



# Institute for Fiscal Studies



## Living standards and income inequality

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**JRF** JOSEPH  
ROWNTREE  
FOUNDATION



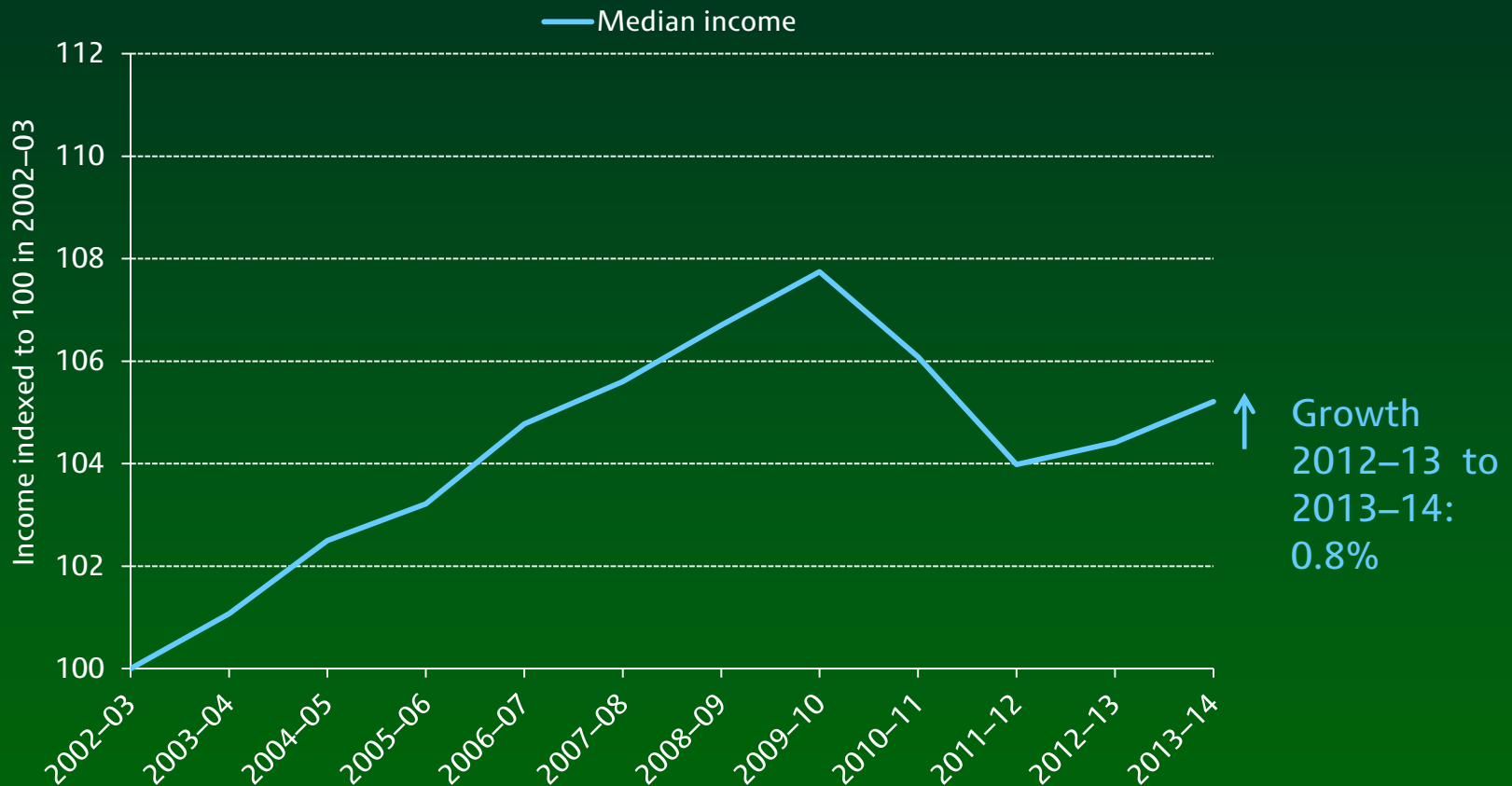
# Where do we get our data?

- Family Resources Survey and predecessors from 1961 to 2013–14
  - Currently a sample of around 20,000 households
  - Subject to sampling error
- Figures using data prior to 2002–03 refer to Great Britain not UK
  - Northern Ireland not included in the data until 2002–03
- We use the same definition of income as measured in “Households Below Average Income” which is produced by the Department for Work and Pensions

# What do we mean by “income”?

- HBAI income is measured net of direct taxes and benefits and is measured at the household level
- Adjusted to account for household size and structure (“equivalised”)
  - Cash amounts are equivalents for a childless couple
- Measure income both before and after housing costs have been deducted (“BHC” and “AHC”)
- Adjusted for inflation to allow comparisons over time
  - Use variants of the Consumer Price Index, which we have constructed (available on the IFS website)
  - Differs from the Retail Price Index used in DWP’s official statistics
  - RPI known to significantly overstate inflation

# Growth in average incomes since 2002–03



Source: Table 2.1 of *Living Standards, Inequality and Poverty in the UK: 2015*

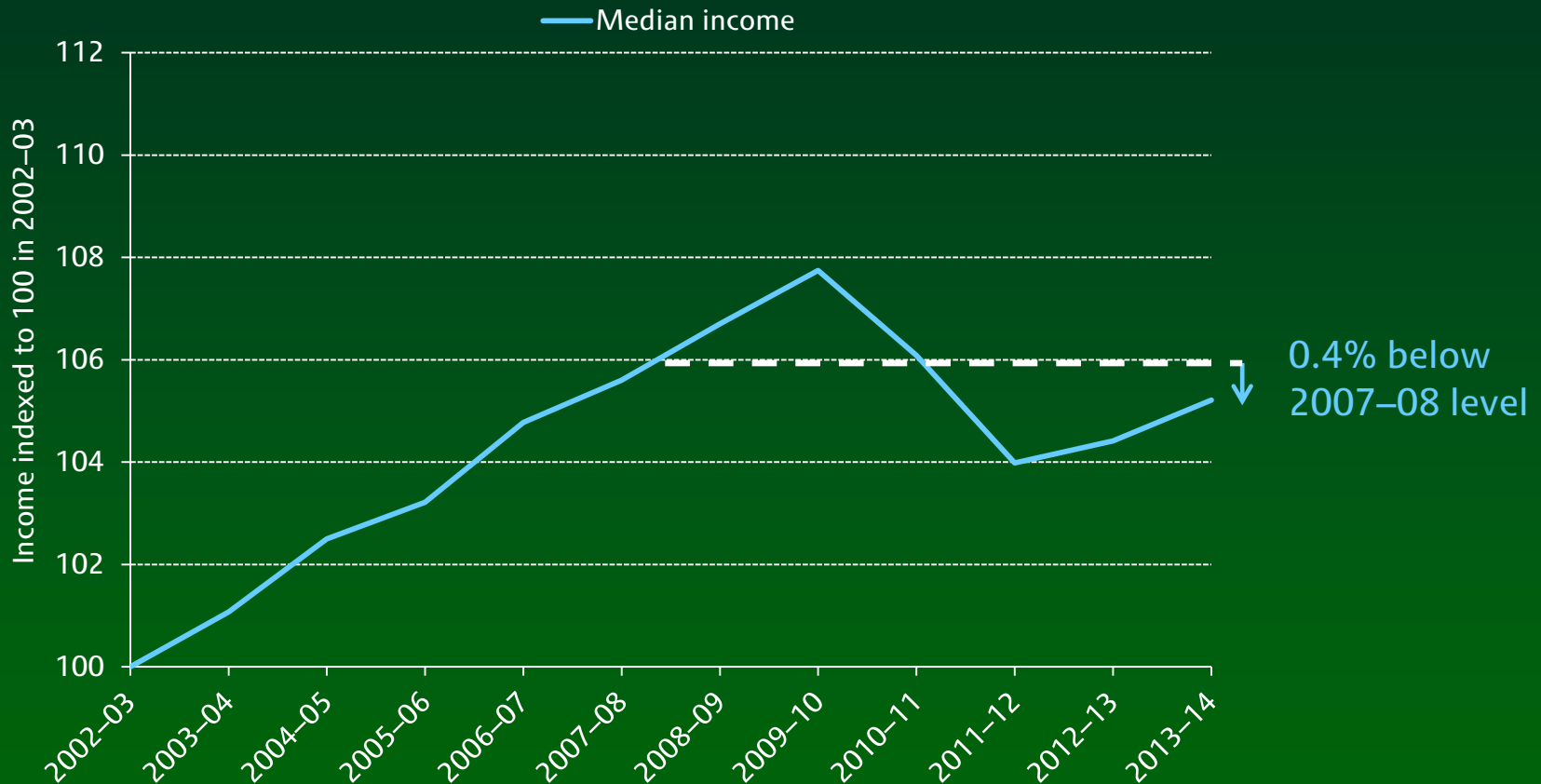


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# Explaining growth in median income in 2013–14

- Income growth in latest year driven by recovering labour market
  - Strong growth in employment (stronger than recorded in LFS)
  - Flat real earnings of employees
  - Also: large rise in income tax personal allowance
  - However: cuts to working-age benefits and tax credits

# Growth in average incomes since 2002–03

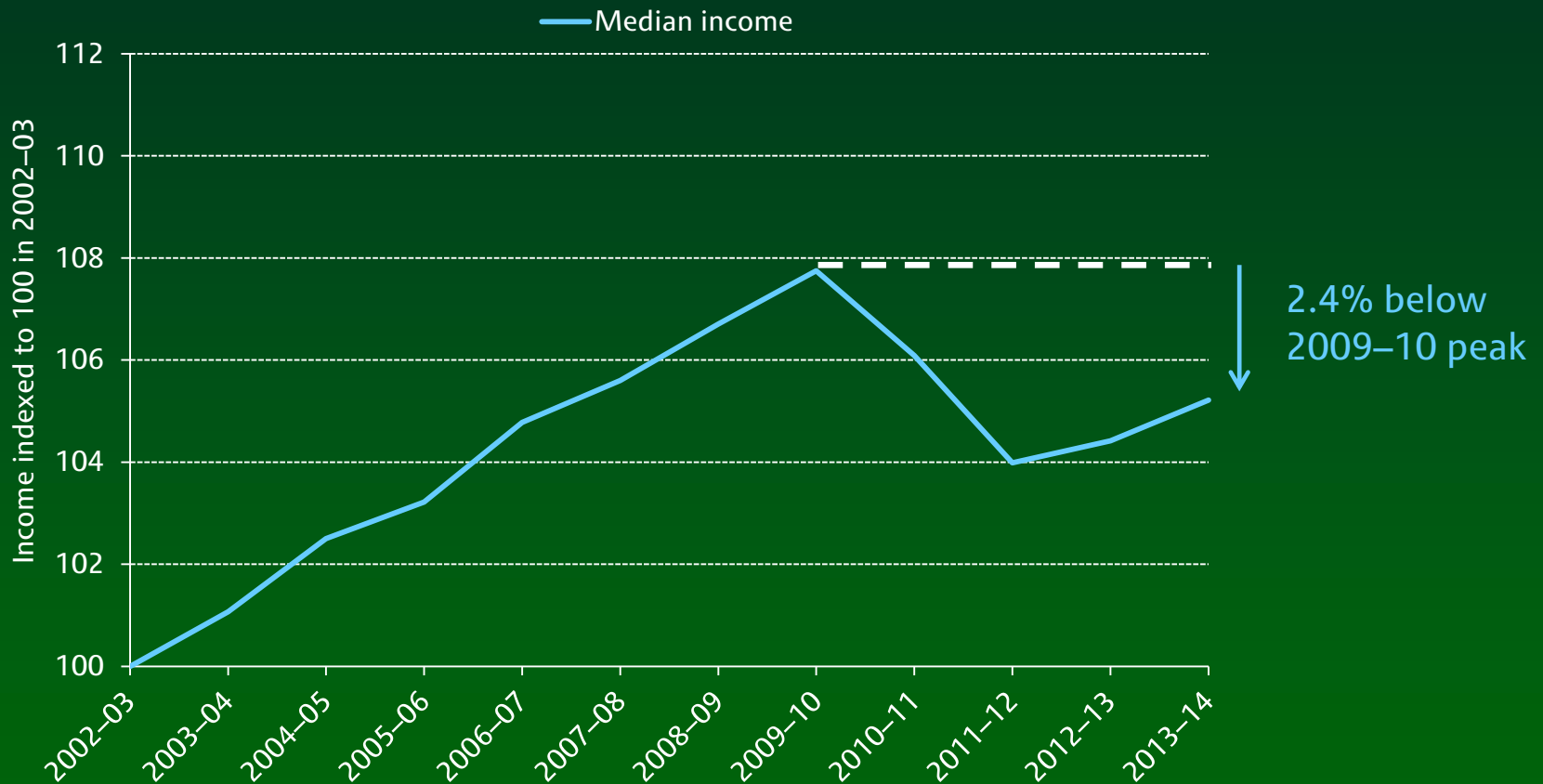


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# Growth in average incomes since 2002–03

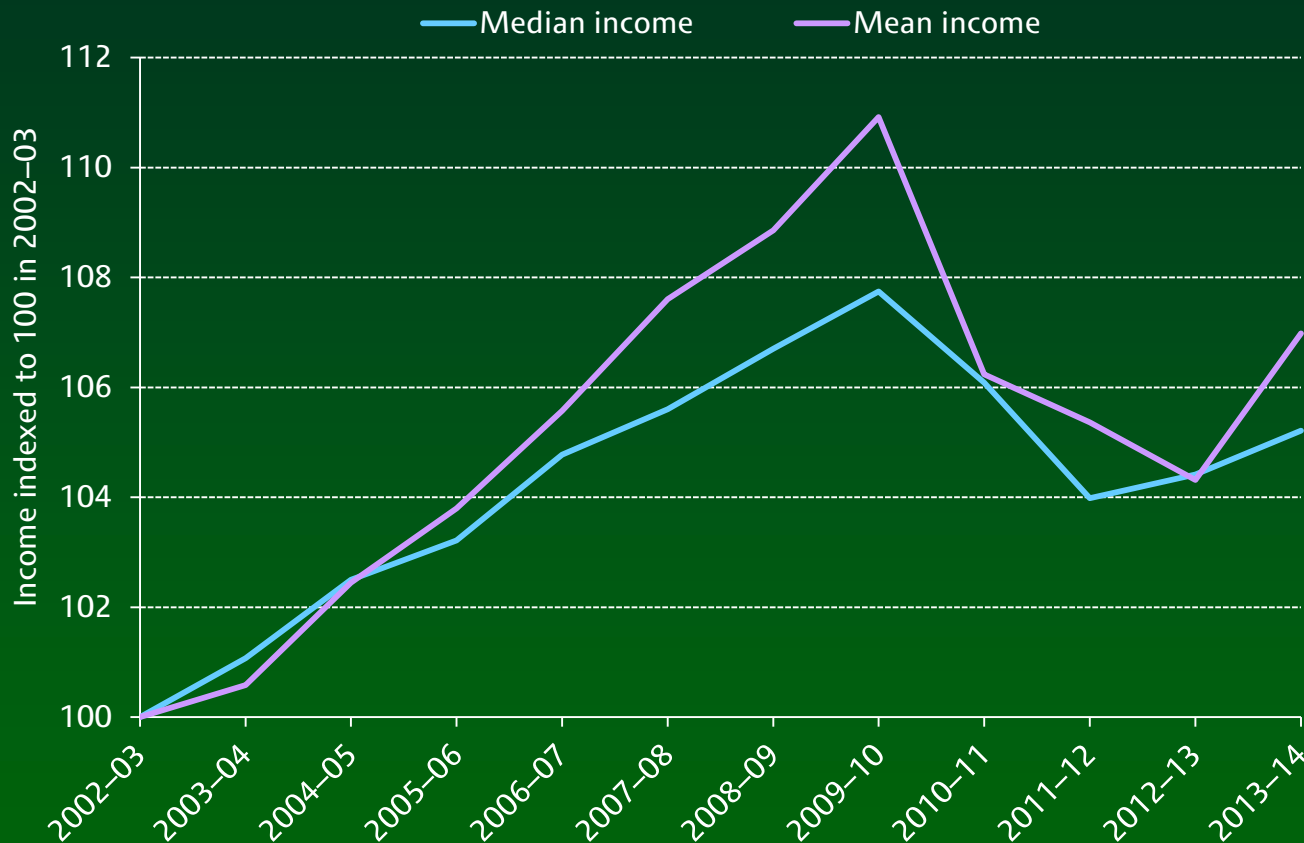


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# Growth in average incomes since 2002–03



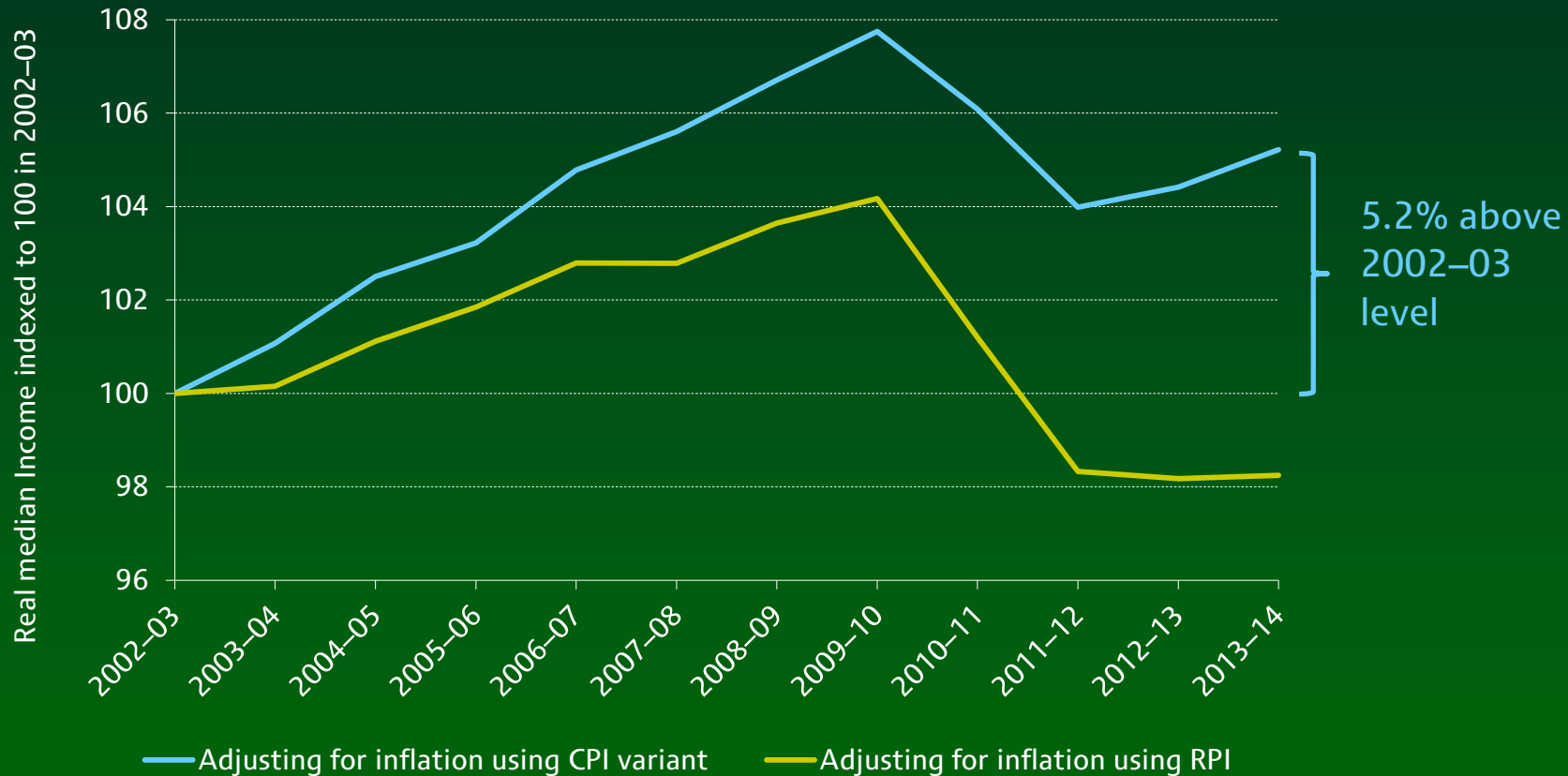
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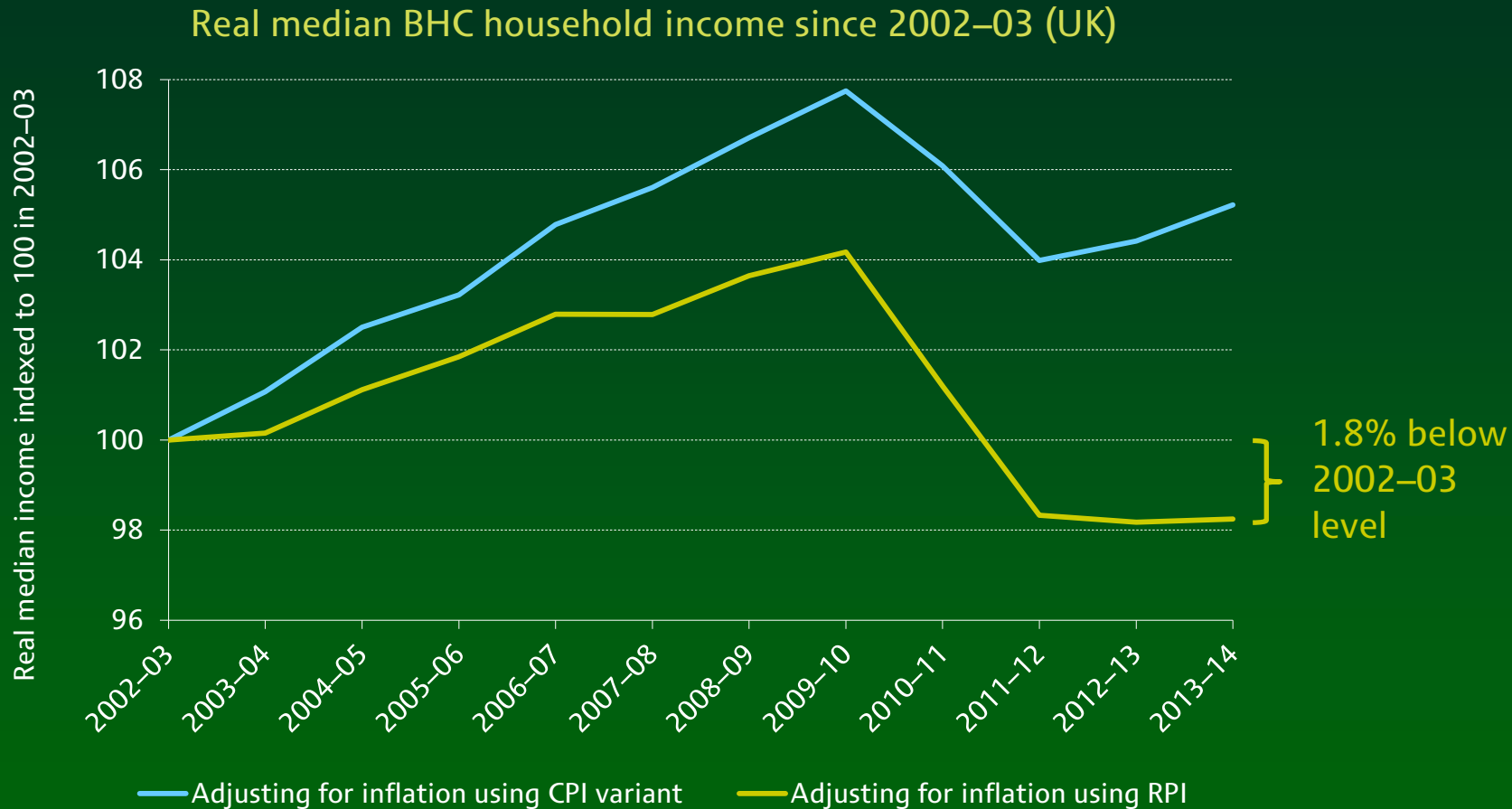


# Adjusting for inflation: CPI vs RPI



Source: Fig 2.2 of *Living Standards, Inequality and Poverty in the UK: 2015*

# Adjusting for inflation: CPI vs RPI



Source: Fig 2.2 of *Living Standards, Inequality and Poverty in the UK: 2015*

# Comparing income growth to previous recessions



Source: Fig 2.4 of *Living Standards, Inequality and Poverty in the UK: 2015*

# Comparing periods of falling incomes

- Profile of changes in living standards very different to previous recessions
- In 2013–14, median income 4 years after peak around same level as 7 years before (2006–07)
  - Compared to between 13% and 17% higher for previous 3 recessions

# Income inequality

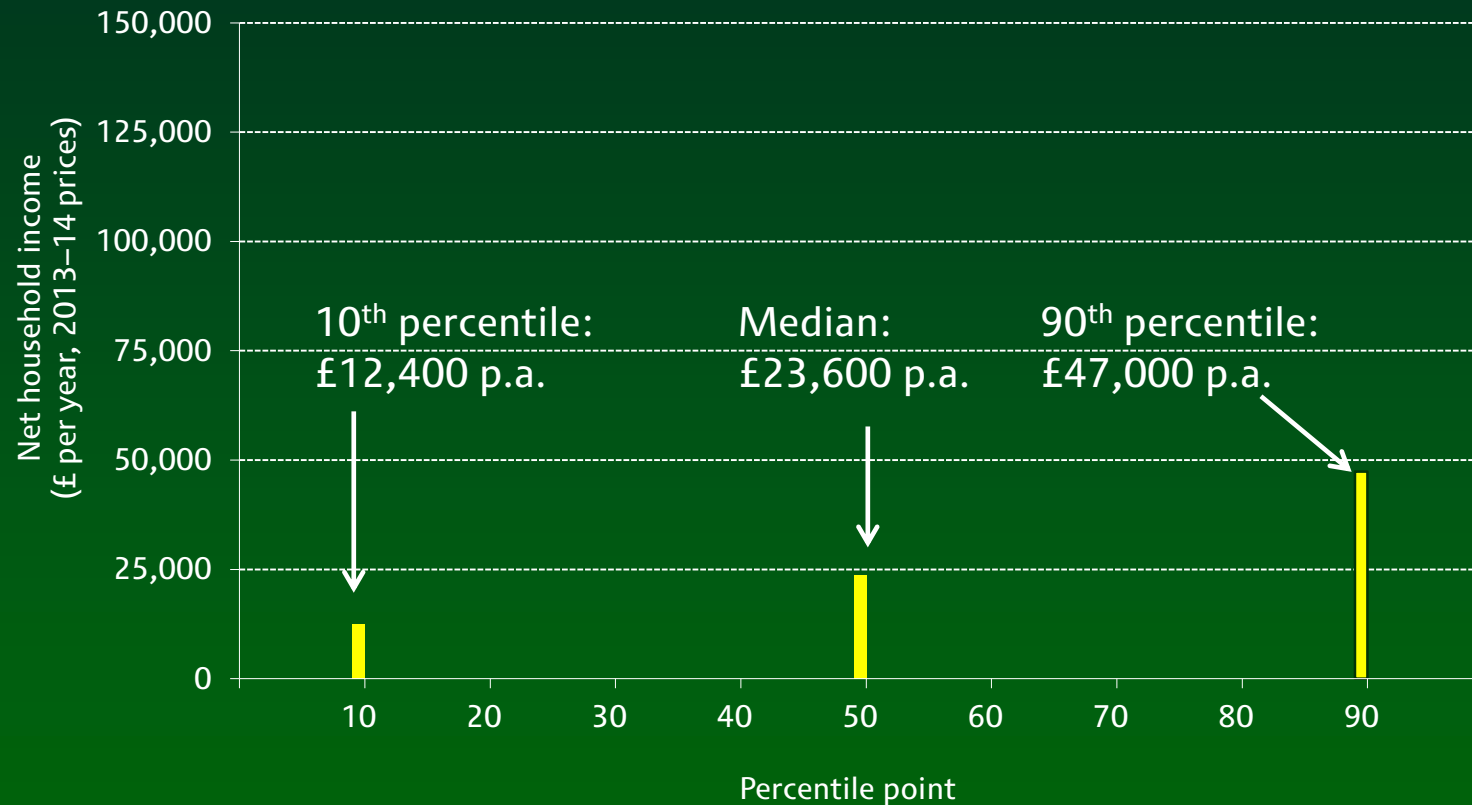
# The UK income distribution in 2013–14



Source: Fig 3.1 of *Living Standards, Inequality and Poverty in the UK: 2015*

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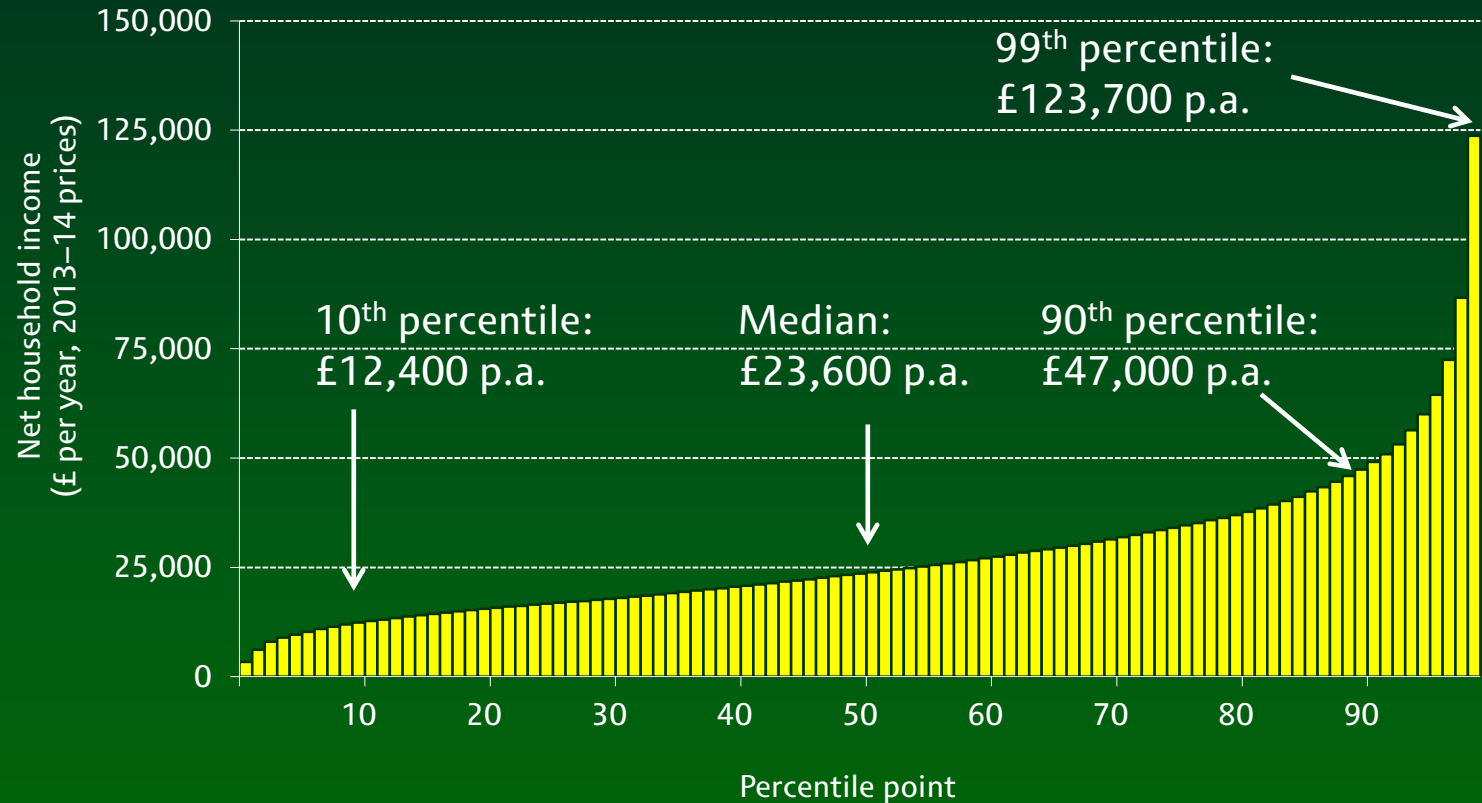
Expressed as equivalent living standards for a childless couple



Source: Fig 3.1 of *Living Standards, Inequality and Poverty in the UK: 2015*

# The UK income distribution in 2013–14

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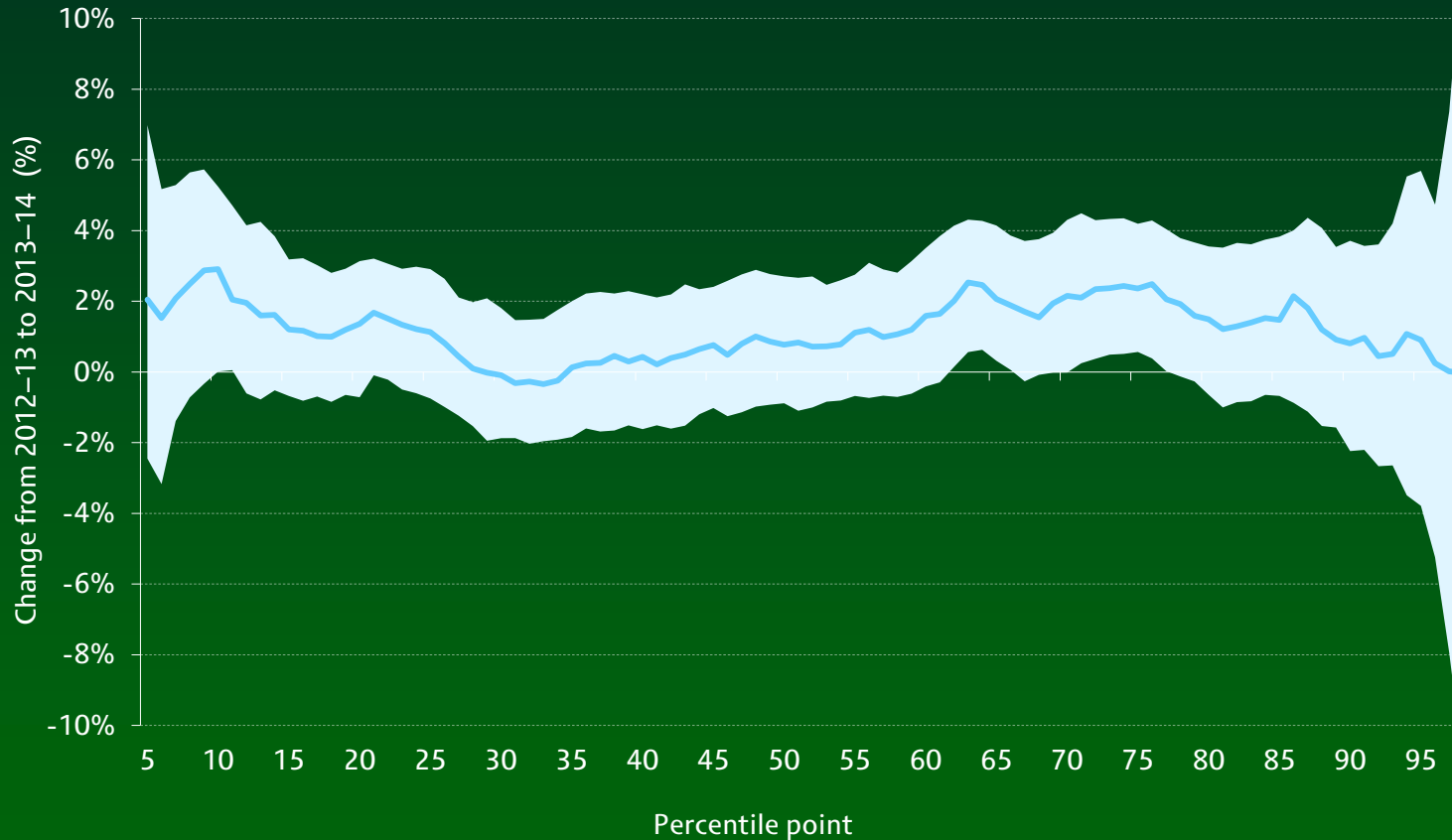


Source: Fig 3.1 of *Living Standards, Inequality and Poverty in the UK: 2015*



# Inequality broadly unchanged in 2013–14

Real income growth by percentile point (BHC), 2012–13 to 2013–14

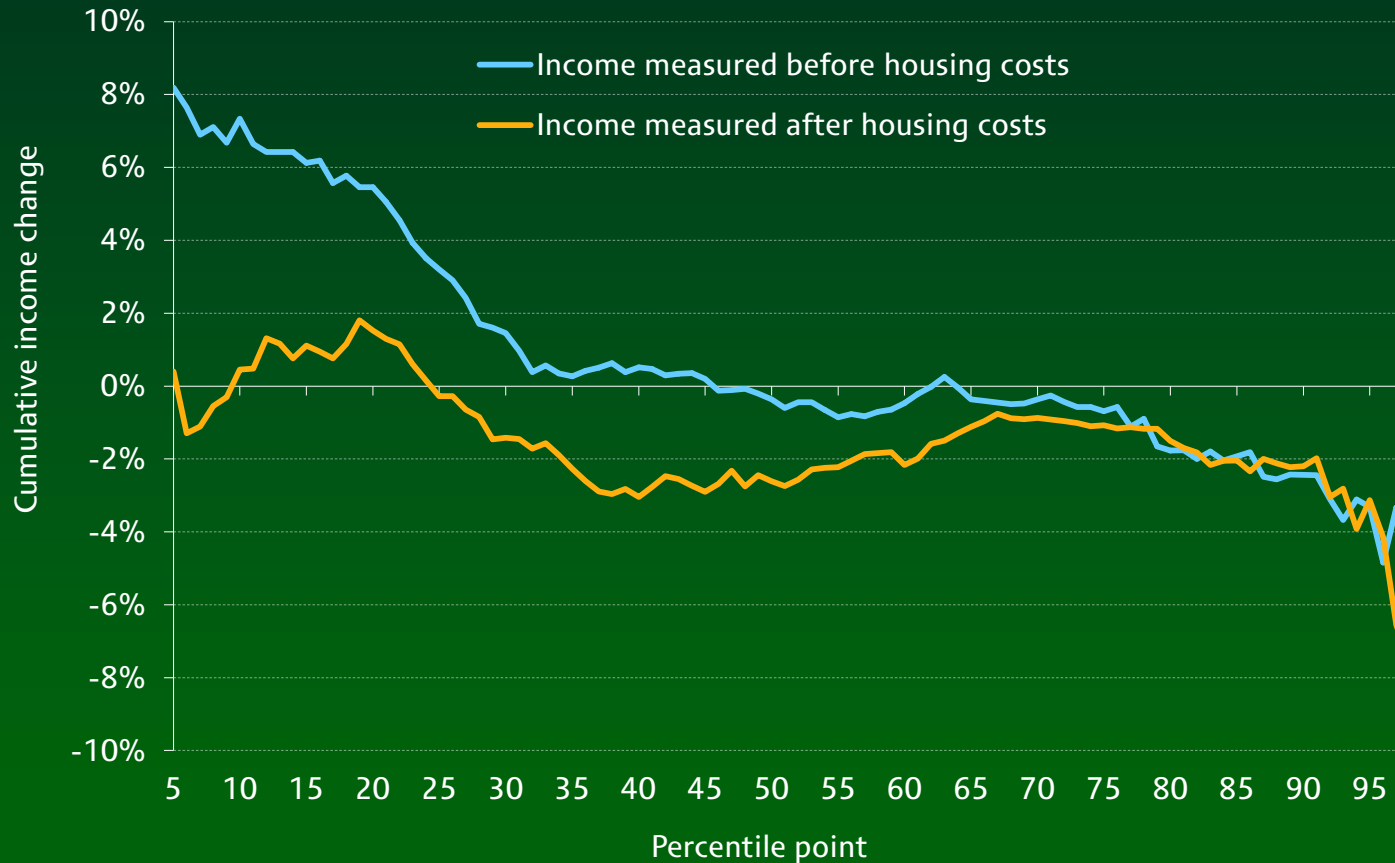


Source: Fig 3.2 of *Living Standards, Inequality and Poverty in the UK: 2015*

Note: Shaded area represents 95% confidence intervals

# Inequality is lower than pre-recession levels

Real income growth by percentile point, 2007–08 to 2013–14



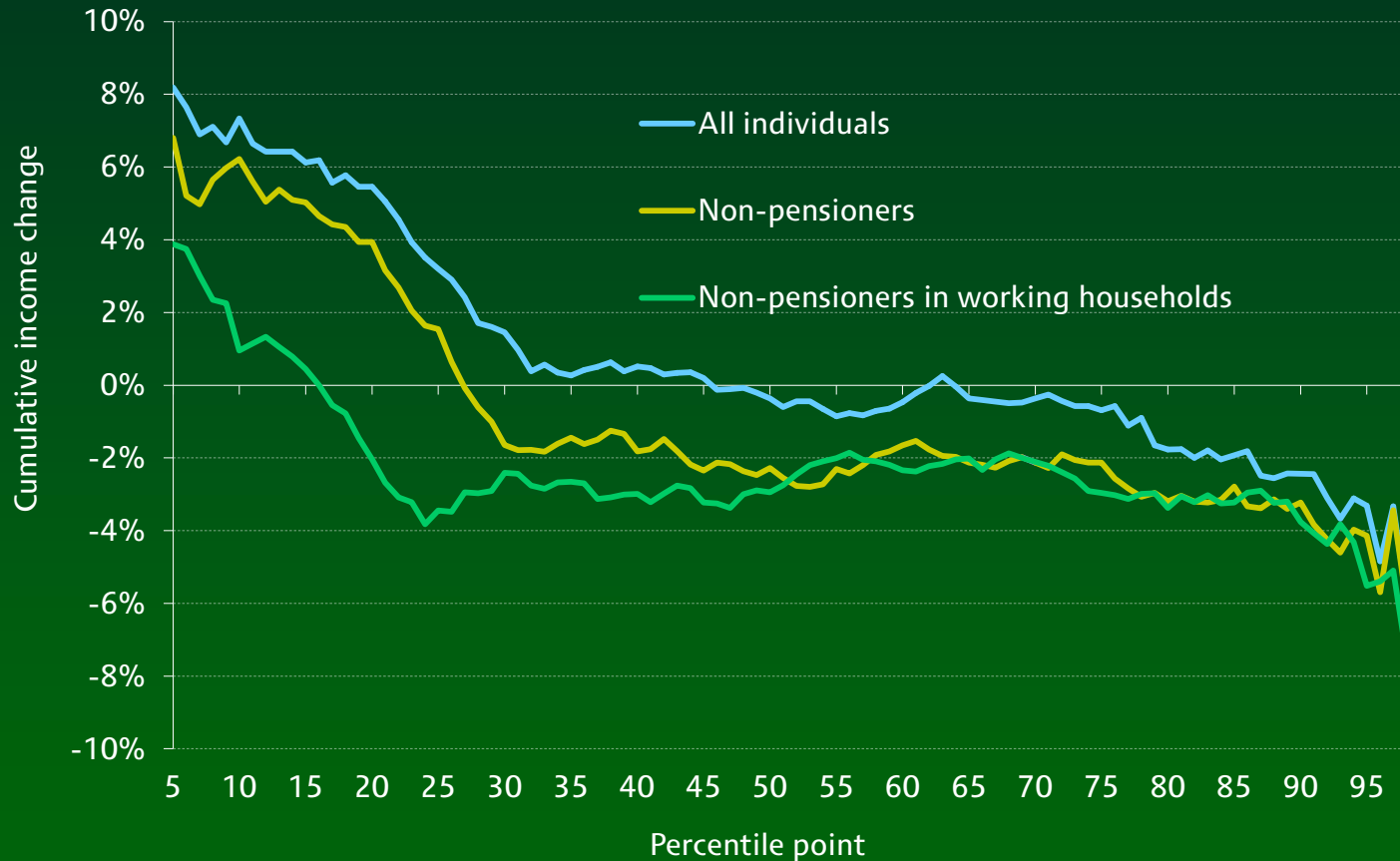
Source: Fig 3.9 of *Living Standards, Inequality and Poverty in the UK: 2015*

# Trends in inequality since 2007–08

- Inequality is lower than prior to recession measured BHC
- Significantly smaller falls in inequality when measured AHC
  - Poorer households did not benefit as much from falling mortgage interest rates

# Explaining recent falls in inequality

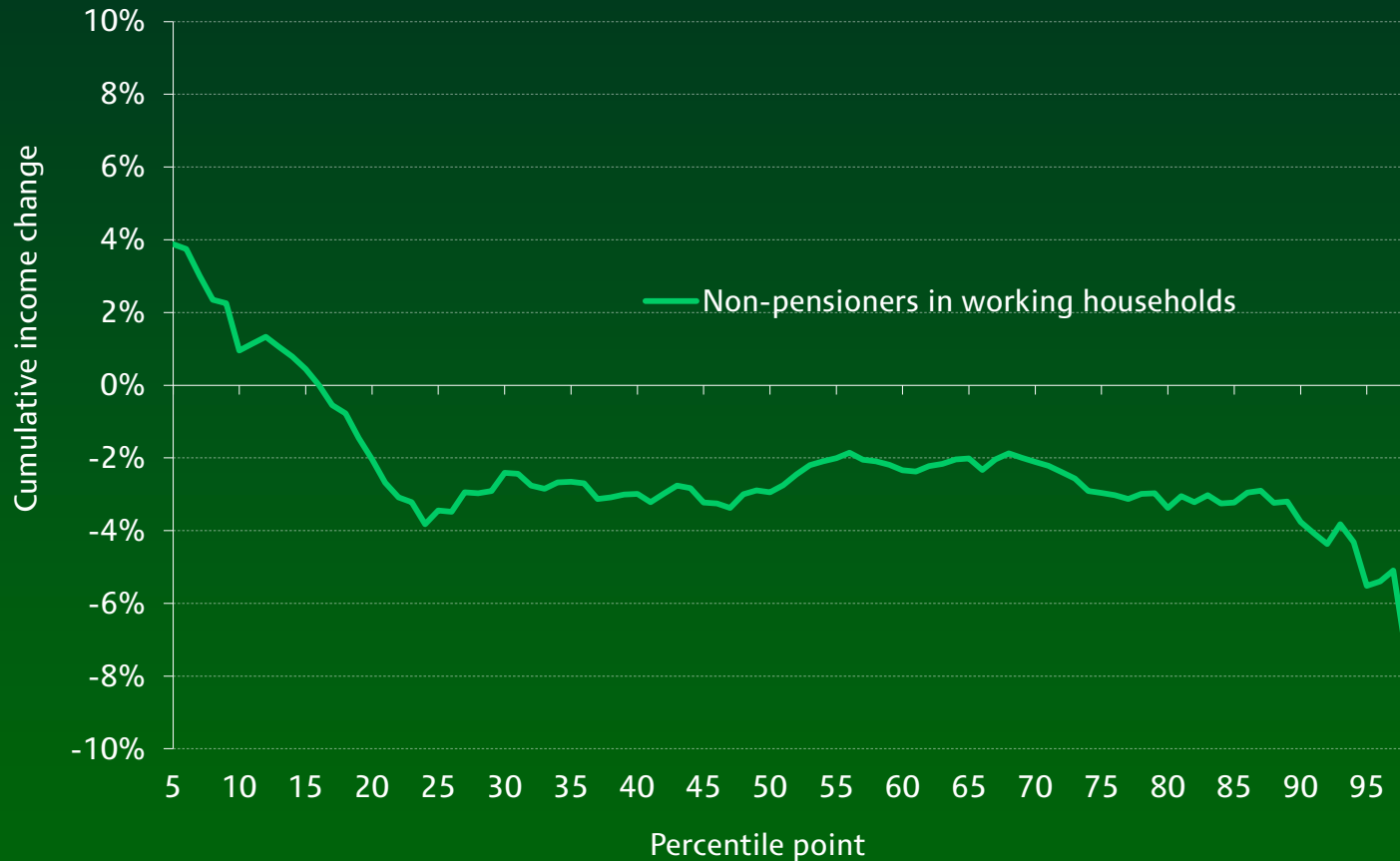
Real income growth by percentile point (BHC), 2007–08 to 2013–14



Source: Fig 3.9 of *Living Standards, Inequality and Poverty in the UK: 2015*

# Why did inequality fall for working households?

Real income growth by percentile point (BHC), 2007–08 to 2013–14



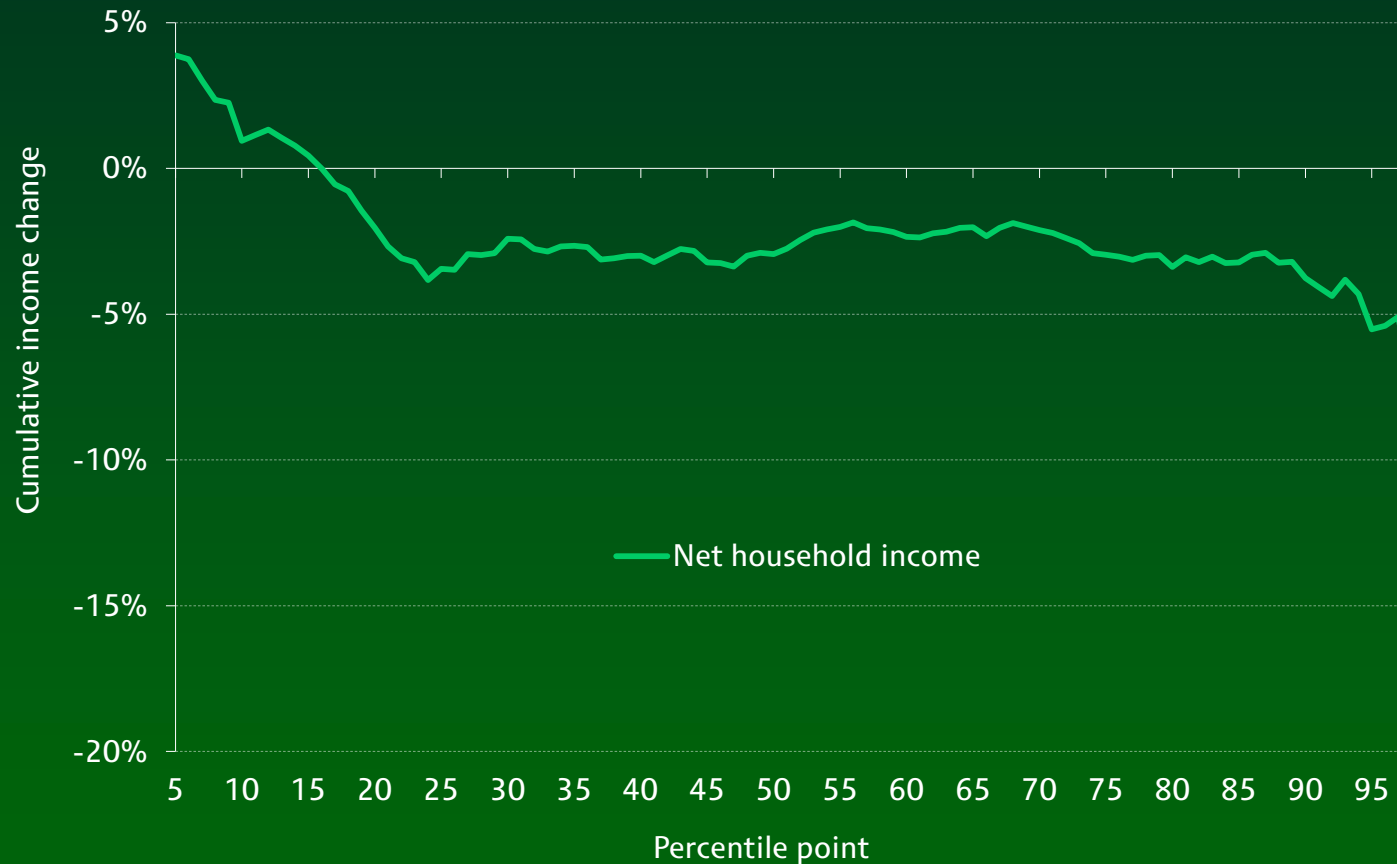
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# Why did inequality fall for working households?

Real income growth by percentile point (BHC), 2007–08 to 2013–14



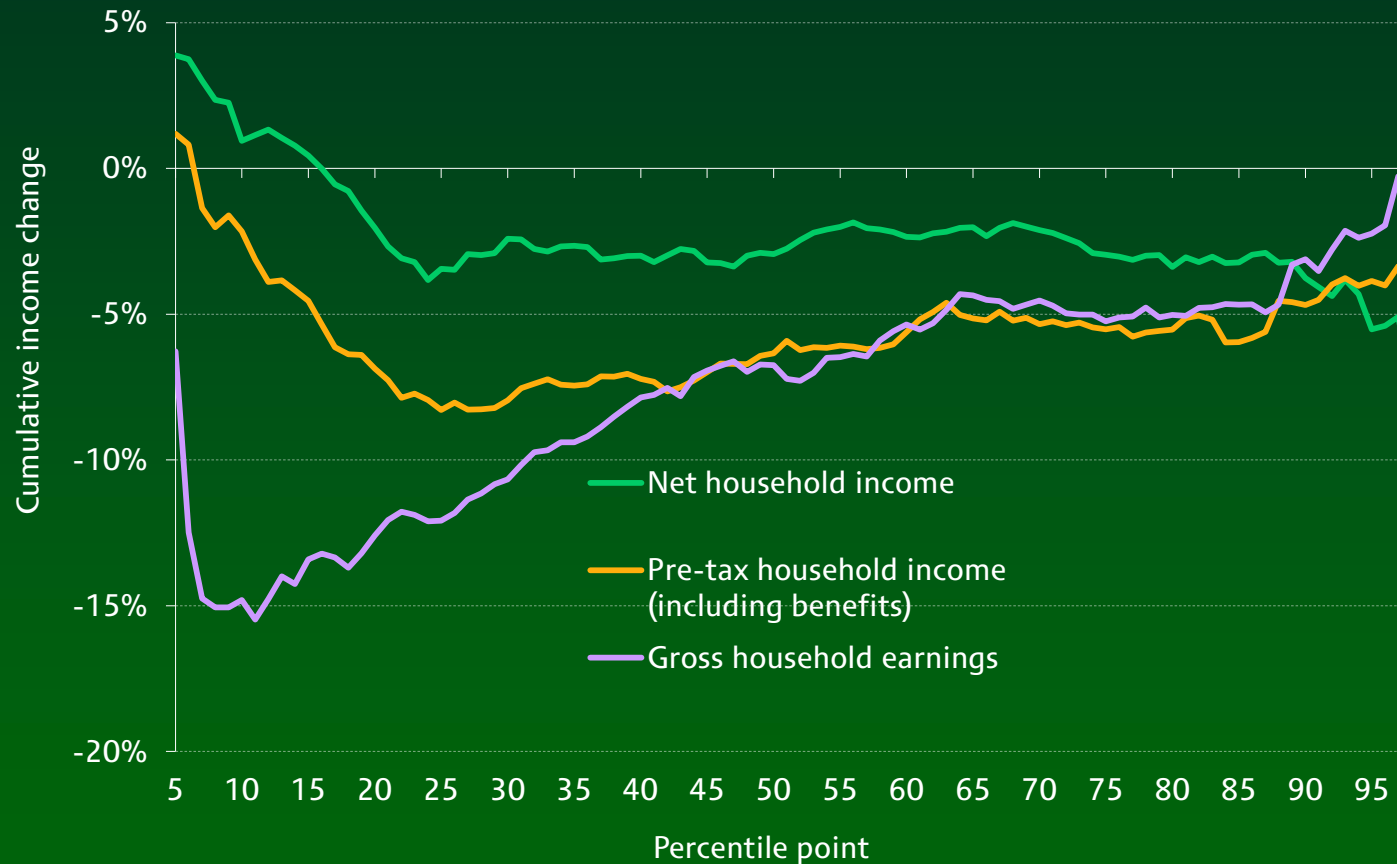
Source: Fig 3.10 of *Living Standards, Inequality and Poverty in the UK: 2015*



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# Why did inequality fall for working households?

Growth by percentile point (BHC), 2007–08 to 2013–14



Source: Fig 3.10 of *Living Standards, Inequality and Poverty in the UK: 2015*



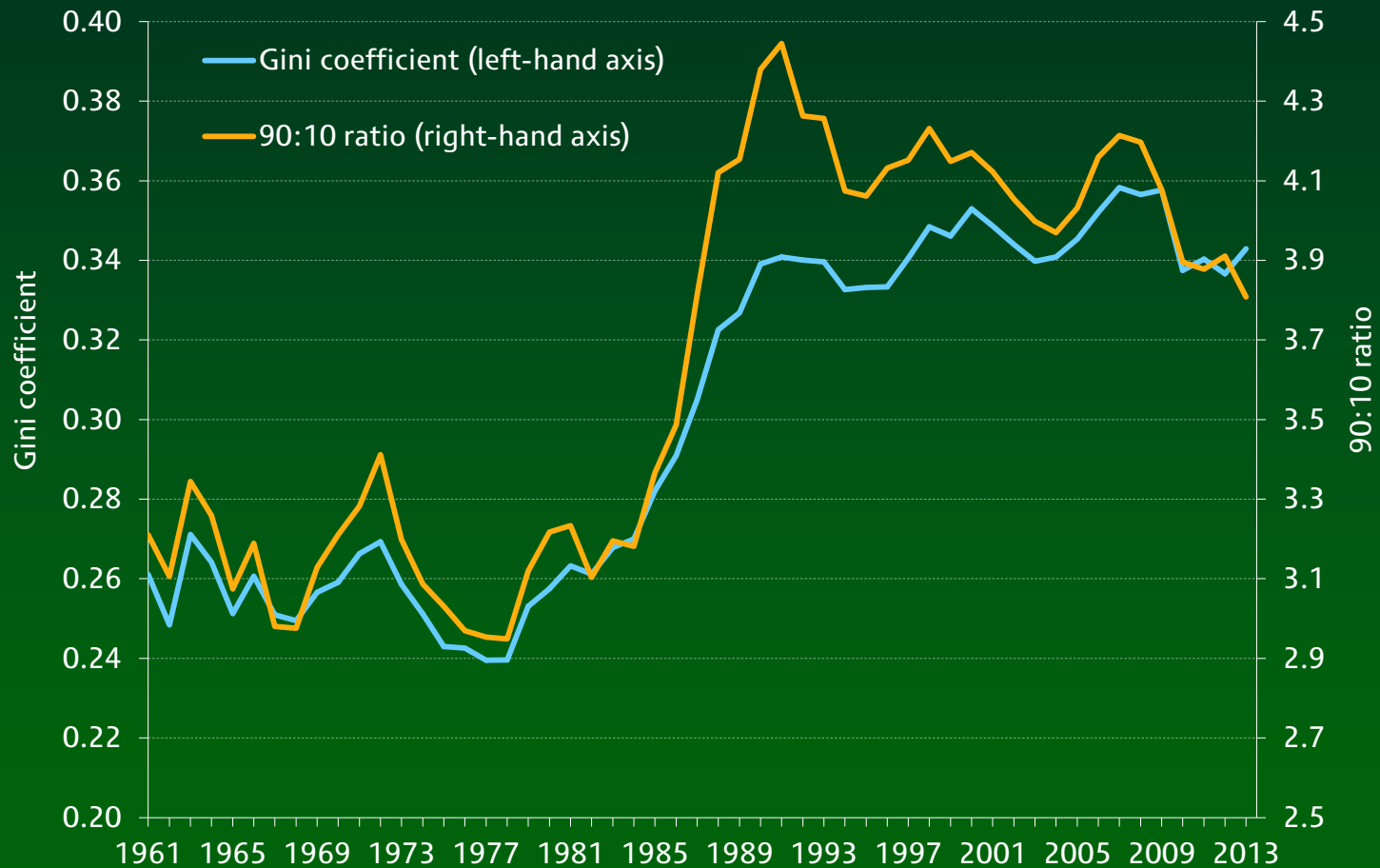
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# Trends in inequality since 2007–08

- Falling inequality for working non-pensioners despite inequality-increasing trends in gross households earnings
  - Benefits are a more important income source for low-earning households than for higher-earning households



# Gini coefficient and 90/10 ratio, 1961 to 2013-14

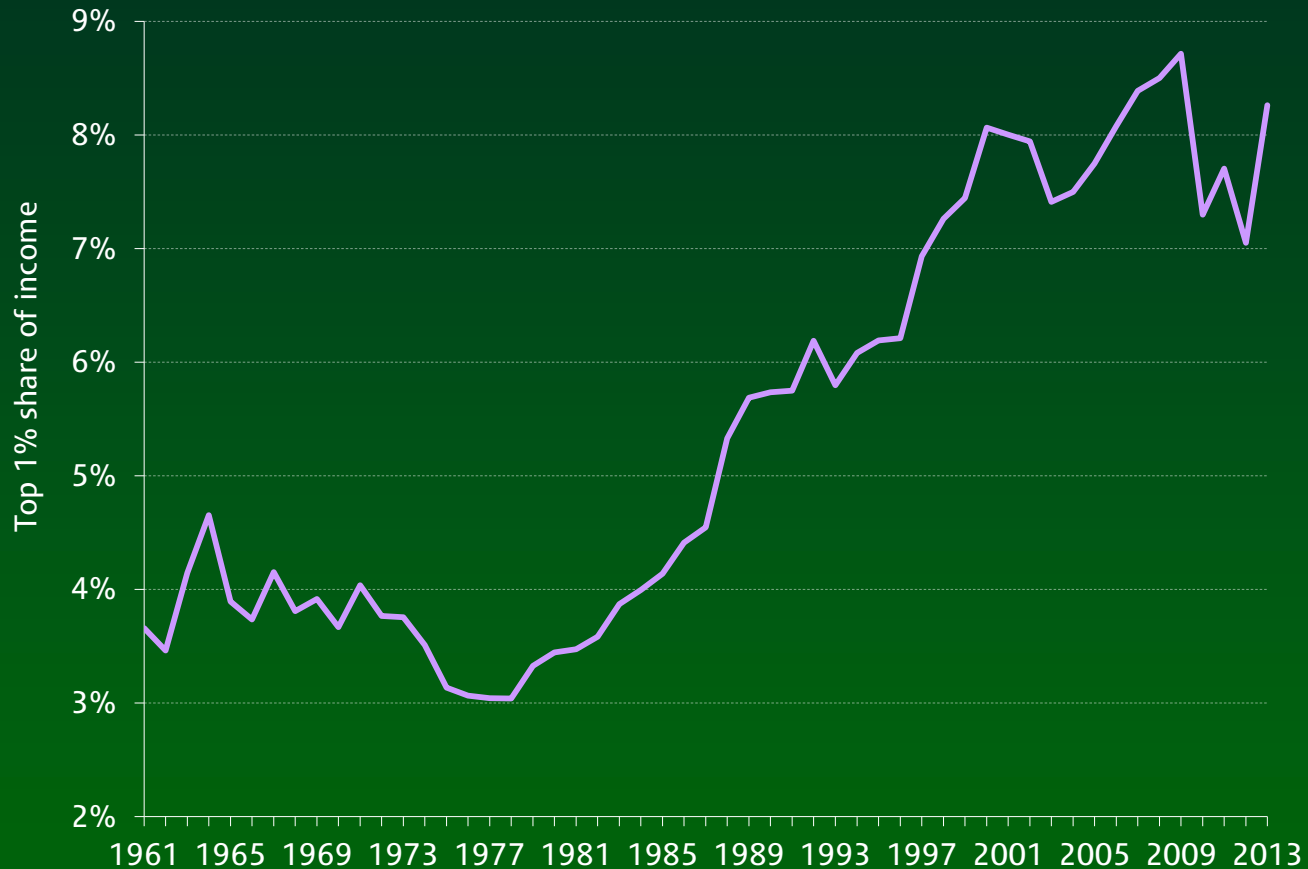


Source: Fig 3.4 of *Living Standards, Inequality and Poverty in the UK: 2015*

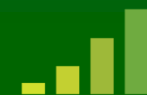


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# The 1% income share 1961 to 2013–14 (GB)



Source: Fig 3.5 of *Living Standards, Inequality and Poverty in the UK: 2015*



# Longer run trends in inequality

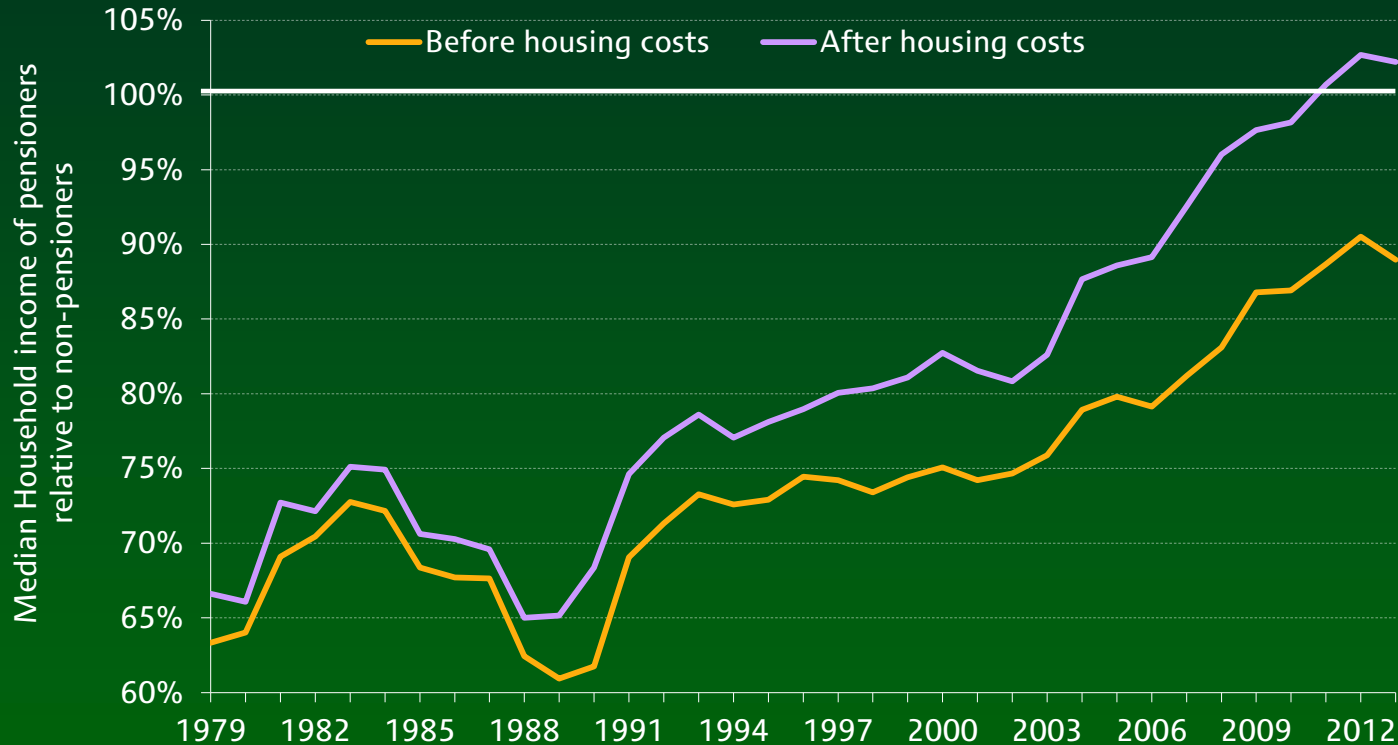
- But changes in inequality are also much larger than seen recently
- Changes in overall measures of inequality can mask important trends
  - From 1990 to 2007–08 Gini coefficient rose 2 ppt
  - This was driven by rises in inequality at the top of the distribution
  - But inequality fell across most of the distribution (90/10 ratio fell)

# Longer run trends in inequality

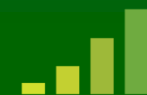
- Why has inequality fallen since 1990 over most of the distribution?
- In part, due to increases in incomes of some relatively poor groups:
  - Pensioners
  - Non-pensioners in workless households

# Incomes of pensioners catching up with the rest...

Median income of pensioners relative to that of non-pensioners, 1979 to 2013–14



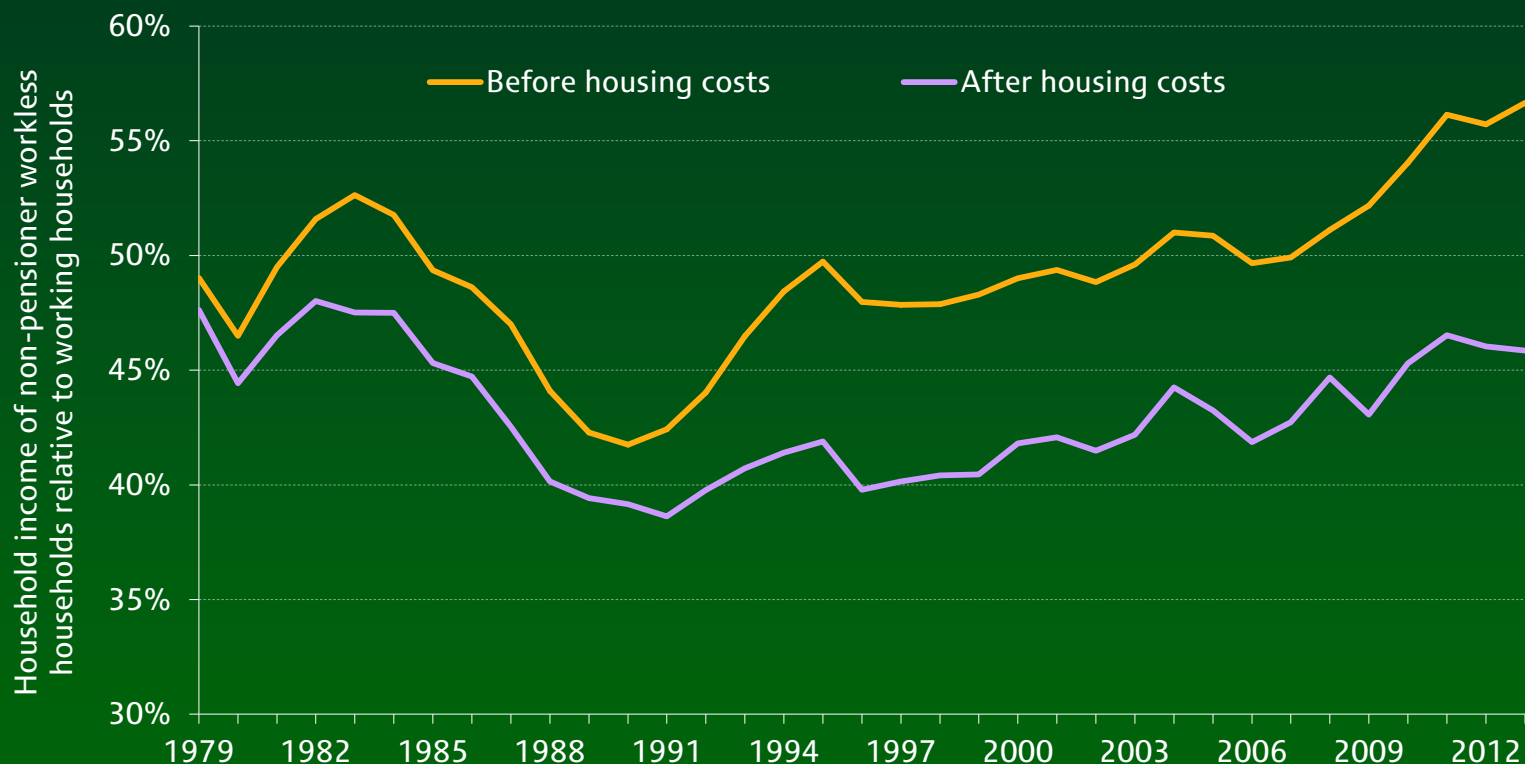
Source: Fig 3.6 of *Living Standards, Inequality and Poverty in the UK: 2015*



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# Smaller improvement in relative position of workless households

Median income of non-pensioners in workless households relative to those in working households, 1979 to 2013-14



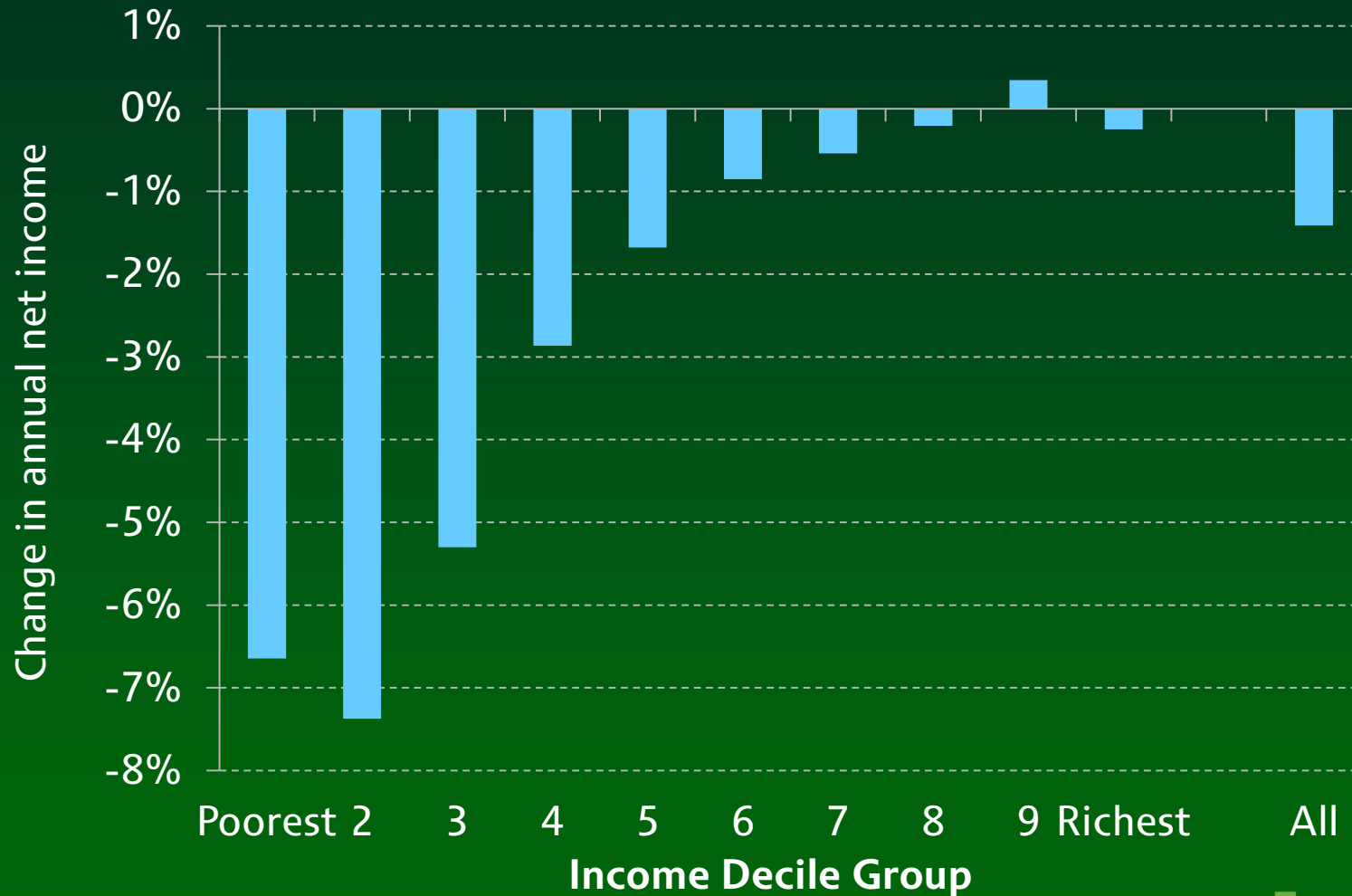
Source: Fig 3.6 of *Living Standards, Inequality and Poverty in the UK: 2015*



# Prospects for living standards and inequality

- Expect to see continued (probably accelerated) growth in median income in 2014–15 HBAI data
  - Rising employment rate (1.2ppt increase in 2014–15)
  - Rapid fall in inflation (to 1.0% in 2014–15) prevents fall in real value of most benefits
  - Modest real earnings growth (0.4% according to AWE)
- Higher real earnings likely to lead to rising living standards (and inequality) over next few years
  - Earnings are more important income source for richer households
- Announced tax and benefit changes will act to increase inequality over the parliament

# Impact of tax and benefit reforms between April 2015 and April 2019 (including universal credit)



Note: Assumes full take-up of means-tested benefits and tax credits.  
Source: A. Hood (2015) 'Benefit changes and distributional analysis' IFS  
Post-Summer Budget 2015 Analysis



# Conclusion

- Modest median income growth in 2013–14
  - Median income around pre-crisis level, but well below 2009–10 peak
- Overall measures of inequality since 1990 mask different underlying trends
  - Rising inequality at the top from 1990 to 2007–08
  - Falling inequality across most of the distribution since 1990 (and particularly since 2007–08)
  - Driven in part by improving relative position of pensioners and workless households