

CSI 2: What has been happening to incomes?

Summary

- Median household income, measured in real terms after taking account of inflation, reached its highest point in 2009-10. It has since fallen back somewhat but is still more than double the level from fifty years earlier.
- Inequality in real household income also reached its highest point in 2009-10 before falling back, but most of the increase in inequality happened between 1979 and 1991.
- Absolute poverty has been in long-term decline while relative poverty decreased after the recession.
- Women have been gradually closing the earnings gap: women's weekly earnings have increased from 50% of men's in 1993 to 63% in 2013
- Individuals of Pakistani or Bangladeshi heritage have earnings consistently lower than those of other groups fluctuating from year to year but averaging around 70% of white earnings.

Introduction

It is increasingly recognized that we need to take a wider view of social welfare than a purely economic one, and for this reason we cover in these briefing notes trends in healthy life expectancy, subjective well-being and unemployment.

ⁱ Nevertheless, income remains the major means through which people are able to satisfy their wants and have access to those marketable goods which they judge for themselves to contribute to their wellbeing.

While changes in GDP are often reported as a key indicator of a country's economic success (or otherwise), there are various reasons why GDP is not entirely suitable for our purposes. For example, in a country with a high level of investment from outside, a proportion of GDP will be returned to the foreign investors. An overall measure like GDP also hides distributional issues. Are the gains from economic growth going to the wealthiest, or are ordinary citizens sharing in the benefits of growth? Since our aim is to explore the well-being of the country's citizens (rather than, say, the economic strength of the British state), we focus on personal incomes, with a particular emphasis on trends for the people at the midpoint of the income distribution.

How has income changed over the longer term?

In Figure 1 we show how real household income has increased over the fifty years since 1961. We show trends at different positions within the income distribution. Thus, the green line shows the trends in

Technical details

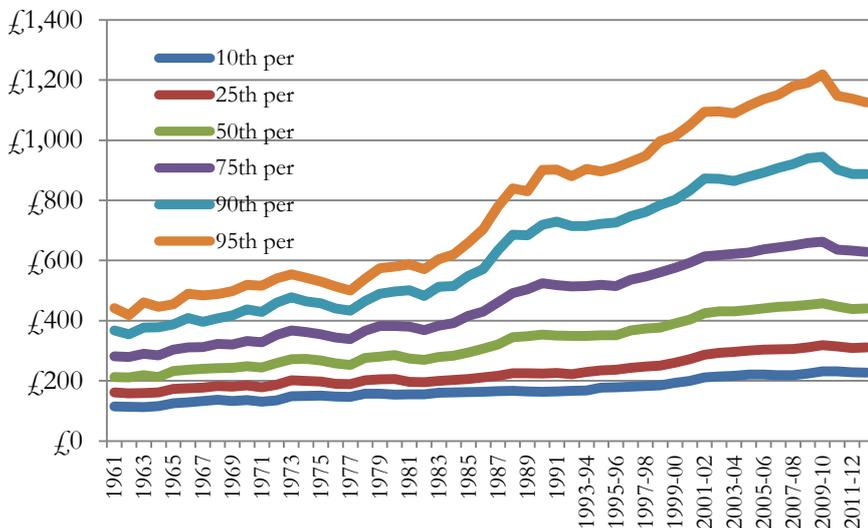
In this briefing note we report trends in weekly household income and in weekly earnings. Household income includes income from all sources, including benefits, after deductions for direct taxes and National Insurance. The figures have been adjusted to take account of inflation using the Retail Price Index (RPI) and are expressed in 2012-13 prices. Household income is 'equivalized' in order to take account of household size and is expressed in terms of equivalent amounts for a childless couple. The estimates do not adjust for housing costs. The figures are derived from the Family Expenditure Survey (FES) up to 1993 and the Family Resources Survey (FRS) thereafter, and cover GB. (The FRS was extended to cover Northern Ireland from 2002-3 but for comparability we restrict the series to GB throughout.)

For earnings we use the Labour Force Survey (LFS) since its larger sample allows us to distinguish ethnic minorities. The LFS covers the UK as a whole. For gender differences, we start in 1993 since earnings questions first appeared in the LFS that year. For ethnic differences we start from 1997-8 since sample sizes were too small in the earlier years. Earnings are gross earnings from employment (i.e. before taxes are deducted or benefits added) and exclude earnings from self-employment since these are not covered in the LFS. We show median real (i.e. adjusted for inflation) gross earnings.

household income for the ‘median’ household, that is for a household in the middle of the distribution (half the population having higher income and half having lower income than the median). The median is a more useful measure than the average in periods when income inequality is growing.

Figure 1: Median real household income in GB has more than doubled since 1961

Expressed in 2012-13 prices, adjusted for inflation using the RPIJ (RPI before 1997). Source: IFS calculations using the FES and FRS.

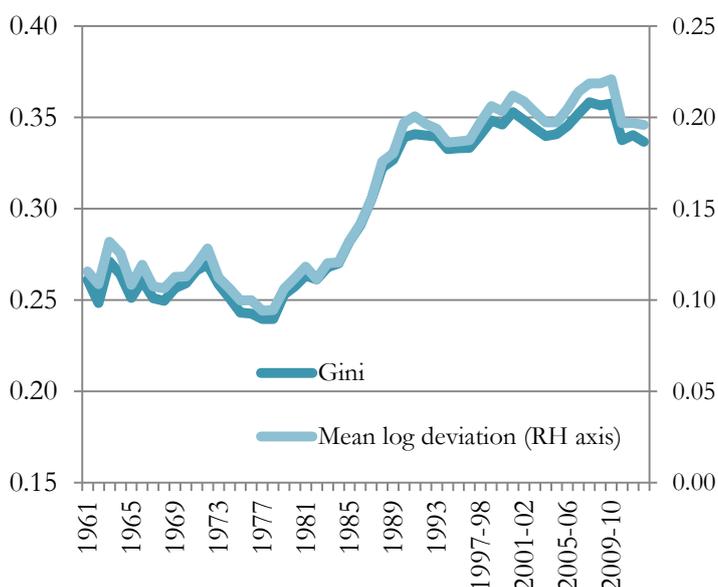


In 1961, when our data series starts, the median household had real income of £213 per week. It reached a maximum of £457 in 2009-10, before falling back somewhat to £441 in 2012-13, but still over double the starting figure. The most recent estimates from the IFS indicate that the median household in the UK recovered somewhat in 2014-5 but remained below its 2009-10 peak.ⁱⁱ It has however been something of a bumpy ride. Thus median real income declined

between 1974 and 1977, after the inflation following the 1973 ‘oil price shock’. Median real income also flatlined from 1990 to 1995-6, before starting to increase again in the long boom which lasted until the financial crisis of 2008, reaching its peak in 2010 after the onset of the recession. This pattern of long-term improvement interspersed with short-term falls or stagnation is mirrored at other points in the income distribution.

Has inequality increased over time? What impact did the recession have?

Figure 1 also shows that the absolute gains in real household income were greater for those higher up the income distribution than for those at the bottom. The relative gains have also been larger. Thus, for couples at the 10th percentile (that is, at an income level where only 10% of the population fall below in



contrast with 90% above), household income almost doubled (increasing by a factor of 1.98) between 1961 and 2012-3. In contrast, for couples at the 95th percentile (at an income level where 95% of the population fall below them in the distribution) real income increased by a factor of two and a half. However, these households at the 95th percentile took a bigger ‘hit’ after the recession – the income of this group had grown by a factor of 2.75 between 1961 and 2009-10 before falling back.

Fig 2: Income inequality increased substantially between 1979 and 1990

Gini coefficient and log deviation

Source: IFS calculations using the FES and FRS

What this means of course is that income inequality rose substantially over this period. There are a number of different statistical techniques for measuring income inequality. Figure 2 shows two of the most commonly-used. Both tell a similar story: despite considerable year-to-year fluctuations, inequality exhibited little trend up until 1978. This was followed by a period of increasing inequality up until 1991. It has since fluctuated, declining after 2009-10 to a level similar to the one reached two decades earlier.

Has poverty declined as Britain has got richer?

The measurement of poverty has been controversial.ⁱⁱⁱ The most commonly-used measure is ‘relative poverty’, defined as real household income less than 60% of median income. The number of people who fall into this category can vary over time. For example, if state pensions or out-of-work benefits are protected, while earnings from employment fall, people on state pensions or out-of-work benefits could

find that their income is now higher relative to that of the median household, and fewer of them will therefore be in relative poverty.

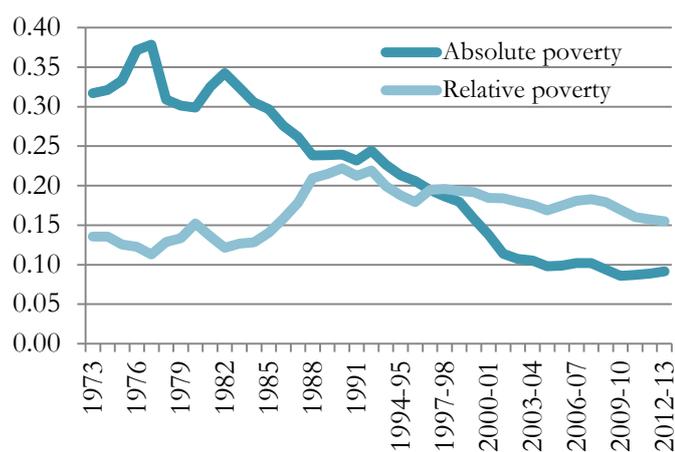


Figure 3: Relative poverty has fluctuated while absolute poverty declined

Relative poverty = percentage of households with less than 60% of median income in the year in question;

Absolute poverty = percentage of households with less than 60% of the 1996/7 median.

Source: IFS calculations using the FES and FRS

Something along these lines has probably occurred since the onset of the 2008 recession: in 2007-8 18.3% of individuals were in relative poverty, falling to 15.5% in 2012-13. In contrast relative poverty had increased substantially (from 12.1% to 22.2%) in the period from 1982 to 1990, a period in which overall inequality had also increased markedly.

We also show a measure of ‘absolute poverty’. The main difference between the two measures is that, in the case of absolute poverty we take a fixed baseline, set at the poverty level of 1996-7. In other words, we ask what proportion of individuals in any given year had real household income less than 60% of the 1996-7 median level of income. Figure 3 shows clearly that the percentage of households in absolute poverty has been in long-term decline, although the rate of decline has been very slow since 2002-3. There were peaks in 1977 with 37.8% in absolute poverty and in 1982 with 34.2% in absolute poverty. The percentage then fell to 10.7% in 2002-03, and has since drifted down a little further. This is a mirror image of Figure 1, the peaks in absolute poverty corresponding to troughs in Figure 1. So the numbers in absolute poverty has reflected the overall trends in real incomes.

Are women closing the gap?

While overall income inequality has grown, it is quite possible that gender or ethnic inequality might have narrowed. Different dimensions of inequality can follow different trajectories. To explore gender and ethnic inequalities over time we focus on earnings from employment, the overall trend in median earnings running more or less parallel to the trend in median household income.

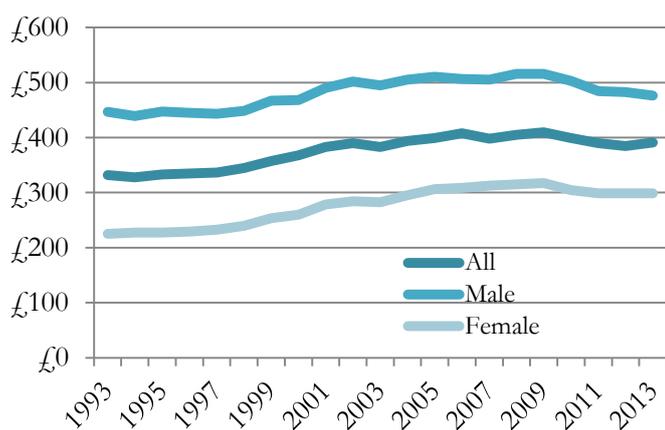


Figure 4: There has been some reduction since 1993 in the size of the gender gap in earnings

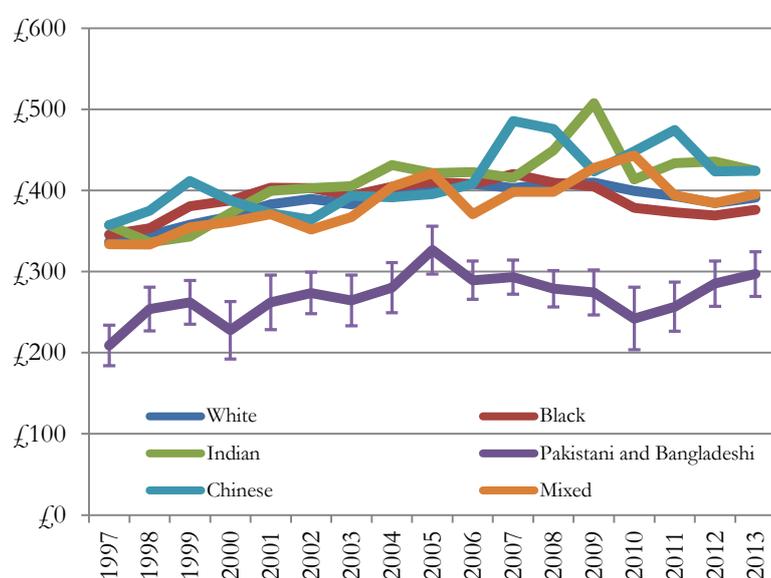
Gross weekly earnings adjusted for inflation. Source: IFS calculations using the Labour Force Survey

How then did the gender gap move over this period? In 1993 women's weekly earnings were 50.4% of men's and the gap closed steadily throughout the period. By 2013 women's weekly earnings had reached 62.8% of men's. The rate of increase was faster up until 2009 than it has been subsequently, and the gap has been closing since 2009 as a result of men's earnings falling rather than because of women's earnings increasing. We should also recognize that the explanations for the closing gap are complex. They will be due in part to improving hourly rates of pay for women; but they will also be due to changing numbers of hours worked each week (part-time working for men increasing after the recession).

Are ethnic minorities closing the gap?

We distinguish between people of Indian, Chinese, Pakistani or Bangladeshi, black Caribbean or black African and those of mixed heritage. We compare them with white British and other white people.

The story told by Figure 5 is that the main difference is between the Pakistani/Bangladeshi group and the other groups. The gap fluctuates, reflecting the small sample size for the Pakistani/Bangladeshi group and the large sampling errors, but over the period as a whole the group's earnings were around 70% of white earnings. In 2013 their earnings reached 75% of white earnings, but it is difficult to be sure whether this represents a longer-term trend or a temporary improvement. Furthermore, the gap would probably be even larger if we were able to include earnings from self-employment.



Partly as a result of these low weekly earnings, a very high proportion of the Pakistani/Bangladeshi group are to be found in relative poverty (see briefing note CSI 10). We should also note that, while the weekly earnings of the two black groups look close to the overall median, they have much higher rates of unemployment and many will not therefore be receiving any earnings.

Figure 5: The Pakistani/Bangladeshi group has much lower weekly earnings

Gross weekly earnings adjusted for inflation.

Source: IFS calculations using the LFS

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ⁱ See J.E. Stiglitz, A. Sen and J-P. Fitoussi, Report by the Commission on the measurement of economic performance and social progress (2009). www.stiglitz-sen-fitoussi.fr/en/index.htm

ⁱⁱ J. Cribb, A. Hood and R. Joyce, Living Standards: Recent Trends and Future Challenges. IFS briefing note BN165. <http://election2015.ifs.org.uk/uploads/publications/bns/BN165.pdf>

ⁱⁱⁱ For an alternative approach to the one adopted in this briefing note see D. Gordon and others, Poverty and Social Exclusion in Britain. Joseph Rowntree Foundation (2000). www.Bristol.ac.uk/poverty/pse/

