Living standards and income inequality
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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

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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*
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

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

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Growth in average incomes since 2002–03

Median income

Income indexed to 100 in 2002-03

2.4% below 2009–10 peak

Source: Table 2.1 of *Living Standards, Inequality and Poverty in the UK: 2015*
Growth in average incomes since 2002–03

Source: Table 2.1 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

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Adjusting for inflation: CPI vs RPI

Real median BHC household income since 2002–03 (UK)

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*
The UK income distribution in 2013–14

Expressed as equivalent living standards for a childless couple

Net household income (£ per year, 2013–14 prices)

150,000
125,000
100,000
75,000
50,000
25,000
0

Percentile point

10
20
30
40
50
60
70
80
90

10th percentile: £12,400 p.a.
Median: £23,600 p.a.
90th percentile: £47,000 p.a.

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

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The UK income distribution in 2013–14

Expressed as equivalent living standards for a childless couple

Net household income (£ per year, 2013–14 prices)

- 10th percentile: £12,400 p.a.
- 90th percentile: £47,000 p.a.

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

Cumulative income change

Percentile point

-10% -8% -6% -4% -2% 0% 2% 4% 6% 8% 10%

5 10 15 20 25 30 35 40 45 50 55 60 65 70 75 80 85 90 95

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

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

Source: Fig 3.10 of Living Standards, Inequality and Poverty in the UK: 2015
Why did inequality fall for working households?

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