



Institute for
Fiscal Studies



Living Standards and Inequality

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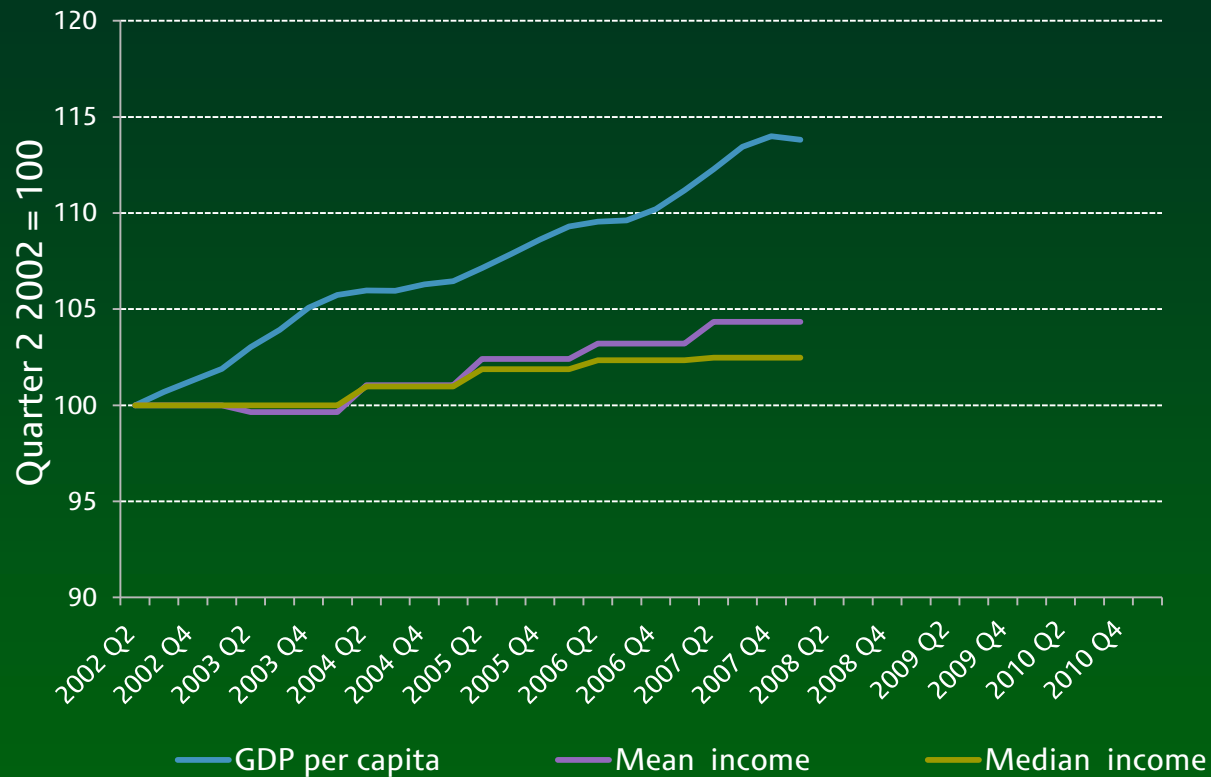
Outline

- Living Standards
 - Changes in income in 2010-11 and the recent recession
 - How did different components of income change?
- Inequality
 - Changes in income across the income distribution
 - Changes in measures of inequality

How household income is calculated in HBAI

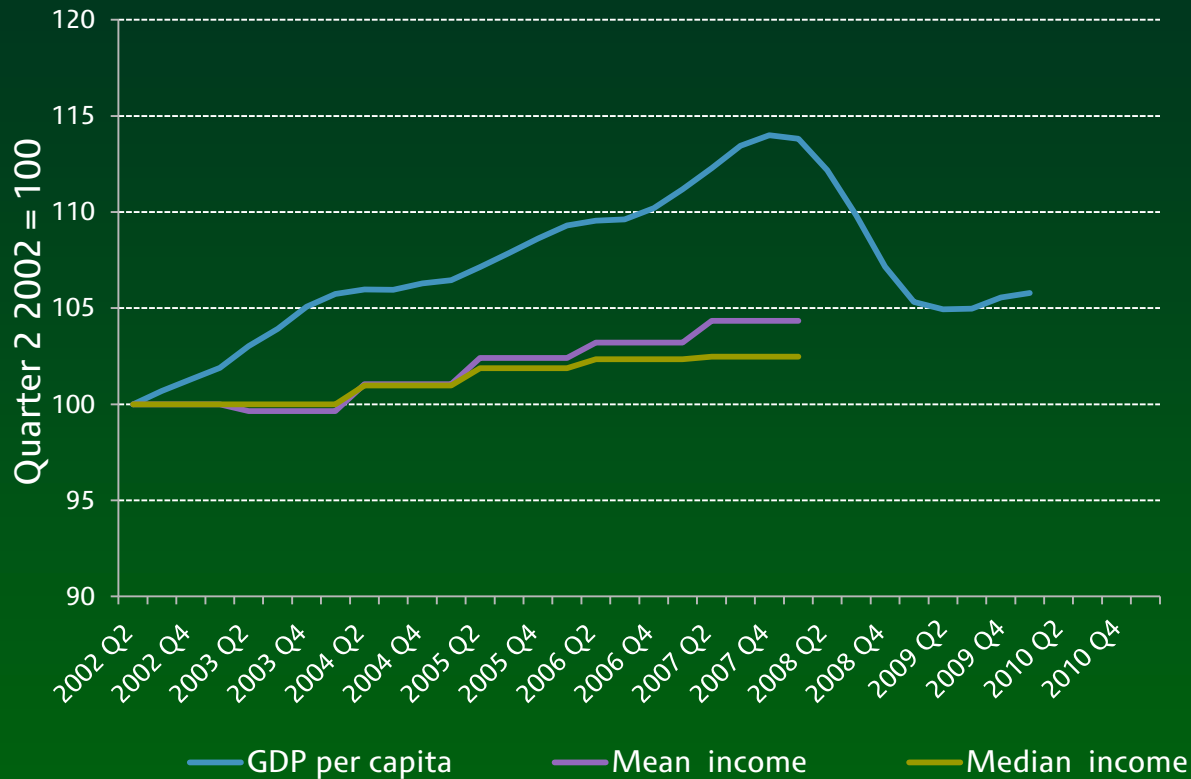
- Income is measured net of direct taxes and benefits
 - We show some new analysis of private incomes (before direct taxes and benefits)
- Measured at the household level
- Adjusted for household size
- Can be measured both before and after housing costs are deducted
- Adjusted for inflation
- Based on Family Resources Survey in 2010-11
 - 25,000 households across the UK
 - Subject to sampling error
- Any figures going back before 2002-03 refer to Great Britain not UK
 - Northern Ireland not included in the FRS until 2002-03

Slow income growth before the recession



Source: ONS series IHW and Family Resources Survey, various years

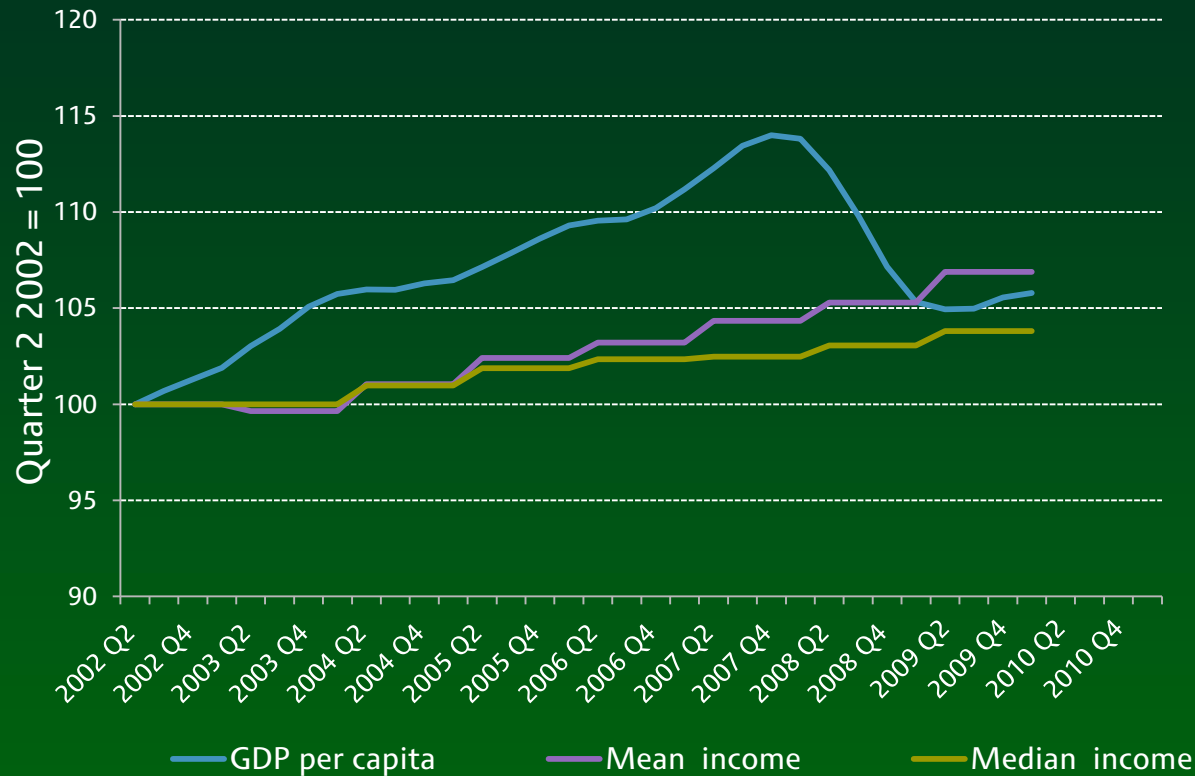
Sharp fall in GDP per capita in recession...



Peak to trough
fall in GDP per
capita of 7.9%

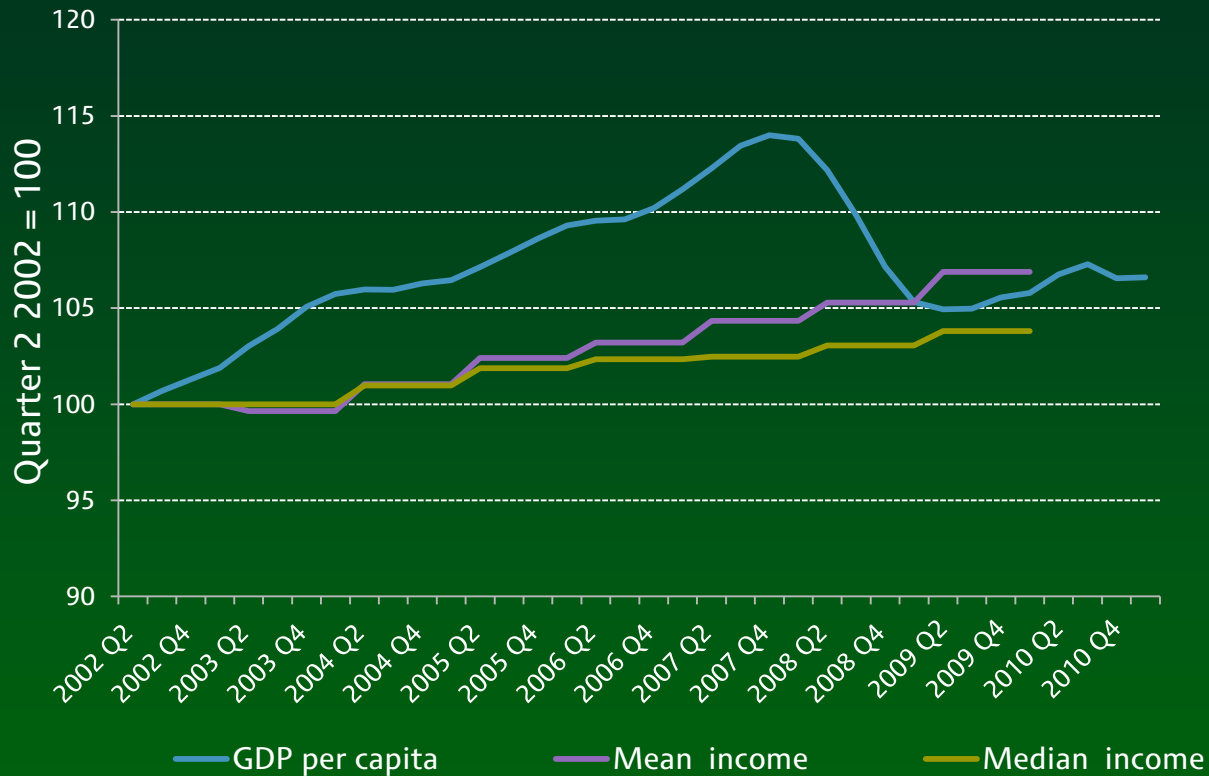
Source: ONS series IHXW and Family Resources Survey, various years

...But average incomes continue to rise



Source: ONS series IHW and Family Resources Survey, various years

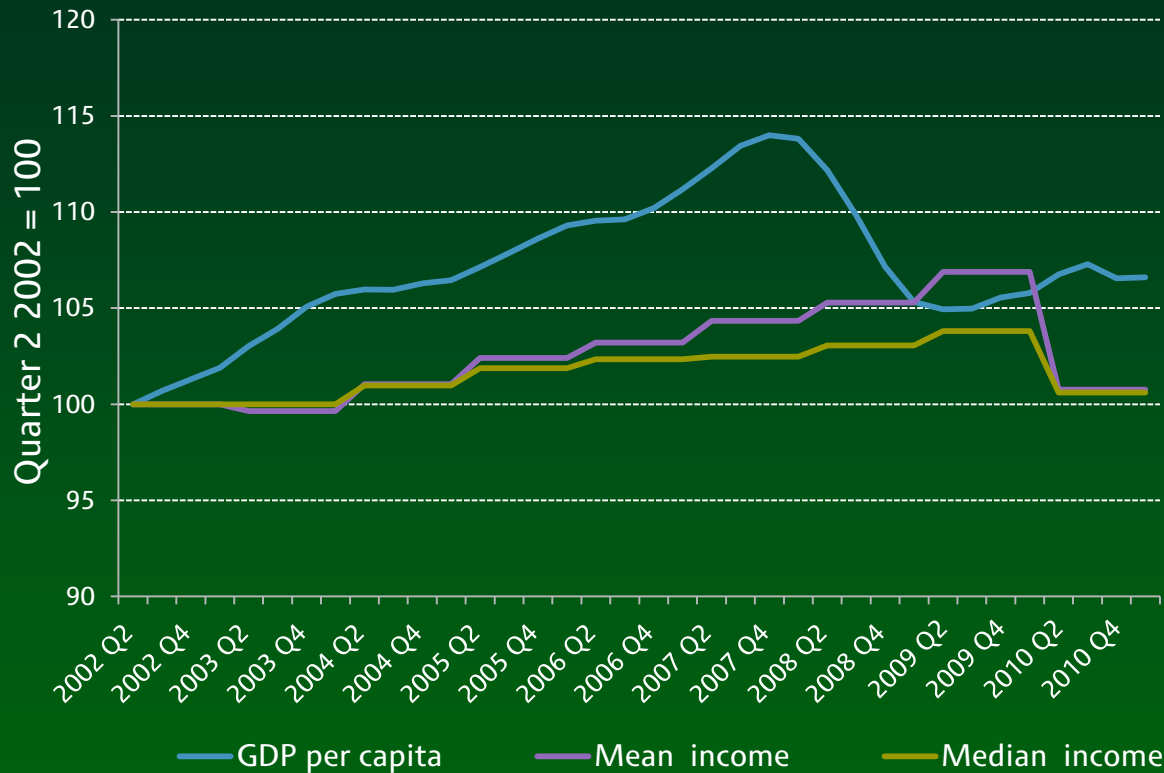
Weak macroeconomic recovery in 2010-11



GDP per capita
grew 1.4% in
2010-11

Source: ONS series IHXW and Family Resources Survey, various years

Large falls in average income in 2010-11



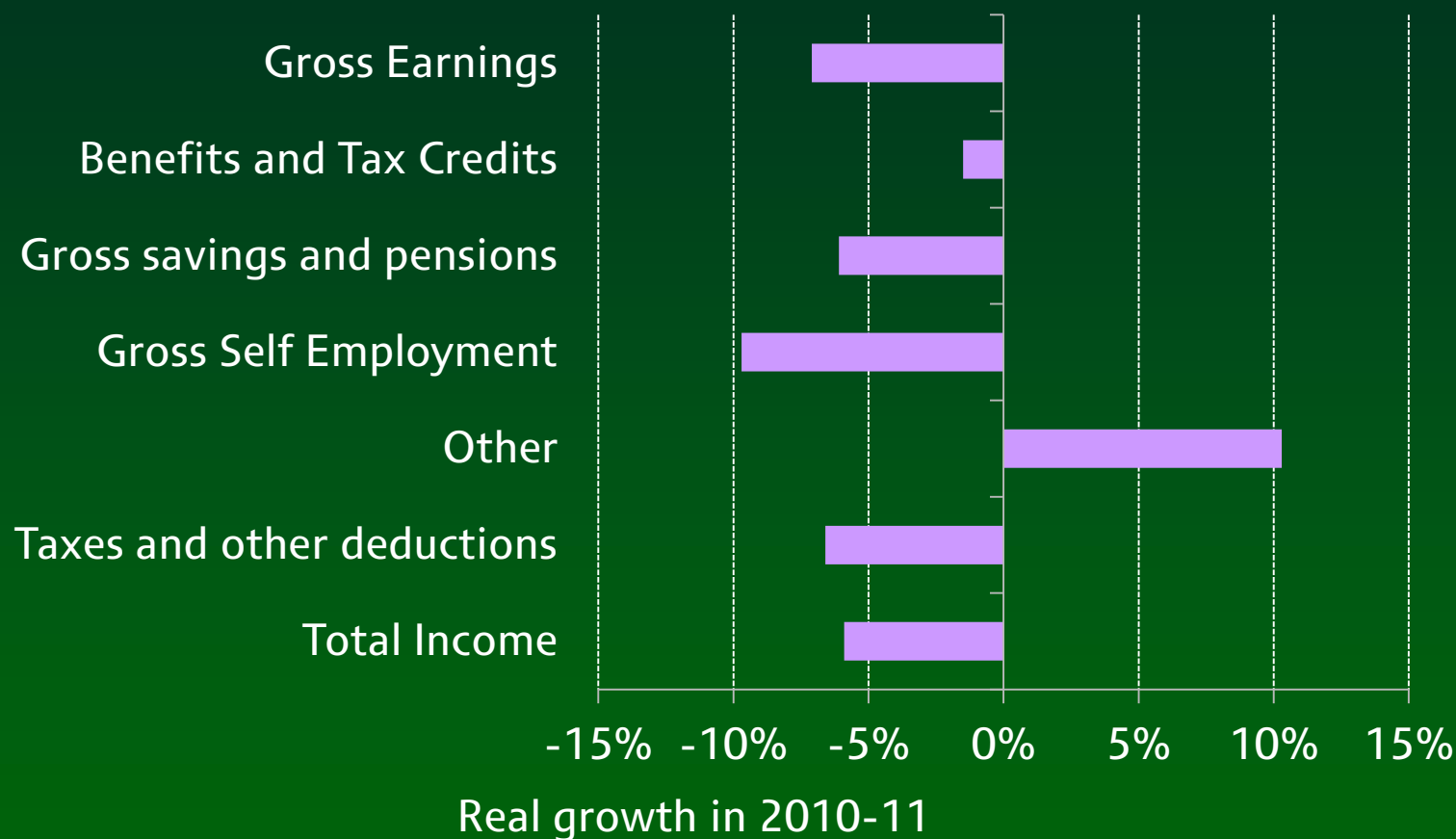
Source: ONS series IHXW and Family Resources Survey, various years

- Median income fell 3.1% to reach £ 419 per week
- Mean income fell 5.7% to reach £511 per week

Historical perspective of 2010-11 falls

- Mean and median income now lower than their respective levels in 2004-05, reversing 5 years of slow growth in one year.
- The largest one-year fall in median income since 1981
- The largest one-year fall in mean income since at least 1961
 - distorted by “forestalling”: introduction of 50p tax rate in April 2010

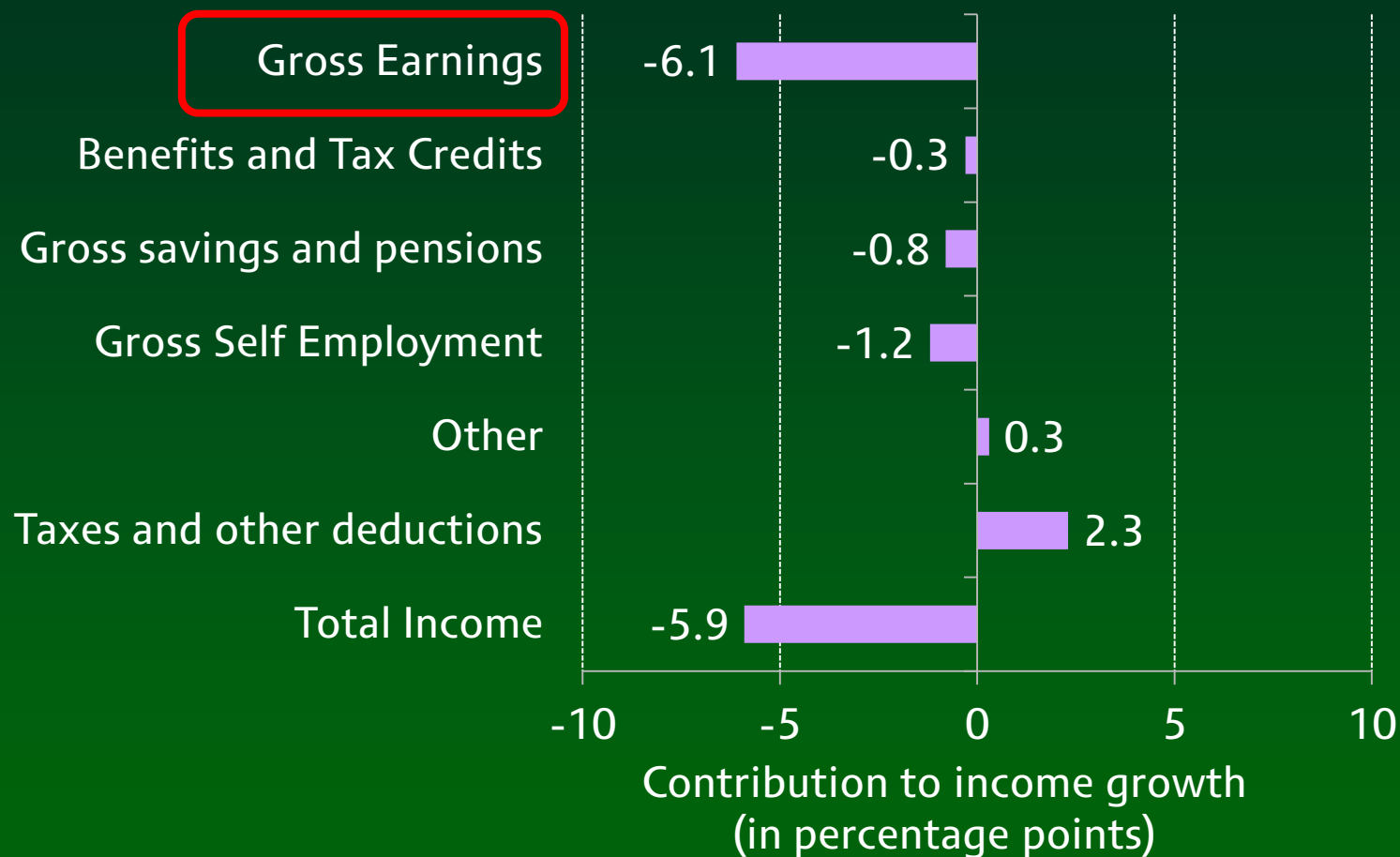
Changes in income components in 2010-11



Source: Table: 2.3 of *Living Standards, Poverty and Inequality: 2012*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

Gross earnings drove income falls in 2010-11



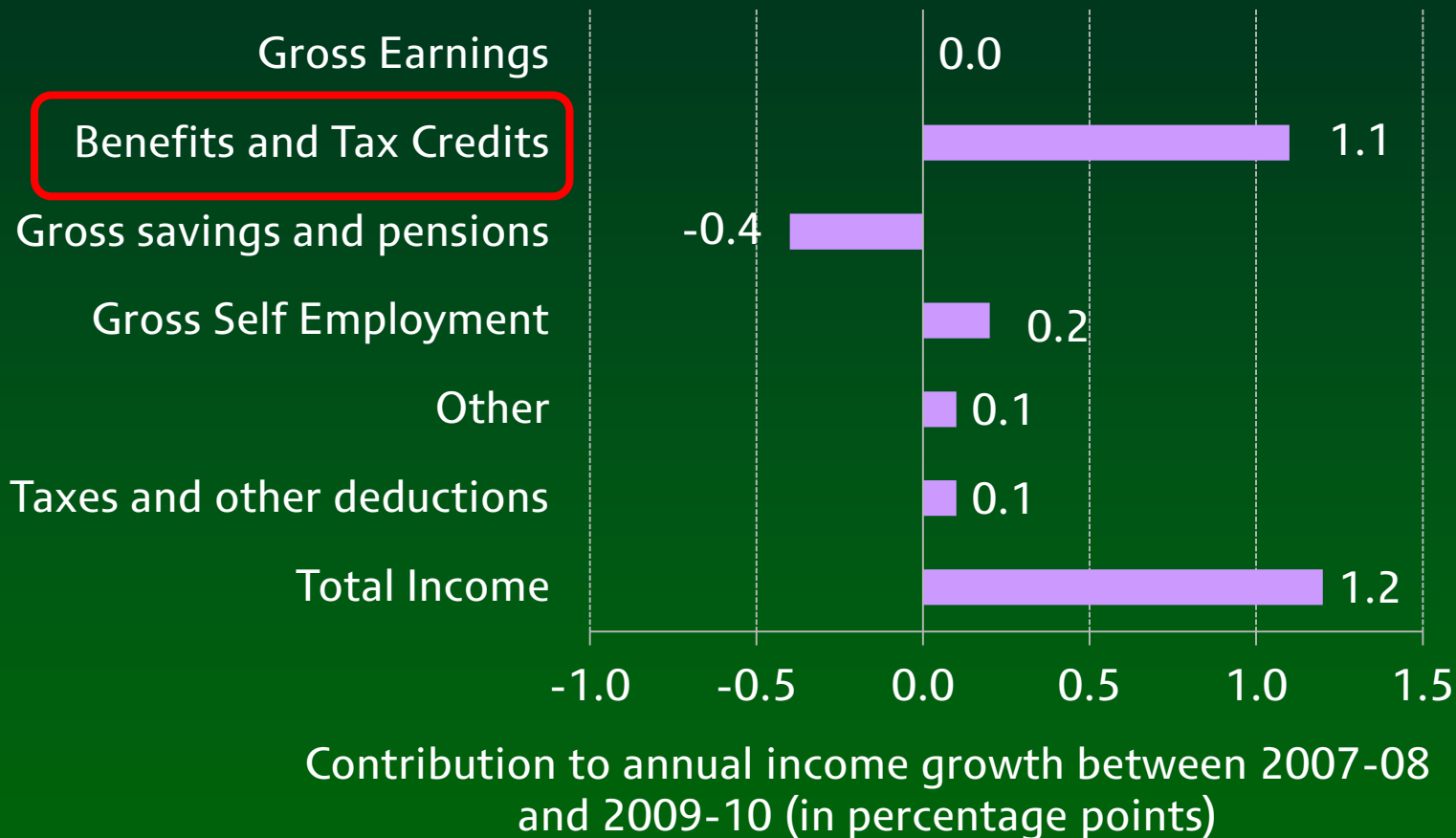
Source: Table: 2.3 of *Living Standards, Poverty and Inequality: 2012*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

What happened to earnings and benefits?

- Gross Earnings
 - Employment was broadly stable
 - Earnings of those employed did not keep pace with rising inflation
- Benefits and Tax Credits
 - Benefits generally increased by inflation in the previous September
 - With inflation rising to 5.1% in 2010-11, real value of benefits fell

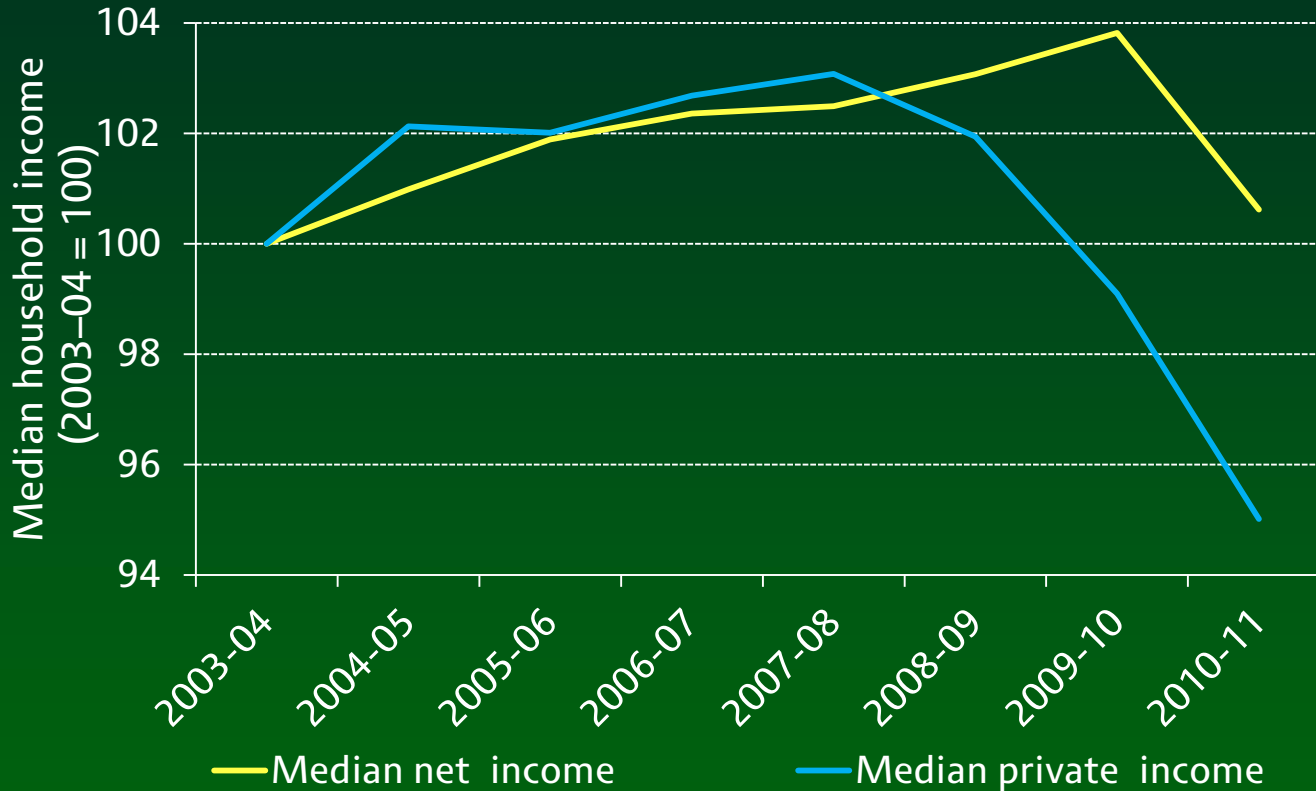
Benefits supported incomes during the recession



Source: Table: 2.3 of *Living Standards, Poverty and Inequality: 2012*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

What happened to private incomes?



- Fall in median private income of 7.8% since peak in 2007-08
- Median private income fell 4.1% in 2010-11 alone

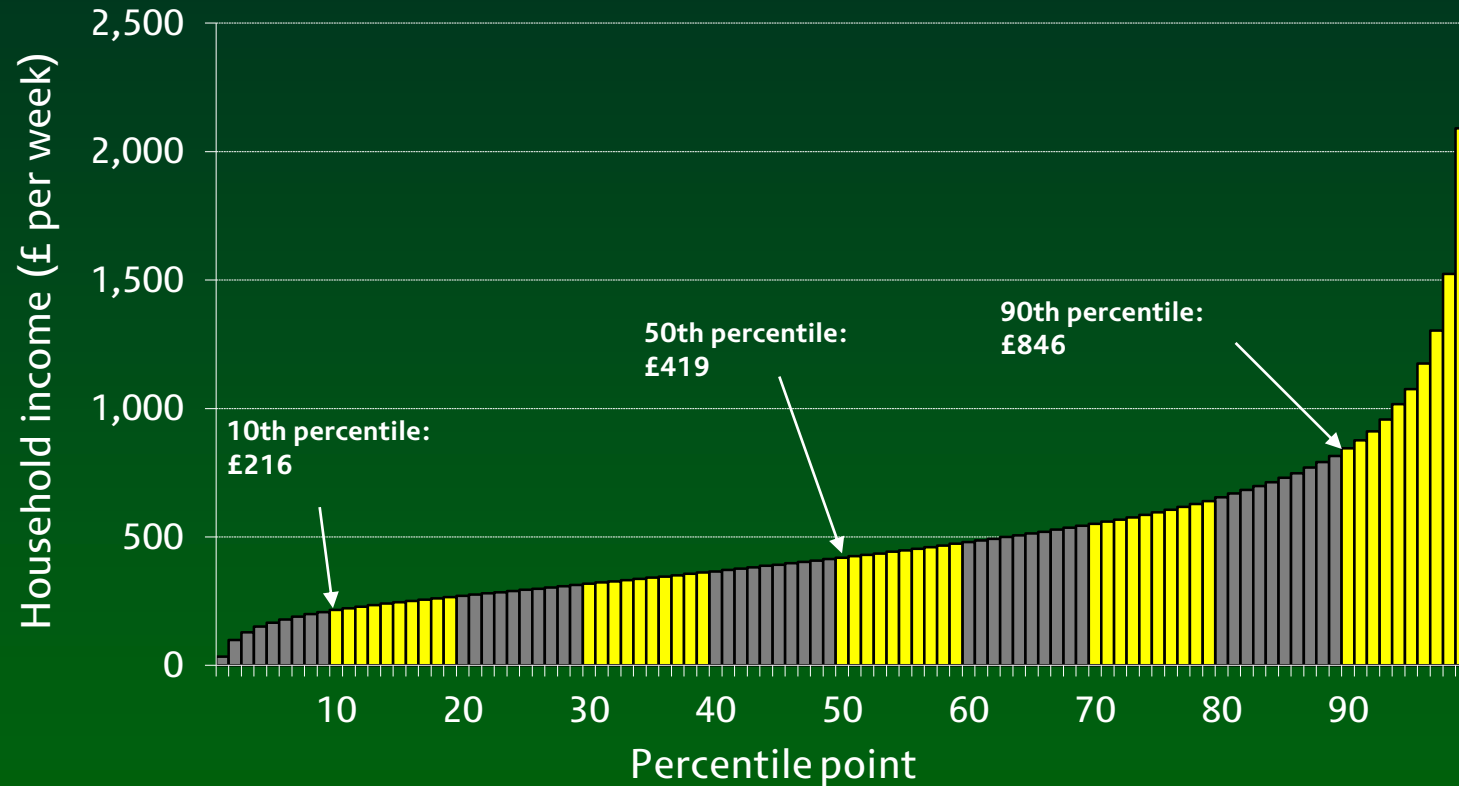
Prospects for living standards

- Earnings
 - 2011-12: Average earnings rose by 1.9%, below inflation of 4.8%
 - OBR predicts negative real earnings growth in 2012-13
- Tax and benefit changes
 - National Insurance rise (1 percentage point) in April 2011
 - Cuts to welfare payments reach about £18 billion per year by 2014-15
- Recent IFS work projected that median income will fall in 2012-13 and 2013-14
- In 2015-16 median income lower than in 2002-03
 - But these are based on uncertain macroeconomic forecasts

Inequality

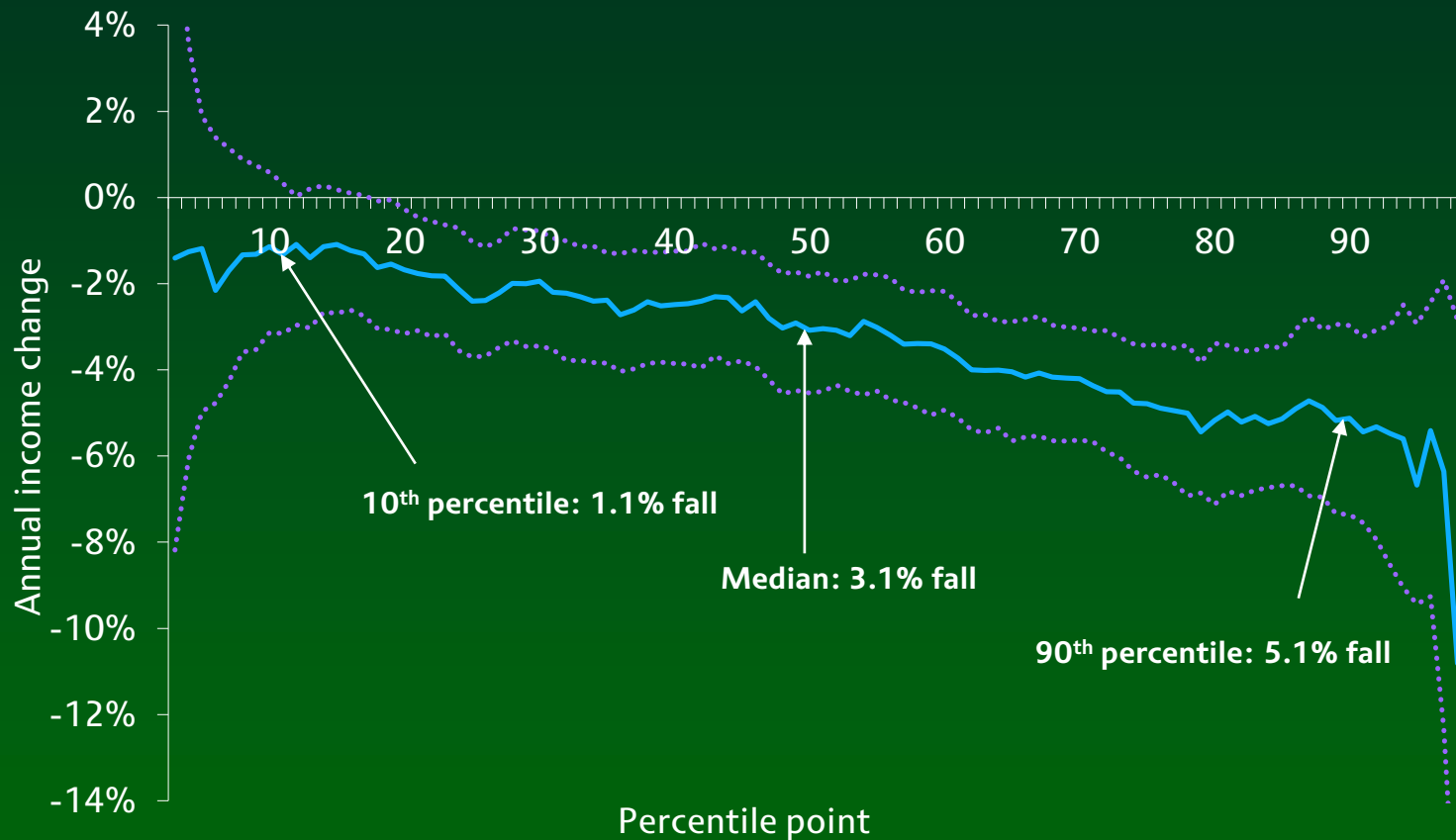


The UK income distribution 2010-11



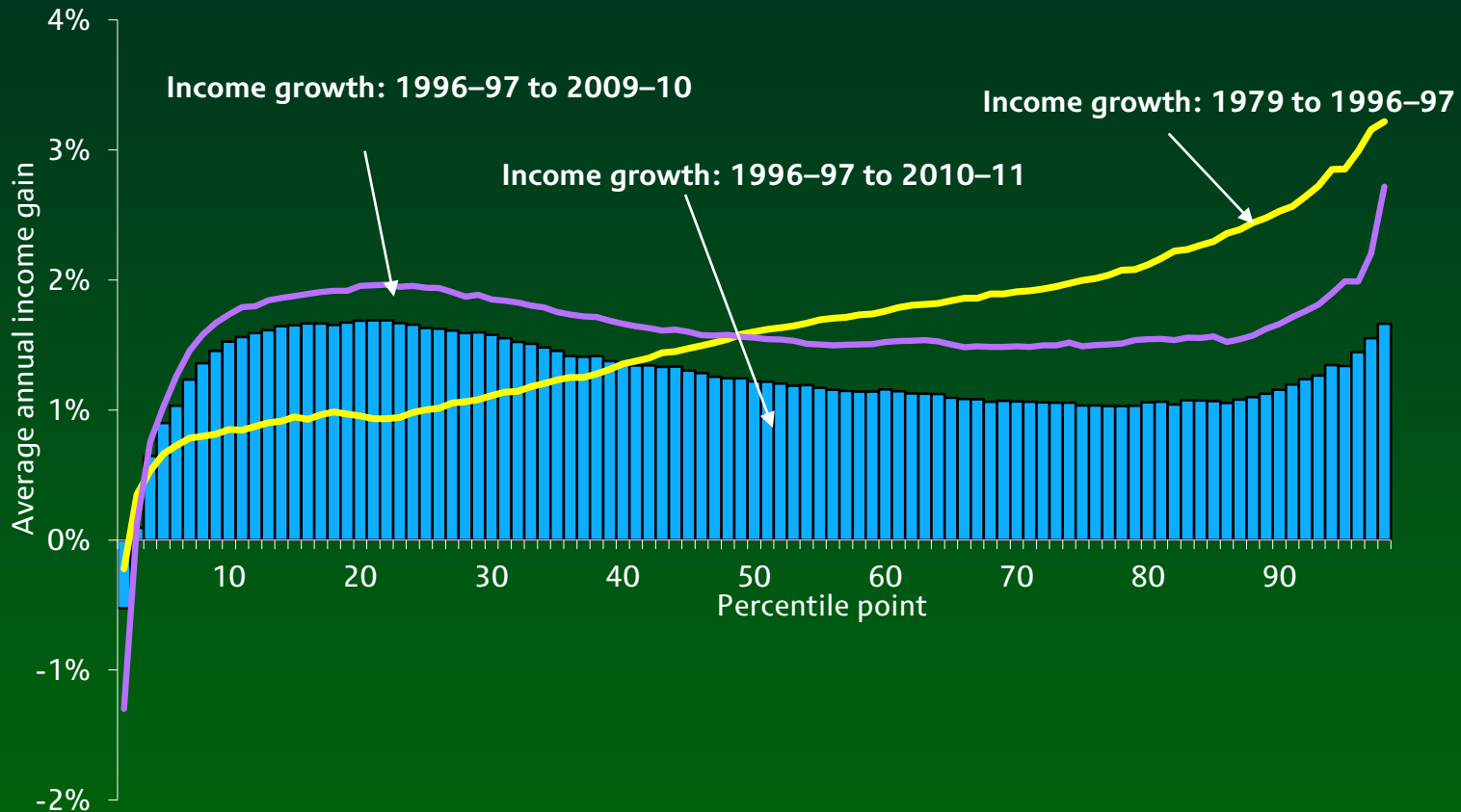
Source: Figure 3.1 of *Living Standards, Poverty and Inequality: 2012*

Income change by percentile point in 2010-11



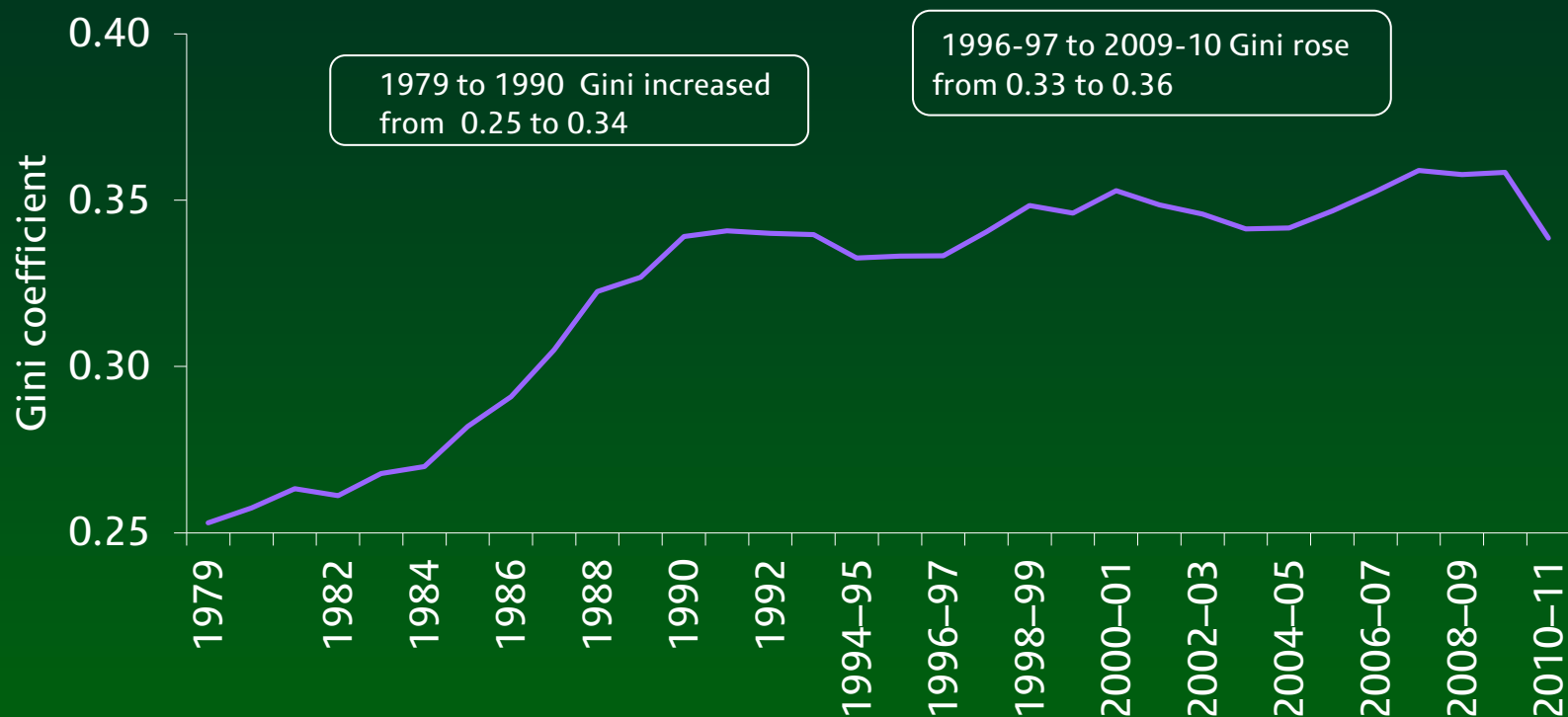
Source: Figure 3.3 of *Living Standards, Poverty and Inequality: 2012*

Income growth since 1979 (GB)



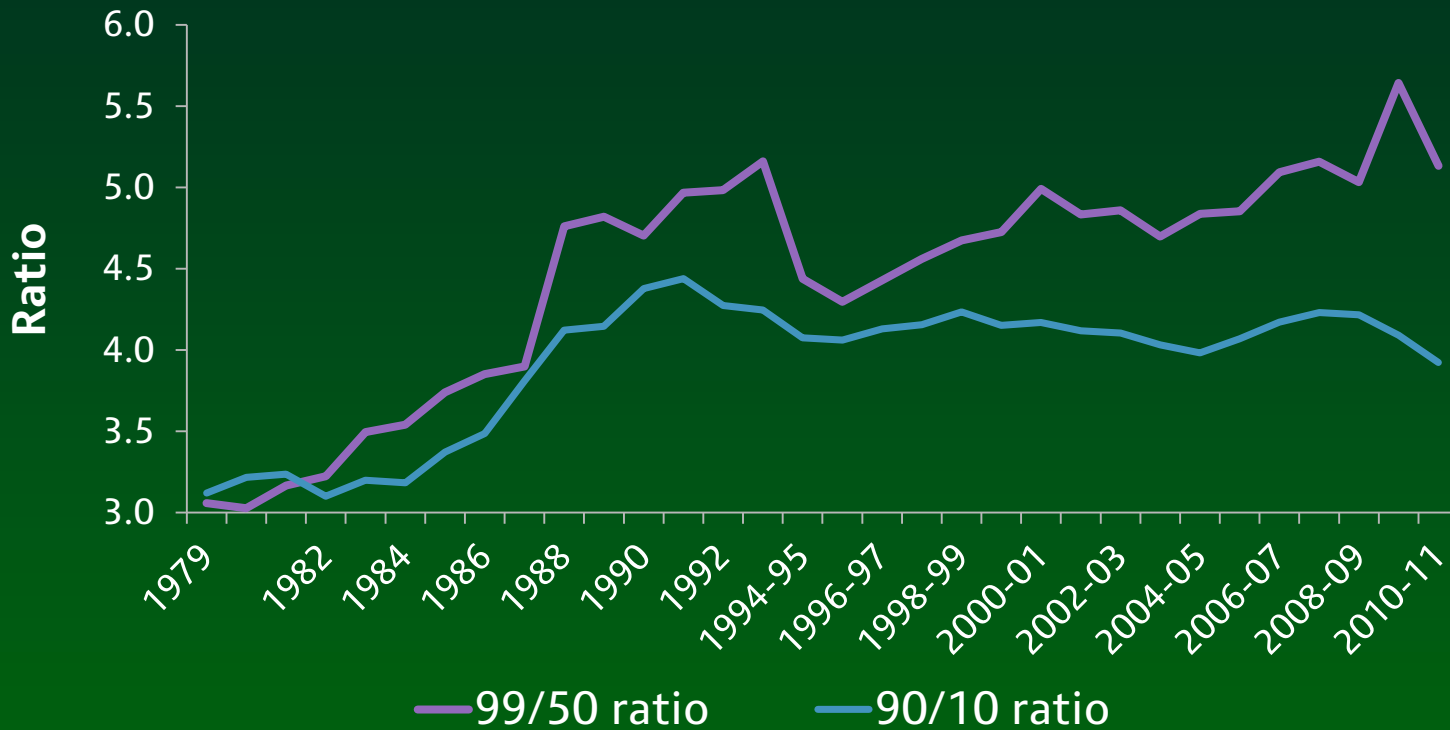
Source: Figure 3.5 of *Living Standards, Poverty and Inequality: 2012*

Gini coefficient: 1979 to 2010-11 (GB)



- Gini fell from 0.36 to 0.34 in 2010-11
- Largest one year fall since at least 1961
- Returns Gini to below its 1997-98 level

Inequality ratios: 1979 to 2010-11 (GB)



99/50 ratio fell to 5.1
(still higher than 2008-09)

90/10 ratio fell to 3.9
(lower than in 1987)



Prospects for inequality

- Evolution of earnings and employment very important, and very uncertain
- Welfare cuts unsurprisingly will hit lower income households proportionately more
- Decrease in top rate of tax from April 2013 likely to increase top household incomes
- At top of distribution, temporary effects of “reverse forestalling” will make it difficult to observe “underlying” income inequality until at least 2014-15, and possibly until 2016/17

Summary

- Effect of the recession was finally felt on average household incomes in 2010-11
- Median income fell by 3.1%, the largest fall since 1981
- Median private income has now fallen 7.8% since 2007-08
- The falls in income were proportionately larger for richer households which meant that inequality fell sharply in 2010-1
 - Inequality measures unaffected by “forestalling” also fell sharply