Living Standards and Inequality

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15th July 2014
Outline

• Living Standards
  – What happened to incomes in 2012–13 and the recent recession?
  – What was the effect of changes in housing costs?
  – How did changes vary geographically across the UK?

• Inequality
  – How did changes in income differ for rich and poor?
  – How does accounting for different housing cost trends affect the picture?
Where do we get our data?

• Family Resources Survey and predecessors from 1961 to 2012–13
  – currently around 20,000 households per year across the UK
  – subject to sampling error

• Figures with data before 2002–03 refer to Great Britain not UK
  – Northern Ireland not included in the FRS until 2002-03
What do we mean by “income”?

• HBAI income is measured net of direct taxes and benefits, and at the household level

• “Equivalised” to take account of household composition
  – all cash amounts are equivalents for a childless couple

• Adjusted for inflation
  – HBAI uses measure based on the Retail Prices Index (RPI)
Slow growth from the early 2000s...

Source: Figure 2.3 of *Living Standards, Poverty and Inequality: 2014*
... followed by large falls in 2010–11 and 2011–12...
... before average incomes stabilised in 2012–13
Trends in average incomes

• Average incomes stabilised in 2012–13
  – but significant falls in previous two years leave median income 5.8% below (and mean income 8.5% below) 2009–10 peak

• Falls in income driven by sharp drop in real earnings
  – 9.4% fall in pre-tax earned income of households between 2009–10 and 2012–13, despite higher employment

• Picture slightly less bleak when we use the ONS’ improved RPIJ measure of inflation
  – real median income 3.6% lower in 2012–13 than 2009–10 peak
  – 2012–13 median income no higher than 2005–06 using the RPIJ, compared to 2000–01 using the RPI
Housing costs

- Rent or mortgage interest repayments paid by each household
  - does not include mortgage capital payments or house prices

- Incomes measured before housing costs (BHC) treat housing like any other consumption good
  - average change in housing costs included in overall inflation

- Incomes measured after housing costs (AHC) deduct housing costs from income for each household
  - capture different trends in housing costs for different groups
Trends in housing costs

• Mean housing costs fell by 20% relative to other prices between 2007–08 and 2012–13
  – without lower housing costs, mean AHC income would have fallen by 13% rather than 10%

• Falls were not evenly spread across households
Real mean housing costs by tenure

Source: Figure 2.7 of *Living Standards, Poverty and Inequality: 2014*
Trends in housing costs

• Mean housing costs fell by 20% relative to other prices between 2007–08 and 2012–13
  – without lower housing costs, mean AHC income would have fallen by 13% rather than 10%

• 37% fall in real housing costs for those with mortgages
  – spent an average of 13% of income on housing costs in 2012–13, compared to 18% in 2007–08
  – but 5ppt fall in proportion of people living in a mortgaged home

• Only slight fall in real housing costs for renters
  – spent an average of 28% of income on housing costs in 2012–13, up from 26% in 2007–08
Changes in incomes across the UK

- Recession had differing impacts across the UK
Real changes in median income by region: 2007–08 to 2009–10 and 2010–11 to 2012–13

Source: Figure 2.10 of Living Standards, Poverty and Inequality: 2014
Changes in incomes across the UK

• Recession had differing impacts across the UK
  – falls in median BHC income ranging between 8% in Northern Ireland and 2% in the East Midlands

• Accounting for different housing costs trends makes an important difference
  – eg. median AHC income fell by 8% in London, compared to 4% BHC
  – London has lowest proportion of mortgagers

• No clear geographic relationship between pre-crisis income levels and income changes since the crisis
Prospects for living standards

• Employment rising, but earnings growth remains weak
  – employment rate among 16-64s up 1ppt in 2013–14, but average earnings rose at best as fast as prices
  – OBR forecasts suggest real earnings will return to 2009–10 levels by 2018–19 at the earliest

• Benefit cuts accelerated from 2013–14 onwards
  – eg. 3 years of 1% nominal increases from April 2013

• So seems likely to be some time before living standards return to their peak
Income inequality
The UK income distribution in 2012–13

Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2014*
The UK income distribution in 2012–13

- Childless couple: £440 pw
- Single person: £295 pw
- Couple with 2 young children: £616 pw

Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2014*
The UK income distribution in 2012–13

- 50th percentile: £440pw
- 10th percentile: £227pw
- 90th percentile: £884pw

Source: Figure 3.1 of Living Standards, Poverty and Inequality: 2014
Income changes by percentile point

Cumulative income change

Percentile

Source: Figure 3.2 of *Living Standards, Poverty and Inequality: 2014*
Trends in income inequality

• Inequality barely changed in 2012–13

• But inequality remained significantly lower than in 2007–08
  – real income 6.2% lower at the 90th percentile, 4.5% lower at the median, and 0.9% higher at the 10th percentile
Gini coefficient: 1979 to 2012–13

Source: Figure 3.3 of Living Standards, Poverty and Inequality: 2014

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Trends in income inequality

• Inequality barely changed in 2012–13

• But inequality remained significantly lower than in 2007–08
  – real income 6.2% lower at the 90\textsuperscript{th} percentile, 4.5% lower at the median, and 0.9% higher at the 10\textsuperscript{th} percentile

• Gini coefficient fell from 0.36 in 2007–08 to 0.34 in 2012–13
  – lower than 1990 level
Why has income inequality fallen?

• Real earnings fell sharply but benefit entitlements remained relatively stable

• Between 2007–08 and 2012–13 real median income fell 6.6% for working households, but rose by 4.9% for other households
  – median income for non-working households rose from 60% to 67% of median income for working households

• 40% of total fall in inequality explained by “catch up” of non-working households
  – 20% if we restrict focus to working-age population
Housing costs and inequality

- Housing costs have fallen less towards the bottom of the income distribution
% change in housing costs by AHC income decile: 2007–08 to 2012–13

Source: Figure 3.6b of Living Standards, Poverty and Inequality: 2014
Housing costs and inequality

- Housing costs have fallen less towards the bottom of the income distribution
  - low income households less likely to have a mortgage

- What effect does taking this into account have on changes in inequality?
Income changes by percentile point before and after housing costs: 2007–08 to 2012–13

Source: Figure 3.5 of *Living Standards, Poverty and Inequality: 2014*
Housing costs and inequality

- Housing costs have fallen less towards the bottom of the income distribution
  - low income households less likely to have a mortgage

- So falls in income inequality are much smaller when incomes are measured after deducting housing costs
  - falls of 8.0% and 6.4% at the 90th and 10th percentiles respectively
  - Compared to a fall of 6.2% and a rise of 0.9% before housing costs

- More generally, higher inflation faced by low-income households since 2007–08 has counteracted favourable trends in incomes

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Prospects for income inequality

• Good reason to think that falls in inequality since 2007–08 are currently being reversed

• Recovery in earnings primarily boosts incomes for middle- and high-income households

• Direct tax and benefit reforms introduced or planned between April 2013 and April 2015 are inequality-increasing
  – act to reduce incomes for the lowest income third, but increase them across the rest of the population

• But rising mortgage interest costs are likely to lead to smaller rises inequality after housing costs
Summary

• Average incomes stabilised in 2012–13
  – but remained well below their 2009–10 peak

• Income inequality barely changed in 2012–13
  – but remained significantly lower than pre-crisis levels

• Falls in inequality much smaller after accounting for different changes in housing costs
  – low-income households less likely to benefit from huge falls in mortgage costs