Household incomes: overall trends and the impact of tax and benefit changes

Robert Joyce
Outline

1. Chancellor and the Leader of the Opposition made contrasting claims about living standards yesterday
   – Will assess these and put them in wider context

2. Will focus on specific role of tax and benefit changes and how they have affected incomes across the distribution
Average household incomes in recent years

• Main source for household income data is the HBAI series
  – Based on annual survey of about 20,000 households
  – Measures household income after taxes and benefits

• Latest data cover 2012-13, but IFS researchers recently projected real median HBAI income up to 2014-15
  – This suggested that, in 2014-15, median income was back to around its 2010-11 level (and growing)
  – Any significant growth in 2015-16 would take it above 2010-11 level
What was the Chancellor referring to?

• Real Household Disposable Income (RHDI), from National Accounts
  – Essentially tries to capture the part of national income that flows to household sector (rather than companies and the public sector)

• Chancellor referred to RHDI per head and per household (effectively measures of *mean* income):
  – “On that measure [RHDI per head] I can confirm, on the latest OBR data today, living standards will be higher in 2015 than in 2010.”
  – “The facts show households on average will be around £900 better off in 2015 than they were in 2010”

• Very likely these measures will be higher in 2015 than 2010
  – OBR thinks RHDI per head in 2014 was around its 2010 level – similar impression to IFS projections of median HBAI income
  – OBR expects RHDI per head to grow by 3.1% in 2015
  – £900 is forecast rise in RHDI per household between 2010 and 2015
Measures of average living standards (2007-08 = 100)

Notes: RHDI figures are presented for financial (not calendar) years, and are expressed per person (rather than per person aged 16+). In both cases this is consistent with HBAI, but different to the OBR figures underlying the Chancellor's Budget speech. This makes a negligible difference. HBAI figures from Cribb, Hood and Joyce (2015), at http://www.ifs.org.uk/publications/7615
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Recovery has been historically slow
Comparison of periods of falling real median HBAI income

Note: The ‘1.8%’ figure for growth in the most recent recovery is based on an IFS projection up to 2014-15
Average changes mask differences across groups

- Advantage of HBAI data is that they allow us to look at variation across population

- Chancellor: “Compared to five years ago: inequality is lower”

- Income inequality fell significantly between 2007-08 and 2010-11

- IFS projections for 2014-15 suggest inequality lower than 2009-10

- But very little change in inequality since 2010-11

- Big variation in income trends by age
Real median income by age group (2007-08=100)

Note: Figures for 2013-14 and 2014-15 are IFS projections
Real median income by age group (2007-08=100)

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Ed Miliband: “People are £1,600 a year worse off”

- This is change in median pre-tax annual pay for employees between April 2010 and April 2014, adjusted for CPI inflation
  - Source: Annual Survey of Hours and Earnings (ASHE)
- Relevant number which highlights that pay levels have fallen a lot

- Why so different to Chancellor’s numbers? Reasons include:
  - Ignores taxes and benefits: sizeable chunk of the £1,600 would have been paid in income tax and NICs anyway; doesn’t pick up impacts of tax and benefit reforms
  - Doesn’t account for rising employment rate
  - Measures one source of income (albeit the largest) for subset of population, e.g. says nothing about most pensioners’ incomes
  - Goes up to April 2014: real earnings growing in 2015
Household incomes: summary

• Reasonable to think real average incomes across whole population will surpass pre-crisis and 2010 levels in 2015. But:
  – This is a low bar: we’ve had very slow recovery
  – Fixation on 2010 is economically arbitrary: big falls occurred between 2009 and 2011; election happened to fall in middle
• Labour’s number on the fall in real pay among employees between 2010 and 2014 also relevant and interesting
• Some of the reasons why Labour’s numbers look less positive than the Chancellor’s are interesting in themselves
  – Real pay has fallen substantially, but:
  – Pensioner incomes have done much better than average
  – Proportion of people in work has risen
  – Things likely to get better in 2015
TAX AND BENEFIT CHANGES
Tax and benefit changes to April 2015

- Only measures announced yesterday for this April are cuts to alcohol duties
  - Total cost of £185m in 2015-16
  - 2% (2.9%) nominal (real) cut to beer and spirit duties
  - Nominal freeze (0.9% real cut) to duties on wine
Impact of tax and benefit reforms between April 2010 and April 2015 (excluding universal credit)

Change in annual net income

- £3,500
- £3,000
- £2,500
- £2,000
- £1,500
- £1,000
- £500
- £0

Poorest 2 3 4 5 6 7 8 9 Richest All

Income Decile Group

- Policies announced before the budget, £ per year (left axis)
- Policies announced at the budget, £ per year (left axis)
- Total, £ per year (right axis)

Assumes full take-up of means-tested benefits and tax credits.
Impact of tax and benefit reforms between April 2010 and April 2015 (excluding universal credit)

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- Distributional impact of all measures implemented by coalition:
  - Biggest losers are bottom half of income distribution (working-age social security cuts) and top decile (tax rises)
  - Treasury analysis suggests smaller losses / bigger gains, particularly at bottom: they model fewer measures, and try to account for non take-up of benefits (but probably overstate its extent)

- Looking at whole fiscal consolidation period, top decile hit considerably harder
  - Due to tax rises implemented by Labour in April 2010
Impact of tax and benefit reforms up to April 2015 (excluding universal credit)

Assumes full take-up of means-tested benefits and tax credits.

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Next parliament: other changes

• Income tax personal allowance to continue to increase faster than inflation, to £10,800 in 2016–17 and £11,000 in 2017–18
  – Basic rate taxpayers gain £48 a year in 2017–18
  – Higher rate taxpayers with income below £121,520 gain £72
  – Costs about £1.5 billion in 2017–18

• Total cost of changes to personal allowance and higher rate threshold between 2010–11 and 2017–18 will be about £10bn
  – Basic rate taxpayers will be £597 a year better off in 2017–18 as a result of these changes
  – Higher rate taxpayers will be £535 a year worse off

• Yet another real cut to fuel duties
  – Brings total annual cost of coalition’s real fuel duties cuts to £4bn
Fuel duty: to uprate or not to uprate? Act VI

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Personal tax and benefit measures: summary

• Some small new measures announced, largely repeating old themes
  – Rise in personal allowance, cuts in fuel and beer duties

• Taking all measures implemented by coalition, top and bottom of income distribution have lost most
  – In comparison, middle and upper-middle heavily favoured by these changes on average
  – Losses at top considerably bigger if whole consolidation is considered (adding in Labour’s tax rises in April 2010)