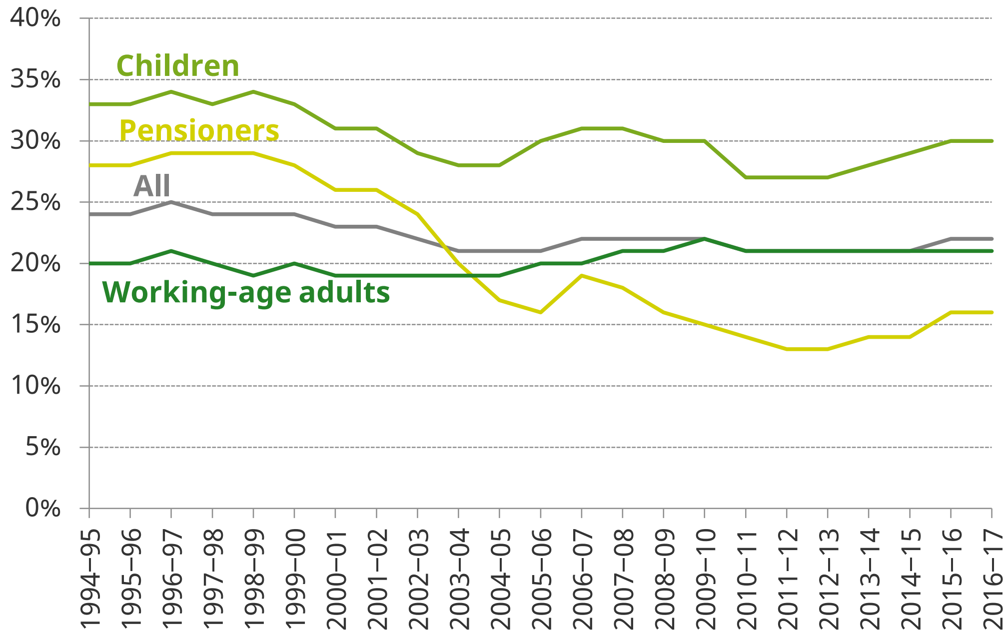
Note: Incomes have been measured net of taxes and benefits and after housing costs have been deducted and have been equivalised using the modified OECD equivalence scale. The absolute poverty line is defined as 60% of median AHC income in 2010–11.
Source: Department for Work and Pensions (2018)

The overall rate of absolute income poverty (measured using incomes after housing costs are deducted) was 19% in 2016–17. This is a decline of around 3 percentage points since 2011–12, when the absolute poverty rate was 22%. This was a result of small but sustained year-on-year declines (since 2012–13), including in 2016–17, when absolute poverty fell by 1 percentage point.

The declines in absolute poverty occurred among pensioners, children and working-age adults, although they have been more muted for pensioners. Indeed, among pensioners, the past 5 years have been relatively disappointing in terms of poverty reduction with poverty falling by just 1ppt between 2011–12 and 2016–17, in comparison to a remarkable 12ppt fall that occurred between 2002–03 and 2007–08 and the fall of 3ppt that occurred between 2007–08 and 2011–12. Among children, by contrast, the 3ppt fall over the past 5 years surpassed the 1ppt fall in the 5 years prior to recession and equalled the reduction that occurred between 2007–08 and 2011–12.

Rises in relative poverty – particularly for children and pensioners – show low income households falling behind middle income households

Figure 5. Relative poverty rate (AHC) by demographic group



Note: Incomes have been measured net of taxes and benefits and after housing costs have been deducted and have been equivalised using the modified OECD equivalence scale. The relative poverty line is defined as 60% of median AHC income in each year. Figures relate to UK households from 2002–03 onwards and to GB households for earlier years.
Source: Department for Work and Pensions (2018)

While the living standards of low income people have been rising on average since 2011–12 (as shown by falling *absolute* poverty rates), their incomes have risen slightly slower than for middle income households (as shown by Figure 1). This has led to very small increases in *relative* poverty. In 2016–17 the overall relative poverty rate was 22%, just above the 21% seen in 2011–12. In a longer-run context, relative poverty has been remarkably stable at around 21% or 22% every year since 2002–03, which is slightly lower than the rates seen in the mid- to late-1990s.

Changes in recent years have been more marked for some groups. Between 2011–12 and 2016–17, relative poverty rose by 3ppt among pensioners and by 3ppt among children. Despite these rises, relative poverty among these groups remains below the levels just before the recession, and – particularly for pensioners – is substantially lower than in the mid-to-late 1990s.

Weak expected earnings growth and cuts to working-age benefits are likely to slow living standards growth in coming years, especially for low-income households

Figure 6. OBR forecasts for growth in earnings, the national living wage and the employment rate between 2016–17 and 2022–23

Note: Average earnings and National Living Wage (NLW) deflated by the Consumer Price Index (CPI). Real average earnings and real NLW growth are proportional, employment growth is percentage point change in the rate. Employment rate refers to all aged 16 or over.
Source: Office for Budget Responsibility (2018) *Economic and Fiscal Outlook*, March 2018.

The Office for Budget Responsibility's (OBR) latest macroeconomic forecast points to slow growth in average earnings between 2016–17 and 2022–23, but a substantial increase in the National Living Wage as it rises to reach 60% of median hourly earnings by 2020–21. The OBR expect the employment rate to slightly decline as the population ages. At the same time the government is planning to implement a series of cuts to working-age benefits, though the state pension is forecast to increase by around 3% in real terms.

If they turn out to be correct, what would these forecasts and policy plans imply for household income growth in coming years? First, weak earnings growth and no employment growth would imply weak median income growth. Second, incomes may grow more slowly still at the bottom, due to working-age benefit cuts. Although the National Living Wage will boost low paid workers, many of those that gain live in middle (rather than low) income households.[3] Third, as many of the benefit cuts fall on households with children, relative child poverty may increase in the coming years.[4]

[3] Cribb et al. (2017) Minimum wages in the next parliament, IFS Briefing Note BN205
[4] Hood and Waters (2017) Living standards, poverty and inequality: 2016–17 to 2021–22.

Appendix: Measuring incomes and poverty in the UK

The “Households Below Average Income” Statistics that the government have released, and that are used in this briefing note, are based on a survey called the Family Resources Survey of around 19,000 households per year. Using these data, Department for Work and Pensions measure household incomes in the following way:

- Incomes are measured after all direct taxes have been paid and state benefits have been received;
- Incomes are measured at the *household* level, meaning the incomes of all household members are added together;
- Incomes are adjusted for the household size and composition (and expressed as the equivalent income for a childless couple);
- Incomes are adjusted for inflation using a variant of the Consumer Prices Index and are expressed in 2016–17 prices.

Using these data, it is possible to measure how many people are in income poverty. There are two main measures of income poverty measured by the government:

- Absolute income poverty: This measures how many people have household incomes below a level that is fixed in real terms (i.e. the level increases in line with inflation over time).
- Relative income poverty: This measures how many people have an income below 60% of contemporaneous median income. Therefore, as median income has grown during the recovery, the amount of income needed to move out of relative poverty has risen too.

In this briefing note, we exclusively look at measures of poverty that use incomes measured after housing costs are deducted (“AHC”). The government also releases poverty statistics using incomes measured before housing costs are deducted (“BHC”). We use AHC measures for low income people, measuring poverty AHC is likely to provides a better reflection of their material living standards. This is discussed in more detail on page 77 of Cribb et al (2017)[5].

Table 1 shows the levels of weekly net household income after housing costs that different sized households require to avoid being classified as in absolute or relative poverty. These threshold income levels vary across household types because income is adjusted to account for household size and composition.

[5] Cribb, Hood, Joyce and Norris Keiller (2017) Living Standards, Poverty and Inequality in the UK: 2017, IFS Report R129

Table 1. Cash values of poverty lines for example families in 2016–17 (£ per week)

	Childless couple	Single adult	Lone parent, one child	Couple, one child	Couple, two children
AHC					
Absolute poverty line	240	139	187	288	336
Relative poverty line	255	148	199	306	357

Note: Incomes have been measured net of taxes and benefits and after housing costs have been deducted. The children in these example families are assumed to be aged 13 or younger. For families with older children, the poverty lines are slightly higher. The absolute poverty line is defined as 60% of median income in 2010–11 and the relative poverty line as 60% of median income in 2016–17.

Source: Department for Work and Pensions (2018)