

Two decades of income inequality in Britain: the role of wages, household earnings and redistribution

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Executive Summary

Two decades of Income Inequality in Britain: The role of Wages, Household Earnings and Redistribution

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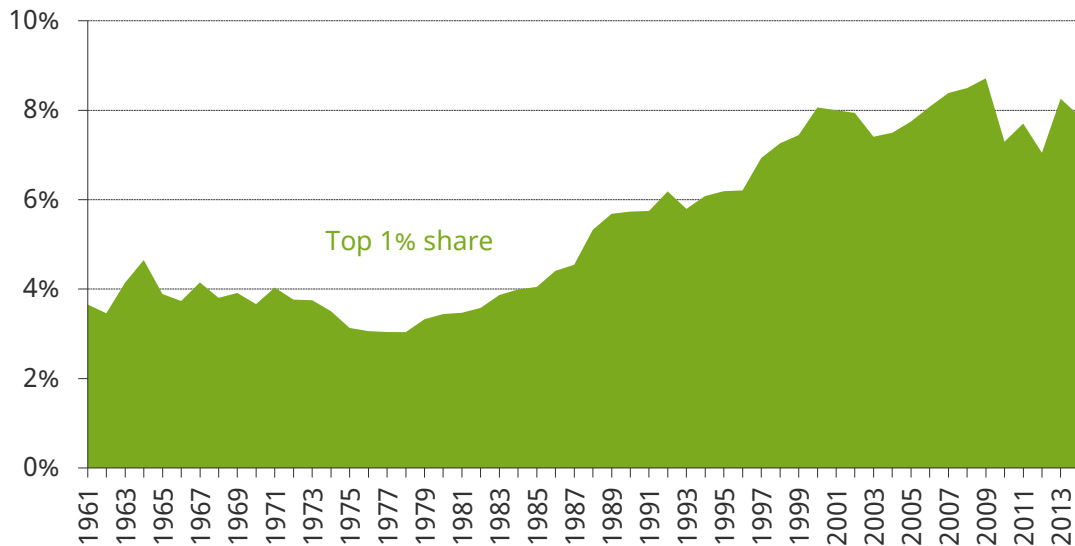
Introduction

This is a summary of the main findings of ‘Two Decades of Income Inequality in Britain: The role of Wages, Household Earnings and Redistribution’, published today as an IFS Working Paper and forthcoming in *Economica*. The paper looks back at changes in income inequality in Great Britain over the past 20 years, with a particular focus on explaining why – contrary to popular perception – income inequality over most of the distribution has actually declined over this period. We focus on inequality in household incomes, net of taxes and inclusive of benefits and tax credits. We explain trends in inequality by breaking this down into the effect of changes in hourly pay and hours worked of men and women, the tax and benefit system, and the incomes of pensioners.

¹ Data from the Households Below Average Income dataset and Family Resources Survey were made available by the Department for Work and Pensions. The Households Below Average Income data prior to 1994–95 were constructed from the Family Expenditure Survey. These data are available from the UK Data Archive. The Labour Force Survey is produced by the Office for National Statistics, and these data are available from the UK data archive. Any errors and all views expressed are those of the authors. Support from the ESRC-funded Centre for the Microeconomic Analysis of Public Policy (CPP) at IFS, grant reference ES/M010147/1, is gratefully acknowledged.

The proportion of income accruing to the top 1% has increased dramatically over time

Figure 1. Share of household income accruing to top 1%, 1961 to 2014-15

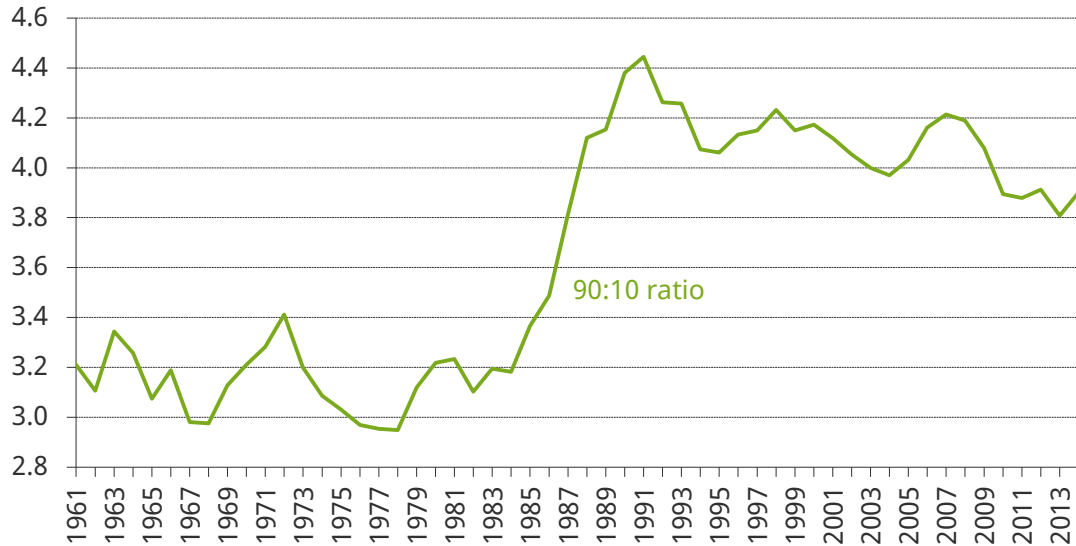


Note and source: See Figure 3 of the main paper.

The 'racing away' of the very top of the income distribution began in the 1980s, but continued steadily throughout the 1990s and most of the 2000s, until the onset of the Great Recession. In recent years the trend is less clear, as there has been volatility in top incomes caused by high income individuals responding to changes in top income tax rates.

But over the last twenty years inequality in net household incomes amongst the majority of the population has fallen

Figure 2. 90:10 ratio in household income, 1961 to 2014–15

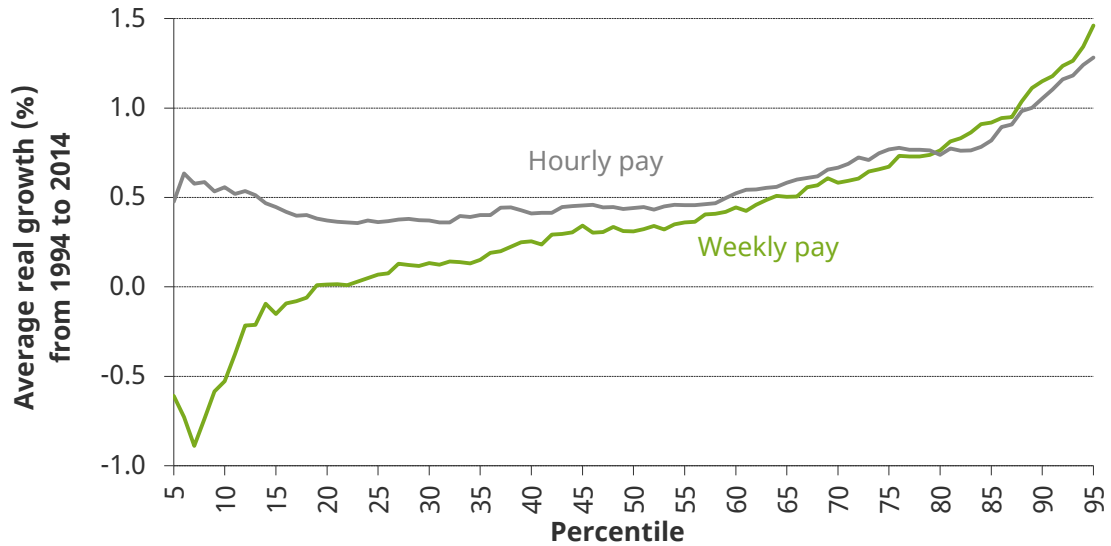


Note and source: See Figure 2 of the main paper.

If we strip out the extremes of the income distribution (and in particular the very top), the story is different. Take the 90-10 ratio, which measures how many times higher incomes are 90% of the way up the distribution compared to 10% of the way up. The large increase in inequality during the 1980s is again evident, but since then the 90-10 ratio has generally been falling, and is clearly lower now than it was 20 years ago. The following graphs explain why.

Weekly pay for men has become more unequal for 2 reasons: hourly pay has become more unequal, and low-paid men are working fewer hours per week

Figure 3. Weekly and hourly pay growth for men, 1994–95 to 2014–15

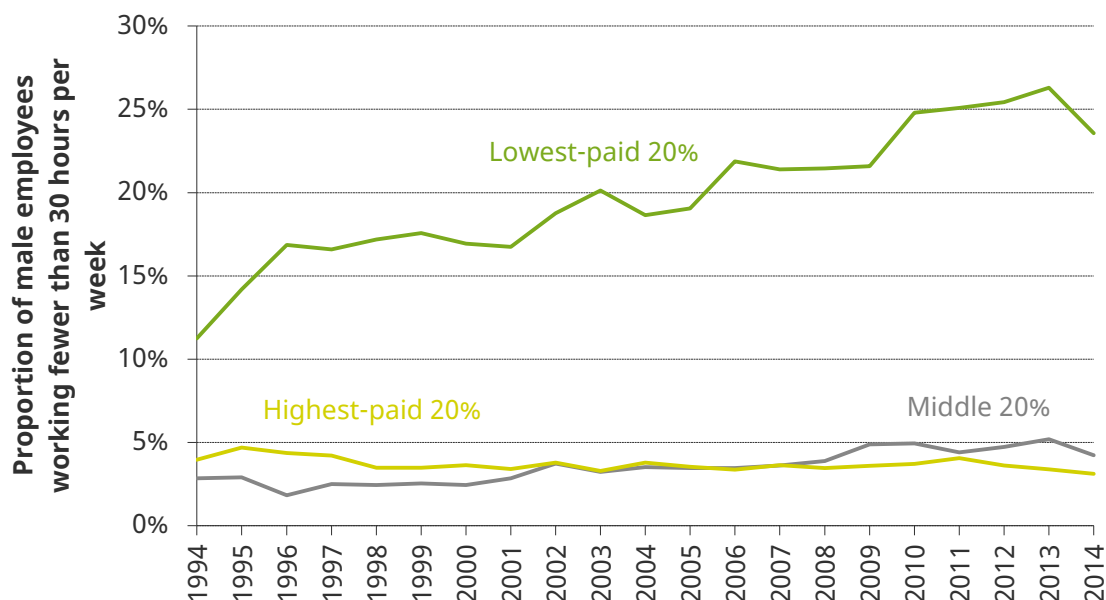


Note and source: See Figure 5 of the main paper.

Low paid men have seen relatively slow growth in hourly pay, and this has been compounded by also experiencing the largest falls in their number of hours worked. This combination has resulted in a substantial increase in weekly pay inequality between men.

Men with low hourly pay have become significantly more likely to work part-time

Figure 4. Proportion of men working part-time by hourly pay, 1994-95 to 2014-15



Note: Sample is male employees of working age, excluding those with hourly pay in the bottom 5% or top 5% of the overall hourly pay distribution. Hours are those in main job, and include paid but not unpaid overtime.

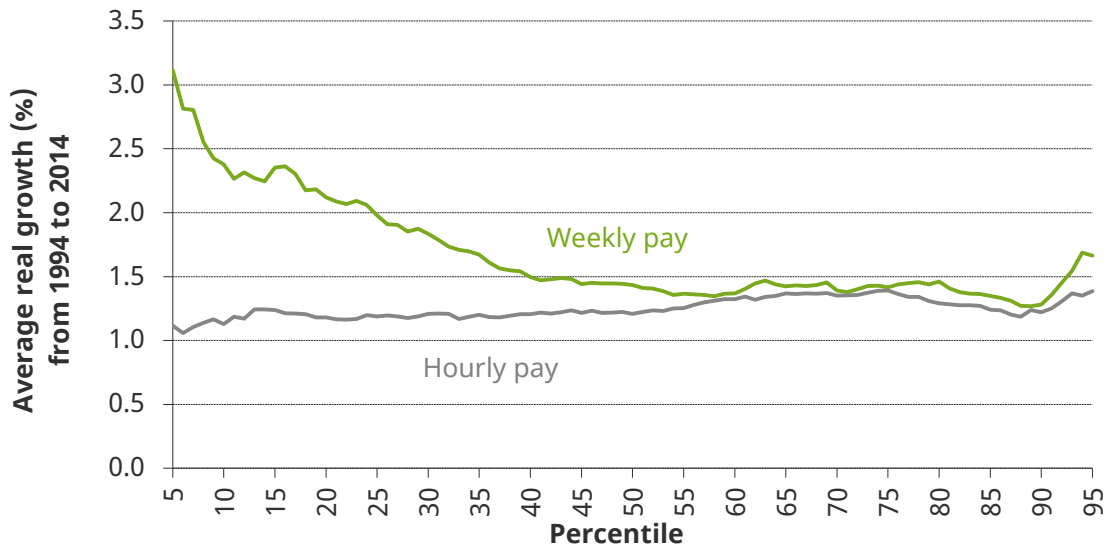
Source: Authors' calculations using the Labour Force Survey, various years.

Twenty years ago it was rare for men to work part-time (fewer than 30 hours per week). Whilst it remains very rare for middle and high wage men, about one in four male employees with low hourly wages now works part-time. Men in this group work on average 5 fewer hours per week than they did 20 years ago. Hence this phenomenon has become increasingly important in explaining inequality in pay between men. It is also clear from the figure that it was not simply an effect of the recession: it has been a consistent trend over the past 20 years.

Looking more closely at these changing patterns of hours worked for men, the increase in part-time work among those on low wages has not been driven simply by the youngest or oldest workers: it has happened among prime-age men too. It has also occurred for both single men and those with partners, and men with and without dependent children. As well as the rise in part-time work, there has also been a steady decline in the proportion of low-paid men working very long hours. The Annex contains further details.

Conversely, inequality in weekly pay for women fell

Figure 5. Weekly and hourly pay growth for women, 1994–95 to 2014–15

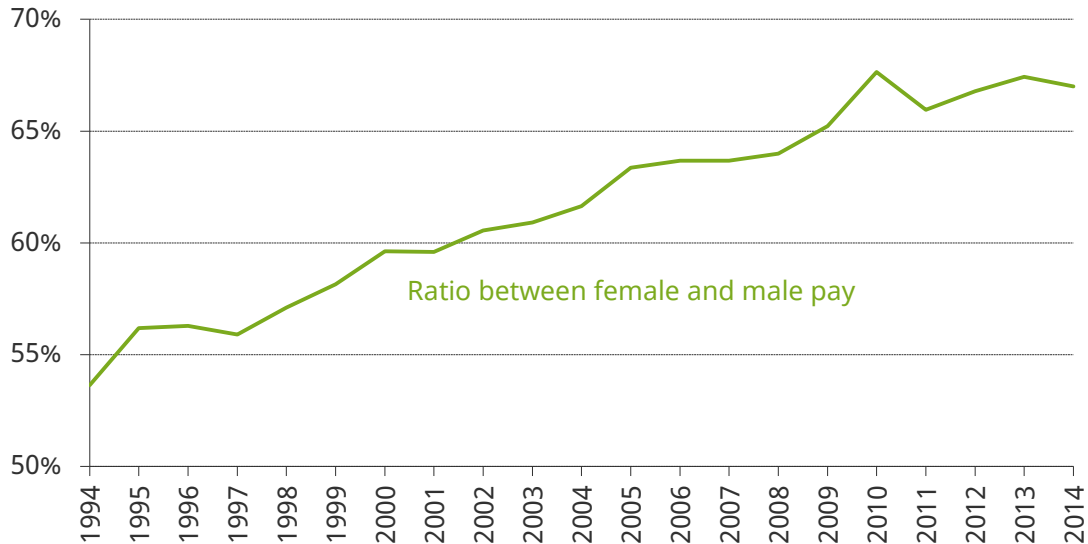


Note and source: See Figure 5 of the main paper.

Hourly pay for women has grown at a similar rate across the distribution over the past 20 years. But patterns in hours worked have acted to reduce inequality in weekly pay for women (the opposite of what has happened for men). There is much less variability in the hours worked by female employees than there used to be, and those with low hourly pay in particular are more likely to be working full-time. As a result, between 1994–95 and 2014–15 female weekly pay rose by 60% at the 10th percentile compared to only 29% at the 90th percentile.

Female weekly pay grew faster than male weekly pay

Figure 6. Female median weekly pay as a share of median male weekly pay, 1994–95 to 2014–15



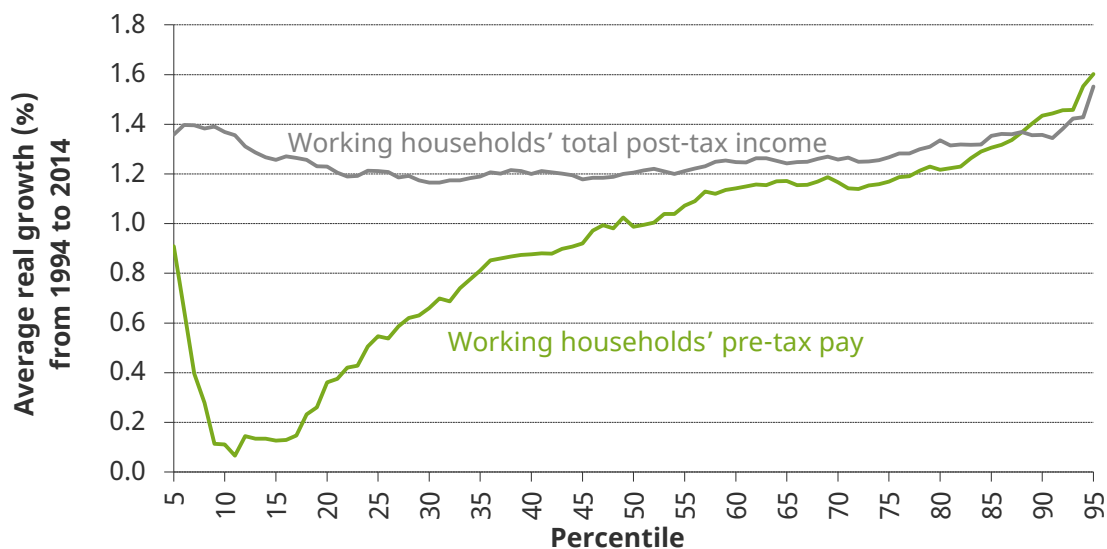
Note and source: See Figure 5 of the main paper.

Increased rates of full-time work among women have been a major factor in narrowing the gap in weekly earnings between women and men.

The gap in hourly pay between men and women has also narrowed, though – as previous IFS research has shown – much of this is due to rises in education levels among women relative to men. Looking within education groups, only among the lowest-educated has the gender hourly wage gap narrowed over the past two decades.

The tax and benefit system has prevented a rise in income inequality between working households

Figure 7. Household income growth for working households 1994 to 2014



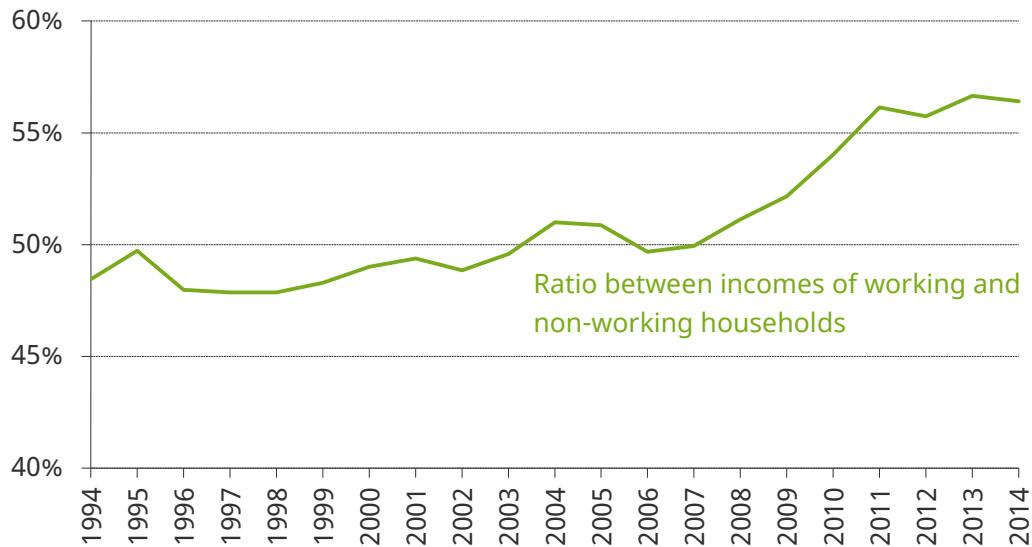
Note and source: See Figure 7c of the main paper.

Looking at working households, inequality in their pre-tax pay is higher than it was 20 years ago. At the 10th percentile, household pre-tax pay rose by 20% between 1994–95 and 2014–15, while at the 90th percentile it rose by 32%. This is primarily due to the rise in inequality in male earnings, which remain the largest source of income for working households. In the paper we also show that an increased tendency for high- (and low-) earning men and high- (and low-) earning women to be partnered with each other has also played a supporting role in increasing household earnings inequality.

However, inequality in their net income – that is, after direct taxes have been paid and state benefits received – did not rise. This was partly the result of deliberate policy decisions, and in particular the large expansion of tax credits in the late 1990s and 2000s, which boosted the income of low-income working households. Another factor was the stabilising effect of the tax and benefit system when pay fell during the Great Recession: the lowest-earning households found that a substantial portion of their income was protected from this (as it came from the state, so was indexed at least to prices), and entitlements to means-tested payments tend to rise when earnings fall.

Since the Great Recession the gap between the incomes of workless and working households has narrowed

Figure 8. Median household income in workless households relative to working households (excluding pensioners). 1994–95 and 2014–15

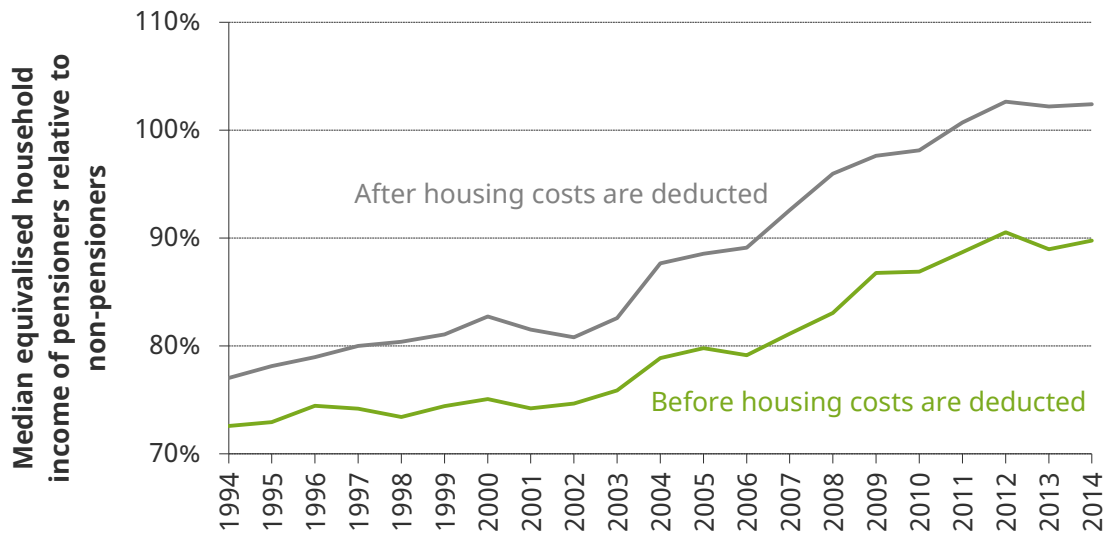


Note and source: See Table 5 of the main paper.

The fall in real pay during the Great Recession had a large impact on the incomes of working households, while workless households – which are more reliant on price-indexed benefit income – were not affected. This relative catch up of workless households led to a fall in working-age household income inequality. In the main paper we also show that the long-running decline in the number of workless households has also acted to reduce inequality.

The incomes of pensioner households have been growing much faster than the incomes of working-age households

Figure 9. Median household income of pensioners relative to non-pensioners, 1994-95 to 2014-15



Note: Incomes measured after taxes and benefits, and equivalised to account for household size.

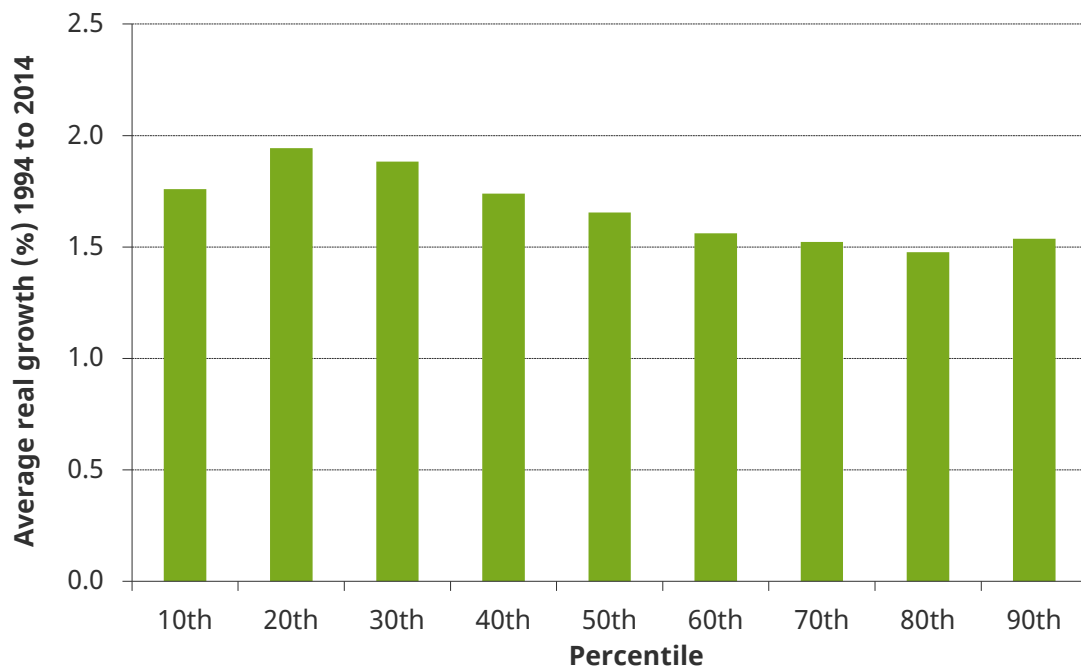
Source: Authors' calculations using the Family Expenditure Survey, various years.

This trend is not simply an artefact of the Great Recession but has been going on for decades. Growth in pensioner incomes has been driven primarily by increases in private pension provision and in entitlements to state pensions across successive cohorts of pensioners. Because pensioners were historically a relatively poor group, this trend has reduced overall household income inequality.

In fact, if we use a measure of income that accounts for differences in housing costs – as is sensible when comparing age-groups – median household income among pensioners has been higher than among the rest of the population since 2011-12.

The net result is that household income inequality fell across the majority of the distribution is lower than it was 20 years ago

Figure 10. Net household income growth across the income distribution, 1994-95 to 2014-15.



Note: Incomes measured after taxes and benefits, and equivalised to account for household size.

Source: Authors' calculations using the Family Expenditure Survey, various years.

At the 20th percentile (20% of the way up the distribution) incomes grew at 1.9% a year on average between 1994-95 and 2014-15. At the 80th percentile (80% of the way up the distribution) incomes grew by 1.5% a year over the same period. That might not sound like a big difference, but it meant that incomes at the 20th percentile rose by 47% in total, compared to a 34% increase at the 80th percentile.

Summary: why is income inequality across most of the population lower than 20 years ago?

Inequality in pre-tax pay across working households rose...

- This is **largely because weekly earnings inequality among men rose**: partly because hourly wages grew faster towards the top than at the middle and bottom of the distribution, and partly because men with low hourly wages are now working fewer hours per week.
- It is **despite a fall in weekly earnings inequality among women**, driven by less variability in the hours worked by female employees, and in particular more full-time work for women with low hourly wages.
- Male earnings remain the largest source of income for working households, so they drove an overall increase in household pay inequality. An increasing tendency for high- (and low-) earning men and high- (and low-) earning women to be partnered with each other also contributed.

...but including benefits and after taxes, inequality in total household income among working households has not risen

- The **tax and benefit system has worked increasingly hard** to offset the rise in inequality in pay between working households.
- This partly reflects **deliberate large increases in benefits and, particularly, tax credits** which boosted the incomes of low-income working households in the late 1990s and 2000s.
- It also reflects the **insurance against falls in pay provided by the tax and benefit system to those on low incomes** during the recession.

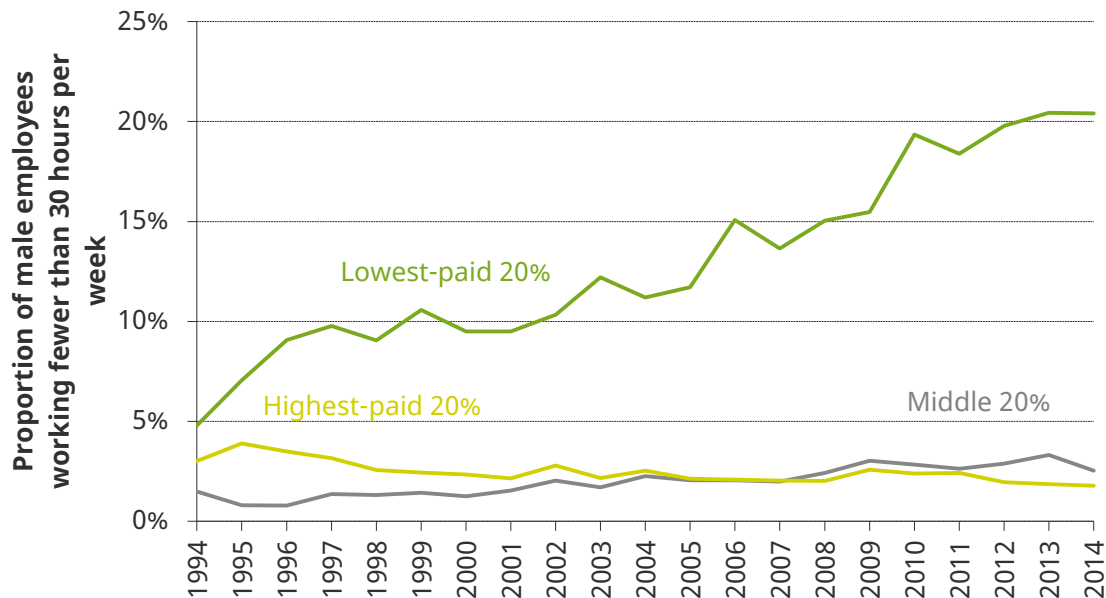
Once we include all households, not just those in work, we find that income inequality has actually fallen over the past 20 years because:

- The number of workless households has fallen.
- The gap between workless households (of working age) and working households has narrowed since the recession.
- Pensioners have caught up with the rest.

Executive Summary – Annex on Hours Worked by Low-Wage Men

Two decades of Income Inequality in Britain: The role of Wages, Household Earnings and Redistribution

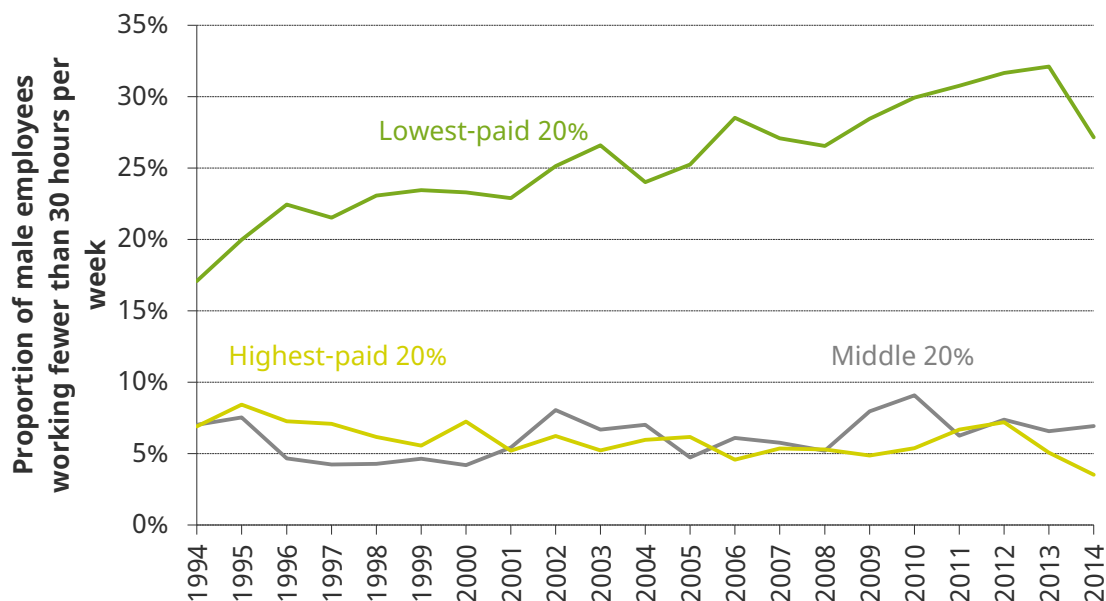
Annex Figure A. Proportion of men aged 25-55 working part-time by hourly pay, 1994-95 to 2014-15



Note: Sample is male employees aged 25 to 55, excluding those with hourly pay in the bottom 5% or top 5% of the overall hourly pay distribution. Hours are those in main job, and include paid but not unpaid overtime.

Source: Authors' calculations using the Labour Force Survey, various years.

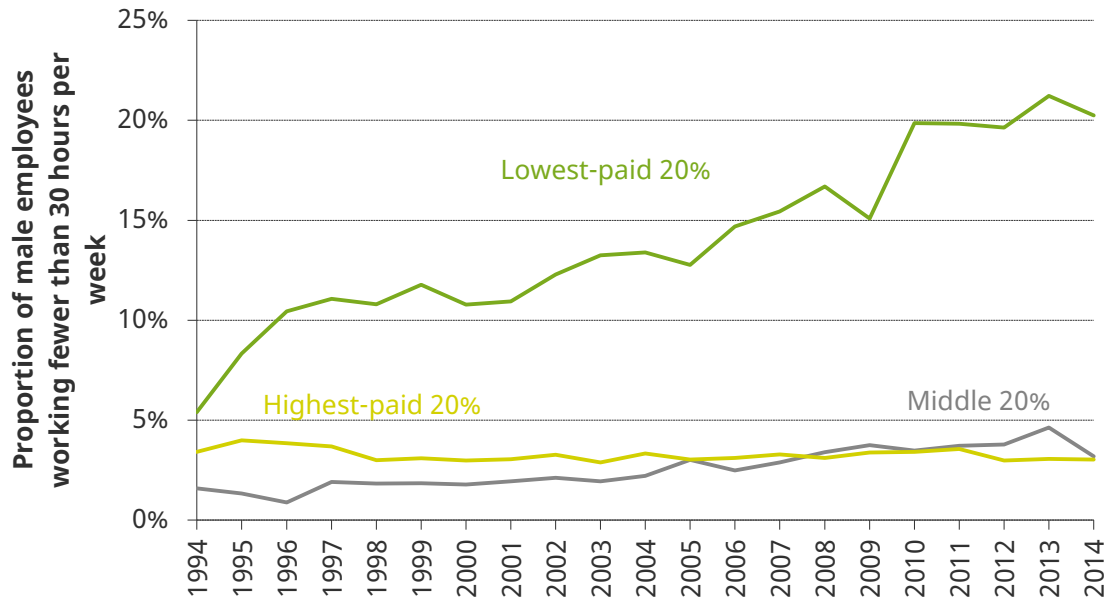
Annex Figure B. Proportion of single working-age men working part-time by hourly pay, 1994-95 to 2014-15



Note: Sample is single male employees of working age, excluding those with hourly pay in the bottom 5% or top 5% of the overall hourly pay distribution. Hours are those in main job, and include paid but not unpaid overtime.

Source: Authors' calculations using the Labour Force Survey, various years.

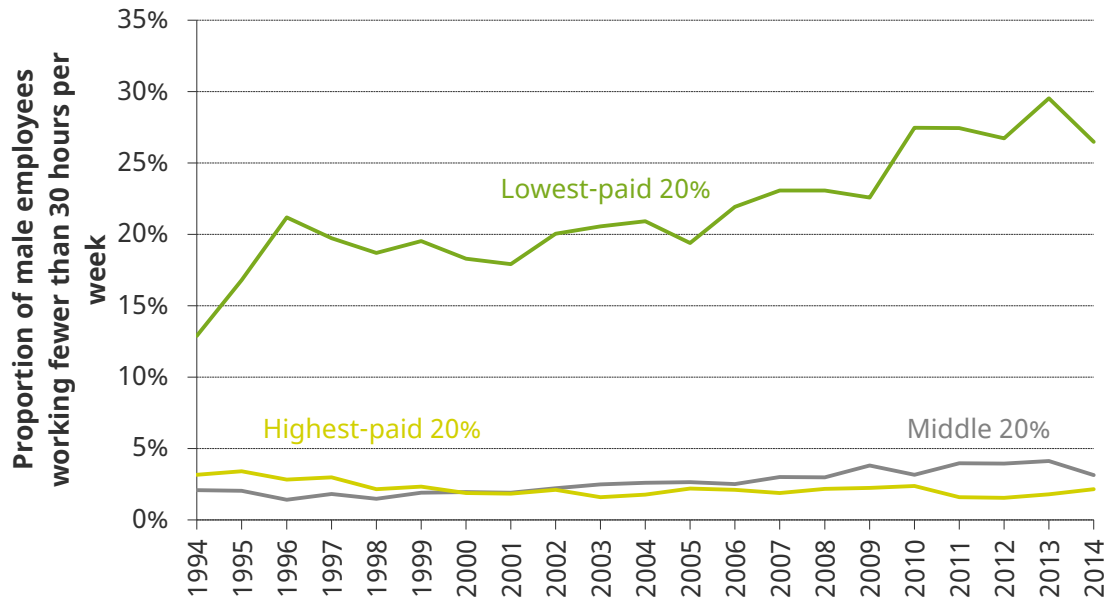
Annex Figure C. Proportion of working-age men in couples working part-time by hourly pay, 1994-95 to 2014-15



Note: Sample is male employees of working-age in couples, excluding those with hourly pay in the bottom 5% or top 5% of the overall hourly pay distribution. Hours are those in main job, and include paid but not unpaid overtime.

Source: Authors' calculations using the Labour Force Survey, various years.

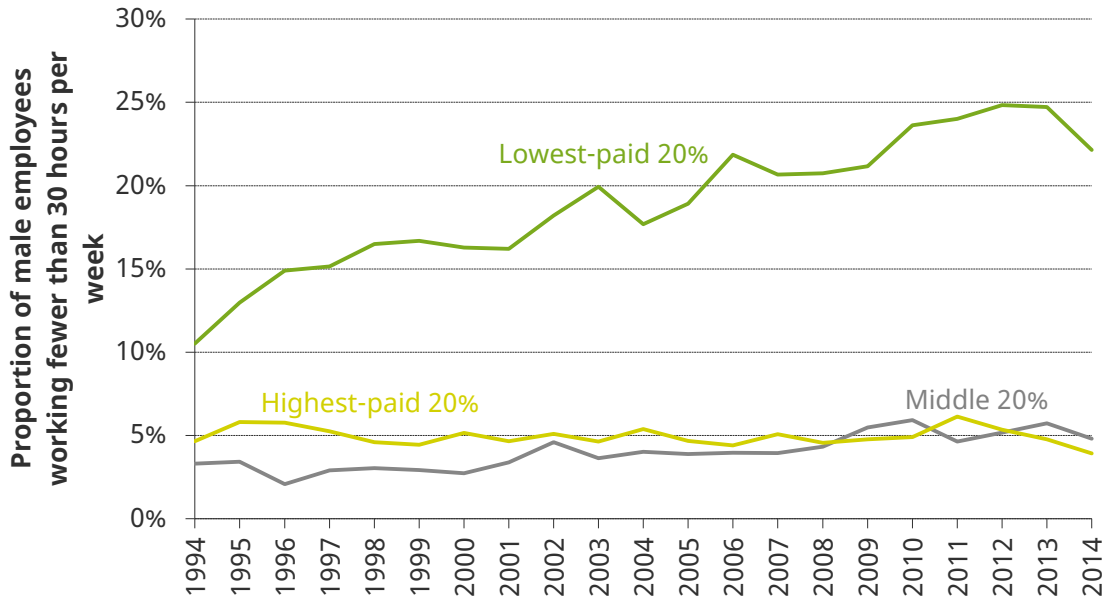
Annex Figure D. Proportion of working-age men with children aged 16 or under working part-time by hourly pay, 1994-95 to 2014-15



Note: Sample is male employees of working-age in couples, excluding those with hourly pay in the bottom 5% or top 5% of the overall hourly pay distribution. Hours are those in main job, and include paid but not unpaid overtime.

Source: Authors' calculations using the Labour Force Survey, various years.

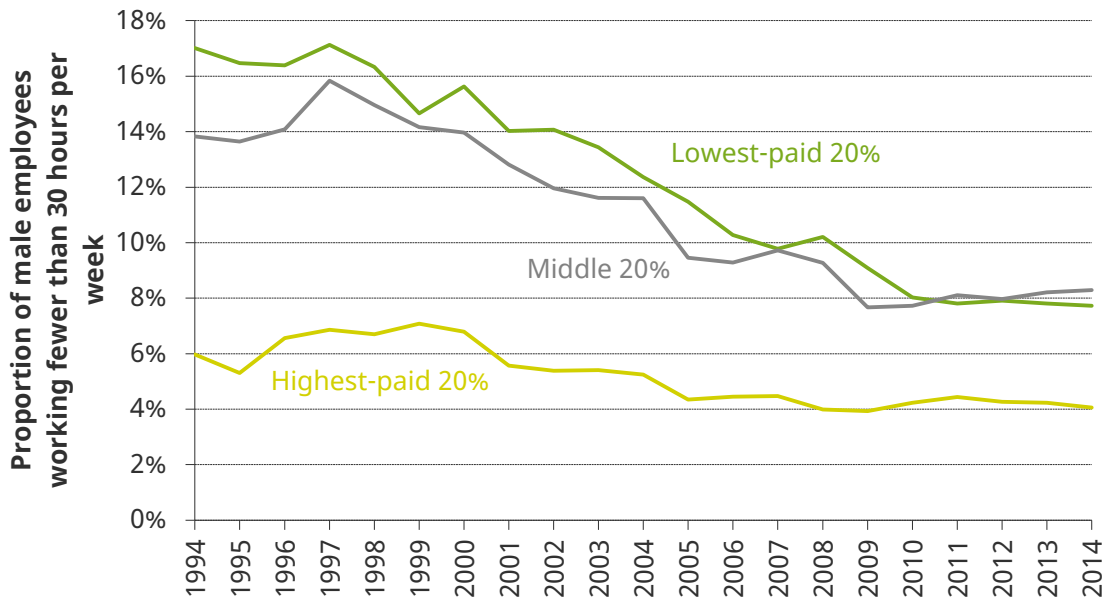
Annex Figure E. Proportion of working-age men without children aged 16 or under working part-time by hourly pay, 1994-95 to 2014-15



Note: Sample is male employees of working-age in couples, excluding those with hourly pay in the bottom 5% or top 5% of the overall hourly pay distribution. Hours are those in main job, and include paid but not unpaid overtime.

Source: Authors' calculations using the Labour Force Survey, various years.

Annex Figure F. Proportion of working-age men working more than 50 hours a week in their main job by hourly pay, 1994-95 to 2014-15



Note: Sample is male employees of working age, excluding those with hourly pay in the bottom 5% or top 5% of the overall hourly pay distribution. Hours are those in main job, and include paid but not unpaid overtime.

Source: Authors' calculations using the Labour Force Survey, various years.