



## Income and wealth: the latest evidence

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The 1995 report of the Foundation's Inquiry into Income and Wealth Distribution in the UK examined data up to the early 1990s. A new report by John Hills from the LSE's Centre for Analysis of Social Exclusion (and secretary to the 1995 Inquiry) reviews newly available data and recent research.

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**f** Average incomes grew by about 40 per cent between 1979 and 1994/95. For the richest tenth of the population growth was 60-68 per cent. For the poorest tenth it was only 10 per cent (before housing costs) or a fall of 8 per cent (after them).

**f** In the period to 1991/92 incomes for the poorest two- or three-tenths (depending on treatment of housing costs) were static or barely rising, while average incomes rose by 36 per cent. Over the next three years, the poorest groups caught up to a limited extent, with growth of about 10 per cent, compared to average growth of 3-4 per cent.

**f** Between 1992/93 and 1994/95, some key factors changed: earnings differentials, and the difference between earnings and benefits, did not widen as quickly as in the 1980s; the numbers on Income Support stopped growing; and tax changes, including abolition of the Poll Tax, had an equalising effect.

**f** Income inequality was still greater in the mid-1990s than at any time in the forty years from the late 1940s. The exceptional rate of inequality growth took the UK near to the top of the international range by 1991.

**f** The main official income distribution series appears to give a fair picture - taking a balanced view between trends before and after housing costs, and discounting some of the most pessimistic figures.

**f** The poor in any one year are not necessarily poor the next. However, concerns about growing inequality cannot be dismissed on the grounds that it is offset by mobility. Allowing for mobility by removing those who appear to 'escape' low income or are only temporarily poor (but including those who are temporarily out of a more persistent period of low income), the 'poverty problem' appears to be 80-90 per cent of the size suggested by cross-section surveys.

**Background**

In 1995, the JRF published the report of its Inquiry into Income and Wealth Distribution in the UK. The report summarised trends in income and wealth distribution, discussed why the Inquiry members found some of these a cause for concern, and put forward a range of policy proposals. The report was based on data and analysis available up to the autumn of 1994. New data and research are now available, and this new study reviews the latest evidence.

**Recent trends in distribution**

Data from the Department of Social Security's Households Below Average Income analysis show that average incomes grew by about 40 per cent between 1979 and 1994/95. For the richest tenth growth was 60-68 per cent, but for the poorest tenth growth was only 10 per cent (before housing costs) or a fall of 8 per cent (after housing costs).

From 1961 to 1979 incomes for all income groups had risen, the lowest fastest. From 1979 to 1991/92 incomes for the poorest two-tenths (before housing costs) or three-tenths (after housing costs) were static or barely rising (or even fell for the lowest, after housing costs). Average incomes grew by 36 per cent during this period. Over the next three years, the poorest groups caught up to some extent, with growth of about 10 per cent, compared to average growth of 3-4 per cent.

Figure 1 combines data from this series with earlier analysis by the Institute for Fiscal Studies. During the 1960s roughly 10 per cent of the population had incomes below half the contemporary average, falling to 6 per cent in 1977. The proportion peaked at over 20 per cent in 1991/92, falling back to 18 per cent in 1994/95 (BHC).

**The latest position**

By 1994/95, some key characteristics of people with low incomes were:

- Nearly 80 per cent of the population below half average income were non-pensioners (compared to just over half in the late 1960s).
- But pensioners were still disproportionately in the poorest half, particularly the second fifth.
- Three-quarters of lone parents and their children were in the poorest 40 per cent in 1994/95.
- One-third of the poorest fifth had earnings; two-thirds did not.
- Three-quarters of those in social housing were in the poorest 40 per cent (compared to under half in 1979).
- The positions of different ethnic minority groups vary widely: two-thirds of the Pakistani and Bangladeshi population were in the poorest fifth, but 25 per cent of the Indian population.

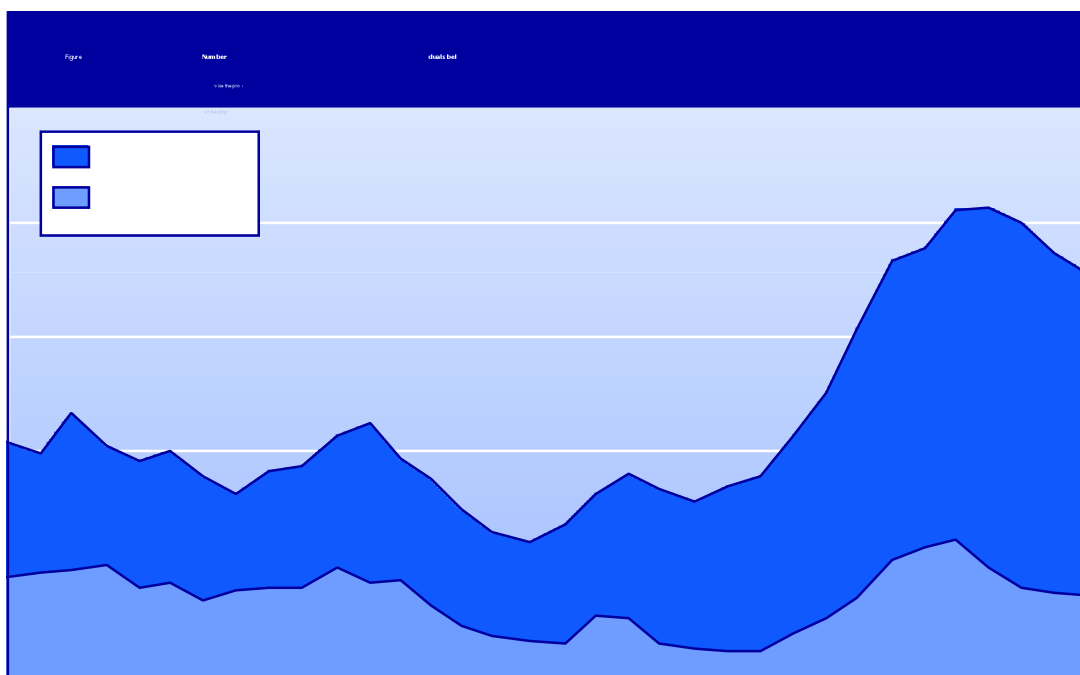
**Inequality trends**

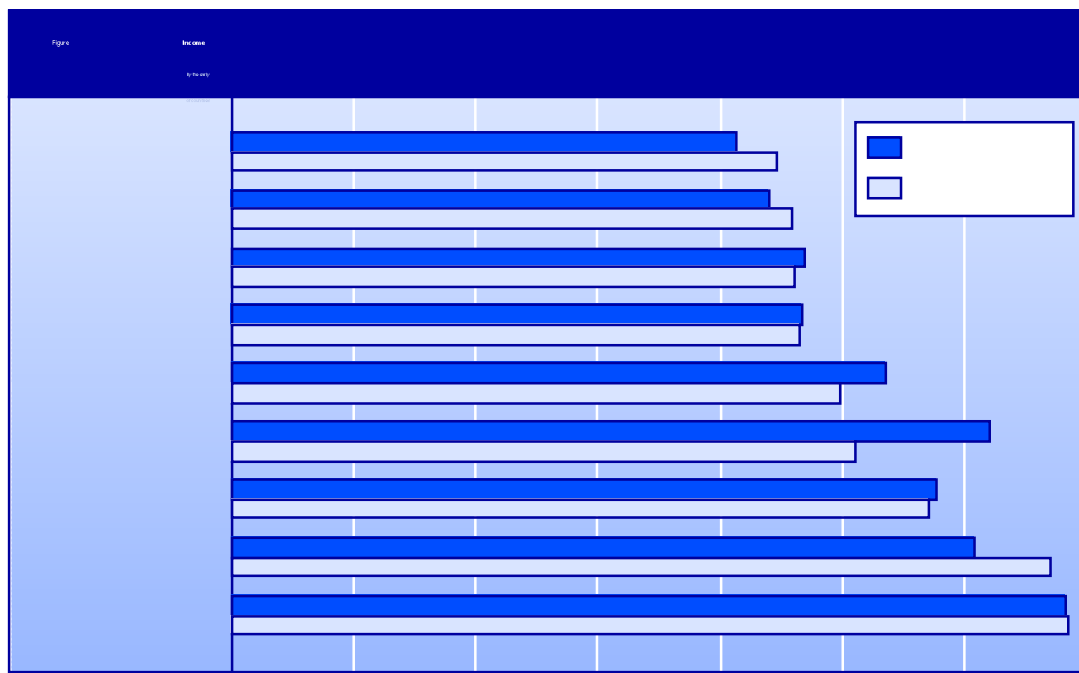
Even with recent falls, overall income inequality in the UK was greater in the mid-1990s than at any time since the late 1940s. As Figure 2 confirms, UK inequality growth was exceptional internationally. Between the mid-1980s and early 1990s, the inequality index for the UK grew faster than in any of the countries shown for which comparable data are available, and had reached a level higher than in any of them apart from the USA.

**What factors have driven recent trends?**

Several factors contributed to income inequality growth between the late 1970s and early 1990s:

- The gap between high and low pay grew rapidly, partly linked to increasing premiums for skills and





qualifications, in turn linked to technological change.

Growing earnings disparities also appear linked to the declining importance of unions and of minimum wage protection.

The number of workless households rose faster than overall official unemployment rates, with more households with only one adult and polarisation between no-earner and two-earner couples.

After the early 1980s price-linking of benefit levels meant that - other things like take-up rates equal - those remaining on benefits automatically fell further behind the rest of the population when overall incomes rose.

Taxation had a fairly neutral impact: discretionary tax changes offset the way in which tax would otherwise have slowed inequality growth.

Between 1992/93 and 1994/95, several of these factors changed:

Earnings differentials did not widen much between 1993 and 1995, and have grown more slowly in the 1990s than in the 1980s.

Unemployment fell and numbers of Income Support recipients stopped growing.

Real earnings grew little, so price-linking of benefits did not increase inequality as it had in the late 1980s.

The proportion of new pensioners fully dependent on

state benefits was smaller than amongst the older pensioners they were replacing.

- Abolition of the Poll Tax and tax rises between 1993 and 1995 - which hit the top half of the distribution hardest - had an equalising effect.

### Are the figures right?

It is impossible to produce an exact picture of the income distribution satisfying all observers. Different measures produce different trends, from the 17 per cent fall in incomes after housing costs for the poorest tenth between 1979 and 1991/92 to a 22 per cent rise in spending (including on housing) comparing groups with the lowest spending in 1979 and 1994/95. Neither extreme is justified.

For instance, rising rents for social housing can spuriously increase income before housing costs (for those receiving Housing Benefit), arguing for more emphasis on incomes after housing costs. However, the omission of 'housing income' in kind can have the opposite effect, making trends after housing costs too pessimistic. Misreported incomes and short periods of low income argue for paying attention to trends in spending (or allowing for this more directly by looking at income mobility as discussed below). However, the arguments do not suggest that more weight should be put on the expenditure than on the income distribution. Some reported incomes of the self-employed may be misleading, but the growth of high and low income self-employment is a genuine feature of the distribution and should not be ignored.

Another problem with the official series is omission of non-cash incomes. For instance, allowing for the 'social wage' in the value of public services improves income growth of the poorest fifth from 1979 to 1993 - but only if the rising relative cost of

services and effects of demographic change are ignored. Allowing for these and for potential public sector productivity growth gives a picture similar to cash incomes. Income in kind from greater ownership of consumer durables implies only slightly faster income growth at the bottom.

On balance, analysis of these and other potential adjustments suggests that the picture given by the main official Households Below Average Income series is a fair one, taking a balanced view between trends in incomes before and after housing costs, and discounting some of the figures showing the most pessimistic picture for those at the bottom of the distribution.

### Income mobility

New data confirm that those poor in any one year are not necessarily poor the next. However, concerns about the widening cross-sectional distribution cannot be dismissed on the grounds that they are offset by mobility.

Fifty-four per cent of the poorest tenth in the first year of the new British Household Panel Survey had escaped it a year later, but two-thirds were still in the poorest fifth, while two-thirds of the poorest fifth as a whole stayed there. Income mobility is mostly short range. Some people drop back after an initial escape and others stick at the bottom. Thirty-six per cent of the poorest tenth in Year 1 were also in the poorest tenth in Year 5. Incomes do not move at random. More than three-quarters of low income observations represent either persistent low income, or are linked to other observations of low income with no apparent escape over a four-year period. Allowing for mobility by removing those who appear to 'escape' low income or are only temporarily poor (but including those who are temporarily out of a more persistent period of low income), the 'poverty problem' appears to be 80-90 per cent of the size suggested by cross-section surveys.

### Policy responses

Many of the new Government's areas of policy concern match those put forward by the Inquiry. However, only limited moves have been made so far (with the main exception of the New Deal measures for the unemployed). The priorities given to education, a minimum wage, 'welfare-to-work' strategies and combating social exclusion suggest radical action, but pressures to control public spending may put very tight constraints on what the Government is prepared to do. Future numbers with relatively low incomes could reflect a race between the positive effects of measures to increase incomes from work at the bottom, and the negative effects of falling relative incomes for those remaining largely

dependent on benefits.

A regular official 'Poverty Report' could give a way of monitoring progress in this area. It could also act as a spur to faster availability of relevant data, and would focus on outcomes rather than means, leaving targets to be set in terms of what policies were intended to achieve, rather than their precise balance.

Growth in income inequality after the mid-1970s was the result of a wide range of compounding factors accumulating over two decades. The halting - and even partial reversal - of some of these trends in the mid-1990s shows that the pressures are not inexorable, as does the difference in outcome of similar pressures in other countries.

### About the study

This study updates some of the main data series used to inform the 1995 Inquiry with information available up to the end of 1997. It also takes account of newly available research, including several studies exploring issues such as income mobility, spending on children, the incomes of ethnic minorities, the distribution of resources within the family, and the changing distribution of the 'social wage'.

### How to get further information

The full report, *Income and Wealth: the latest evidence* by John Hills, is published by the Foundation (ISBN 1 85935 040 2, price £13.95 plus £1.50 p&p). It is available from York Publishing Services Ltd, 64 Hallfield Road, Layerthorpe, York YO3 7XQ, Tel: 01904 430033, Fax: 01904 430868.

The following *Findings* look at related issues:

- *Income and wealth: report of the Inquiry Group*, Feb 95 (*SPS3*)
- *Private welfare insurance and social security*, Feb 97 (*SP111*)
- *The changing distribution of the 'social wage'*, May 97 (*SP114*)
- *Income mobility in Britain*, July 97 (*SP121*)
- *Movements in and out of low pay*, July 97 (*SP122*)
- *Expenditure on children in Great Britain*, July 97 (*SP118*)
- *Combining work and welfare*, Oct 97 (*SP132*)
- *Social protection: European challenges for the United Kingdom*, Nov 97 (*SP136*)

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