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THE BIG PICTURE: UK INCOME INEQUALITY IS FALLING

- IFS analysis suggests that poorer working age households have been hit most by changes to the tax and benefit system since 2010.
- But this does not reflect the overall impact of government policies on household income, largely because of the major increase in employment.
- The bigger picture shows that the final incomes of the poorest households have – despite or because of the tax and benefit reforms – grown faster than the richest.
- From 2010-2014, the final incomes of the poorest 40% of households increased by 11%, while those of the richest 20% fell by 4.5%.
- As a result, UK income inequality has fallen over this period. The Gini coefficient is down from 33.7 to 32.4.
- However, wealth inequality is on the up. Rapid growth in asset prices has increased the richest quintile's wealth by 14% in two years, according to the ONS.

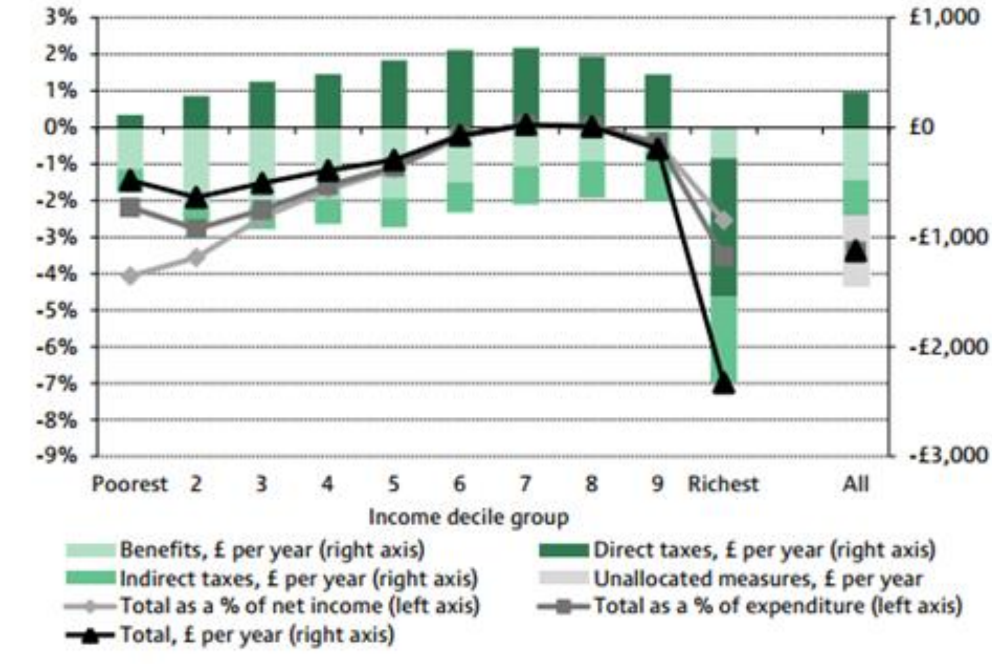
1. SUMMARY

The fallout from the 2016 Budget has put the spotlight on whether the Government's policies are benefiting the wealthy at the expense of the poor. This bulletin seeks to examine this claim. It finds that – despite static analysis finding that tax and benefit reforms are disproportionately affecting poorer households – the incomes of the bottom and 2nd quintiles have increased faster than those higher up the income scale. This has arisen from large increases in the amount of original income received by poorer households, which is largely due to higher rates of employment.

From 2010-11 – 2013-14, the final incomes of the bottom and 2nd quintiles have increased by 11% in cash terms compared to a fall of 4.4% for the top decile. This has occurred at a time when welfare bills have remained static in cash terms. This suggests that welfare reforms have been successful in incentivising people into work. Moreover, although real terms average living standards did fall during the Coalition's time in office, the poorest households received the highest increases in final income over this period.

2. STATIC IMPACT OF TAX AND BENEFIT REFORMS (2010-2015)

Figure 1: Impact of Tax and Benefit Reforms introduced between May 2010 and May 2015 by income decile



Note: Income decile groups are derived by dividing all households into 10 equal-sized groups according to net income adjusted for household size using the McClements equivalence scale. Assumes full take-up of means-tested benefits and tax credits.
Source: Authors' calculations using TAXBEN run on uprated data from the 2012–13 FRS and 2012 LCFS.

Source: Institute for Fiscal Studies link

The Institute for Fiscal Studies (IFS) estimates the Coalition's tax and benefit reforms led to an average loss for households of £489 per year, comprising an average gain of £321 from cuts to direct taxes, an average loss of £333 from increases in indirect taxes and a £477 loss from benefit cuts. As shown in Figure 1, the IFS estimates that low-income working-age households have been proportionally hit the hardest from these changes as a percentage of their income. This has led some to claim that the government's overall policies have hurt the poorest households proportionally. For example, Oxfam claimed that: "IFS analysis shows that – as a result of tax and welfare changes between 2010 and 2014 – the poorest two-tenths of the population will have seen greater cuts to their net income, in percentage terms, than every other group, except the very richest." The Guardian newspaper reported that "Britain's poorest families have suffered most from the coalition's welfare cuts and tax rises, according to the Institute of Fiscal Studies."

However, the IFS' report emphasises that there are important caveats to this static analysis of tax and benefit changes. The first is that the impact of these changes is more evenly spread across the income distribution from a lifetime perspective compared to the snapshot presented in the graph. The second, and more important, caveat is that the analysis assumes households do not change their behaviour in response to these tax and benefit changes, meaning that the dynamic impacts are unaccounted for. For example, people may be more likely to enter paid work if out-of-work benefits and taxes on earned income are reduced – something its analysis would not account for.

The IFS analysis – although useful in some ways – should therefore not be used as a way of determining the overall impact of the Government's policies on poorer and wealthy households.

3. CHANGES IN INCOME (2010 - 2014)

The ONS publishes datasets annually on the final income of UK households by quintile. This is calculated by including household income from employment and benefits and subtracting the impact of direct and indirect taxes.

Analysis of non-retired households suggest that incomes (in cash terms) of the bottom and 2nd quintiles have outpaced that of higher income groups. The poorest two quintiles have both increased their final incomes by 11.1% from 2010-11 – 2013-14, while the richest quintile has lost 4.5% in income over the same period. The marked increase in final incomes of the poorest has been driven by higher income from increased employment levels. For example, the 2nd poorest decile's cash benefits remained steady, while original incomes increased by over 11%.

Table 1: Changes in Final Income by Quintile of Non-Retired Households

Quintile	2010-11	2013-14	% change
Bottom	£8,554	£9,502	11.1%
2nd	£16,951	£18,829	11.1%
3rd	£24,336	£24,771	1.8%
4th	£32,971	£34,416	3.8%
5th	£62,533	£59,742	-4.5%

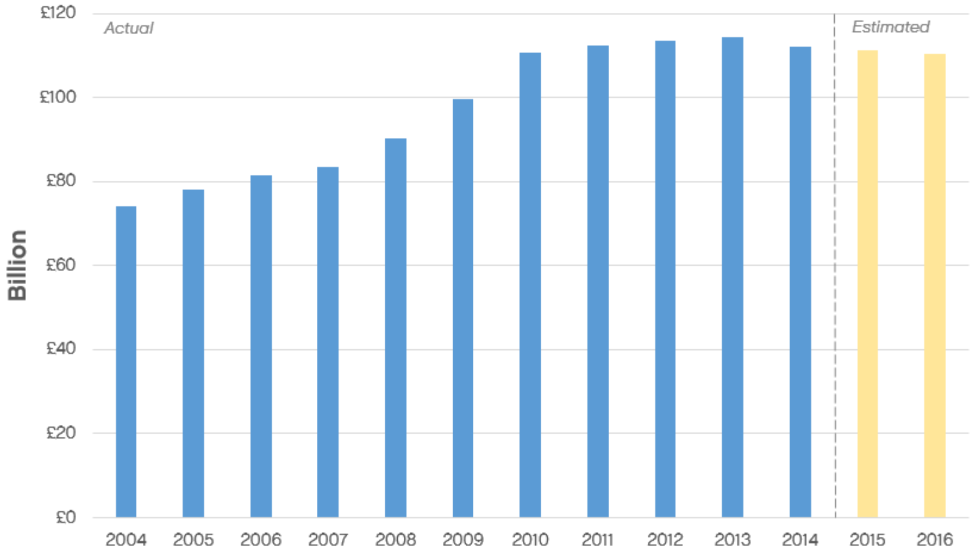
Source: Office for National Statistics (ONS) link

Note 1: Calculation: [(original income + cash benefits) – (direct taxes + NIC) – (indirect taxes)

Note 2: Figures are in cash terms

There is strong evidence to suggest that welfare reforms have helped bring increases in household incomes by boosting employment levels. While non-pensioner welfare spending has remained virtually flat in cash terms since 2010, unemployment and workless households in the UK have fallen dramatically. Unemployment is down from a peak of 8.5% in 2011 to just 5.1% currently, and the number of workless households in the UK has fallen by 479,000 – a drop of 25%, according to the ONS' Labour Force Survey.

Figure 2: UK total public spending on non-pensioner welfare



Source: Office for National Statistics (ONS) link

The relative increase of the incomes of the poorest over this period has meant that income inequality in the UK has declined. The UK's Gini Coefficient – the most popular measurement of inequality – has fallen from 33.7 to 32.4 over the period 2010/11 to 2013/14.

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4. WEALTH INEQUALITY

Table 2: Changes in Wealth Inequality [Gini coefficient]

Great Britain, July 2006 to June 2014

	July 2012 to June 2014	July 2010 to June 2012
Property Wealth (net)	0.66	0.64
Financial Wealth (net)	0.91	0.92
Physical Wealth [1]	0.45	0.44
Private Pension Wealth	0.73	0.73
Total Wealth [1]	0.63	0.61

Source: Office for National Statistics *link*

Although income inequality has fallen in the UK, there has been a modest increase in wealth inequality. This has been driven by the rapid inflation of asset prices, with the property wealth Gini Coefficient rising from 0.64 in June 2012 to 0.66 in June 2014. Analysis published by the ONS suggests that the richest quintile has increased its median wealth by 14% in the last two years.

The Bank of England's Asset Purchase Programme – known more commonly as Quantitative Easing – has had the impact of pushing up asset prices. By inflating asset prices, the increase in the value of households' financial wealth has been skewed towards the richest given that the top 5% of households hold 40% of the assets, according to analysis from the Bank of England.

There are also a number of other factors that are leading to inflated assets prices. Rapidly increasing house prices, for example, are being caused by rising demands for housing and the UK's sluggish and bureaucratic planning system that inhibits the supply of new homes onto the market – as highlighted in a previous economic bulletin.

5. CONCLUSION

Despite claims to the contrary, income inequality fell over the Coalition Government's period in office. Final incomes of those in the bottom 40% of the distribution have risen by 11% from 2010-11 to 2013-14, while those in the top fifth of the distribution have seen falls in final income of 4.5%. As a result, the Gini Coefficient measure of income inequality fell over this period.

It would therefore be unfair to suggest that the Coalition Government's policies, taken as a whole, have disproportionately hit the living standards of the poorest households. In fact, the reverse appears to be true. Incomes of the poorest have increased the most proportionally and unemployment has collapsed – all the while the non-pensioner welfare bill has remained static in cash terms.

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The static analysis of tax and benefit changes does not account for the huge increase in labour participation rates since 2010. There are now nearly ½ million fewer workless households in the UK since 2010, which has had the effect of boosting the final incomes received by poorer households. Some of this increase is likely to be due to the Government's welfare reform programme.

However, wealth inequality appears to be on the rise due to the large increase in asset prices. This has mostly come about from loose monetary policy from the Bank of England and problems associated with the UK's housing market. This highlights the need for reforms to the UK's bureaucratic planning system and the need to tackle factors behind rapidly rising demands for housing.

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