

Living Standards, Inequality and Poverty

ELECTION BRIEFING 2005

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Summary

Living standards and income inequality

- Mean household disposable income has risen in real terms by an average of 2.5% a year between 1996–97 and 2003–04. Median income increased by 2.3% a year over the same time.
- This compares with an increase in mean income of 2.1% a year and in median income of 1.6% a year under the Conservatives between 1978–79 and 1996–97. These patterns of income growth are strongly influenced by economic booms and recessions.
- Average income growth was faster over Labour's first term than its second, and was particularly sluggish in 2003–04, when mean income showed a small fall and the median showed a small rise. Income growth has been strongest amongst lone parents, though they remain on average the poorest population group.
- Despite a large package of redistributive measures, the net effect after seven years of Labour government is to leave inequality effectively unchanged.

Poverty

- Relative poverty has fallen amongst pensioners and children under Labour. In 2003–04, there were 700,000 fewer children in poverty than in 1996–97 on one of the government's most commonly used poverty measures, cutting the proportion of children in poverty from 33% to 28%. On the same measure, there were also about 800,000 fewer poor pensioners in 2003–04 than in 1996–97, cutting the proportion in poverty from 28% to 20%. By contrast, poverty has risen slightly amongst working-age adults without children.
- The government has a target for child poverty in 2004–05 to be one-quarter lower than its 1998–99 level, on two different poverty measures. Sampling error means that little can be inferred with certainty from a single year's data, but the likelihood that the government will hit its targets seems a little lower now than it was a year ago. Measured before housing costs, child poverty should probably fall to levels close to the government's target. But measured after housing costs, even additional spending on tax credits in 2004–05 and the ironing-out of administrative problems in their delivery do not alone seem sufficient for child poverty to meet its target.

1. Introduction

In this Election Briefing Note, we assess what has happened to living standards under Labour, setting out how average incomes, income inequality and poverty have changed since 1996–97. We compare these changes with what happened under previous governments, and highlight where there have been differences between Labour’s first and second terms.

Before we begin, it is important to explain how living standards are measured. Most would agree that people’s living standards are determined by more than just their material circumstances, but taking this into account is very difficult. Here, we focus just on material circumstances and use income as our measure.

There are a number of different ways of measuring people’s incomes and different data sources available to assess them. The most reliable source for examining how incomes are distributed across the whole population in Great Britain is the Department for Work and Pensions’ (DWP) Households Below Average Income (HBAI) series. This forms the basis for the DWP’s annual HBAI analysis.¹ HBAI is based on the Family Resources Survey, a survey of around 25,000 households in Great Britain that asks detailed questions about income from a wide range of sources. Income in HBAI is:

- a snapshot measure, meaning that it will reflect ‘actual’ or, in some cases, ‘usual’ income around the time of interview;
- a measure of household income, summed across all members of a household;
- rescaled (‘equivalised’) to take into account the fact that households of different size and composition have different needs;
- a measure of disposable income, which is measured *after* income tax, employee and self-employed National Insurance contributions, and council tax;
- measured both before housing costs have been deducted (BHC) and after they have been deducted (AHC).

The latest available HBAI figures are up to the financial year 2003–04. Because HBAI figures are calculated from a sample of British households, rather than from the full population, there is necessarily a degree of uncertainty surrounding the results derived from them. We discuss the degree of uncertainty in the statistics we present throughout our analysis. A more detailed discussion of the HBAI income measure and its advantages and limitations can be found in Brewer et al.²

HBAI is the most reliable source of information when looking at the entire distribution of income or the incomes of subgroups (e.g. ‘the poor’, ‘families with children’). If we are interested in what has happened just to the average income (captured by the mean), then there are a number of other useful sources for analysing this, based on the National Accounts. Section 2, which looks at recent trends in living standards, compares HBAI information on

¹ For the latest edition, see Department for Work and Pensions, *Households Below Average Income 1994/95–2003/04*, Corporate Document Services, Leeds, 2005.

² M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

average incomes with information contained in the National Accounts. Comparisons of this sort are only possible for changes in mean income, because the National Accounts do not tell us anything about individual households.

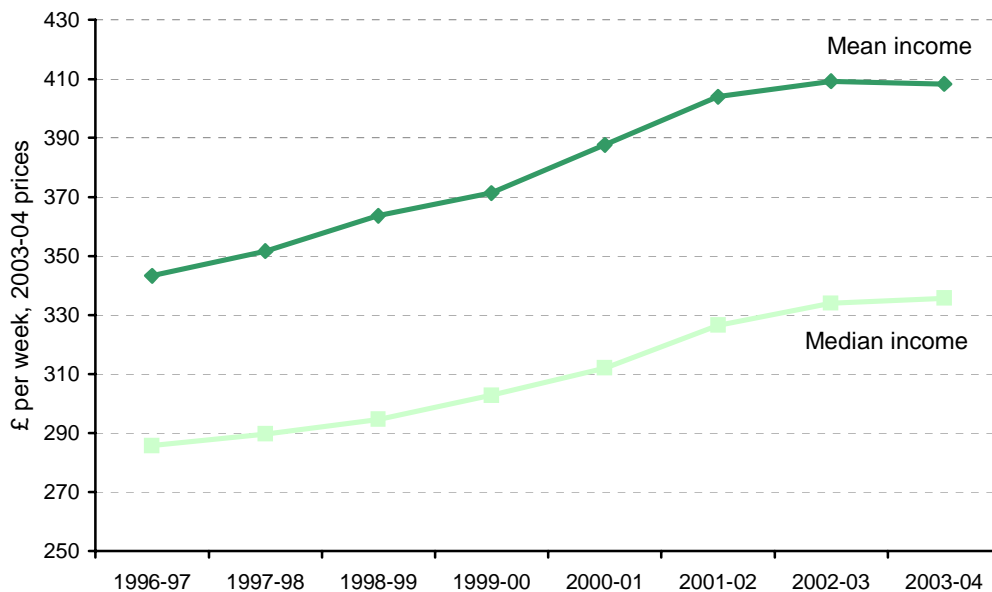
2. Living standards

This section shows how incomes have changed since 1996–97, both on average and for specific family types, and across regions. All monetary values in this section are expressed in average 2003–04 prices, and so all the differences we refer to are unaffected by inflation.

2.1 Changes in mean and median income

Recent trends in average income, based on DWP’s HBAI series, are shown in Figure 1. The graph shows that mean weekly BHC income was £343 in 1996–97 and increased to £408 by 2003–04. This corresponds to a real rise of around 19%, or 2.5% on an annualised basis. Similarly, median income increased by 17% (2.3% when annualised), from £286 to £336.³ The growth of income is slightly stronger when measured AHC rather than BHC: mean and median incomes increased by 26% and 24% respectively measured after housing costs.

Figure 1. Changes in average real incomes



Note: Incomes have been measured before housing costs have been deducted.
 Source: Authors’ calculations using Family Resources Survey, various years.

³ Mean income is obtained by adding up all incomes and dividing by the total number of people in the population. It gives equal weight to all observations and can therefore be quite sensitive to very low and very high incomes. In contrast, the median is a measure of average that divides the population into two equally sized groups. Half the population have incomes below the median and half have incomes above it. The median is not affected by the presence of very high and very low incomes in the distribution. It is because of the potential differences in these measures of average that it is useful to consider both.

Figure 1 also shows that income growth has slowed considerably in the past two years, with especially sluggish growth in 2003–04. Indeed, in 2003–04, median income BHC increased by just under £2 a week (an increase of 0.5%) and mean income fell slightly (a change of –0.2%). This is the first time since the recession of the early 1990s that mean income is estimated to have fallen. It is important to remember, however, that these figures for mean and median income growth are based on a sample of households (rather than the whole population), so we cannot be absolutely sure where the true value of either statistic lies. Mean income growth could in fact have been slightly positive, or indeed could have been more negative; median income growth could have been slightly negative or more positive.⁴

Box 1. Incomes, taxes, and tax and benefit reforms

This box brings together and summarises IFS analysis on how average incomes have changed since 1997, how tax and benefit reforms have affected average income, and what has happened to tax revenues over Labour's time in government.

- Mean household disposable income has risen in real terms by around 19% since 1996–97, or 2.5% on an annualised basis. Median income increased by 17%, or 2.3% when annualised.
- Looking just at the effects of tax, benefit, and tax credit reforms implemented by the past two Labour governments on household incomes, IFS analysis suggests that they have resulted in a small net giveaway. In total, fiscal reforms have raised mean household disposable income by £1.69 a week or 0.4%. Taking into account above-inflation increases in council tax since 1997 leaves households overall £2.85 a week (or 0.6%) worse off on average (the mean). See IFS Election Briefing Note no. 1 for more details.^a
- Tax revenues have gone up considerably: total current receipts increased from 37.0% of GDP in 1996–97 to 39.3% in 2005–06. This is the equivalent of an increase in tax payments of approximately £1,150 per household in 2005–06 prices. Around two-thirds of this increase is due to discretionary reforms to taxes and benefits, with the rest due to changes in the economy. See IFS Election Briefing Note no. 4 for more details.^b

IFS Election Briefing Note no. 10^c assesses statements about living standards and tax made by different political parties in their election manifestos.

^a S. Adam, M. Brewer and M. Wakefield, *Tax and Benefit Changes: Winners and Losers*, IFS Election Briefing Note no. 1, 2005 (<http://www.ifs.org.uk/bns/05ebn1.pdf>).

^b C. Emmerson, C. Frayne and G. Tetlow, *Taxation*, IFS Election Briefing Note No. 4, London: Institute for Fiscal Studies, 2005 (<http://www.ifs.org.uk/bns/05ebn4.pdf>).

^c M. Brewer, A. Goodman and J. Shaw, *Better or Worse Off? More or Less Heavily Taxed? An Assessment of Manifesto Claims*, IFS Election Briefing Note no. 10, 2005 (<http://www.ifs.org.uk/bns/05ebn10.pdf>).

⁴ The 95% confidence interval for the change in mean income between 2002–03 and 2003–04 is –2.2% to 1.9%. The 95% confidence interval for the change in median income between 2002–03 and 2003–04 is –0.6% to 1.9%. Since both confidence intervals straddle zero, neither mean nor median income growth is statistically different from zero.

Brewer et al.⁵ discuss the extent to which the increases in National Insurance contributions, income tax and council tax affecting household incomes in April 2003 could have contributed to this change in mean and median income; they also discuss the possible role of other factors, such as changes to the incomes of the self-employed, in driving these changes. Box 1 contains more information about average incomes, taxes, and tax and benefit reforms.

To put this income growth into context, it is necessary to look at what has happened over a longer period. Looking at periods of time defined by political events is one interesting way to do this, although it is important to realise that these periods cover different periods in the economic cycle, and income growth rates are very sensitive to this.

Bearing this in mind, Table 1 shows that between 1990 and 1996–97, when John Major was Prime Minister, both mean and median income increased by 0.8% on an annualised basis. This contrasts with the experience between 1979 and 1990 when, under the premiership of Margaret Thatcher, mean and median annualised income grew by 2.9% and 2.1% respectively. Average income growth under Blair, therefore, has been much stronger than it was under Major, and of roughly comparable magnitude to what was experienced under Thatcher. Table 1 also shows income growth for Blair’s first and second terms in office (up to 2003–04). Mean income grew faster in the first parliament, but median income grew faster in the second.

Table 1. Annualised real average income growth

| | Mean | Median |
|---------------------------------|-------------|---------------|
| Blair (1996–97 to 2003–04) | 2.5% | 2.3% |
| Major (1990 to 1996–97) | 0.8% | 0.8% |
| Thatcher (1979 to 1990) | 2.9% | 2.1% |
| Conservatives (1979 to 1996–97) | 2.1% | 1.6% |
| Blair (1996–97 to 2000–01) | 3.1% | 2.2% |
| Blair (2000–01 to 2003–04) | 1.8% | 2.5% |

Note: Incomes have been measured before housing costs have been deducted.

Source: Authors’ calculations using Family Resources Survey and Family Expenditure Survey, various years.

2.2 A comparison with the National Accounts

It is useful to compare these estimates with other sources. The National Accounts have the advantage that they do not rely to the same extent on data gathered from samples, and so they are not subject to the same degree of statistical uncertainty as the HBAI data. However, they are also quite limited in their use in analysing living standards, since they are only able to provide estimates of the mean; they do not allow us to assess the median, or any other information about the distribution of income. It is also important to realise that the National Accounts do not allow us to measure living standards in exactly the same way as HBAI, so the change in average income they report is likely to differ from the HBAI series. One

⁵ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

complication is that the ‘household sector’ as defined in the National Accounts includes bodies such as charities and most universities, as well as families.

Table 2 gives growth rates under Blair for a number of different series taken from the National Accounts, presented alongside mean BHC income growth in HBAI. Although not directly comparable, median BHC income growth in HBAI is included in the table for reference purposes.

Table 2. HBAI income growth compared with the National Accounts

| Year | HBAI-based measures | | National Accounts-based measures | | |
|---|----------------------|------------------------|----------------------------------|---|---|
| | Mean HBAI BHC income | Median HBAI BHC income | National income per head | Real household disposable income per head | DWP-adjusted real household disposable income per household |
| 1996–97 | 3.4% | 4.3% | 2.6% | 2.5% | 1.8% |
| 1997–98 | 2.4% | 1.4% | 3.1% | 4.0% | 2.9% |
| 1998–99 | 3.4% | 1.7% | 2.7% | -0.6% | -0.8% |
| 1999–00 | 2.1% | 2.8% | 2.9% | 4.9% | 3.5% |
| 2000–01 | 4.4% | 3.1% | 3.1% | 5.3% | 4.0% |
| 2001–02 | 4.2% | 4.6% | 1.4% | 2.8% | 5.0% |
| 2002–03 | 1.3% | 2.3% | 1.7% | 1.3% | 0.0% |
| 2003–04 | -0.2% | 0.5% | 2.2% | 2.7% | 0.9% |
| Labour I & II: 1996–97 to 2003–04 | 2.5% | 2.3% | 2.4% | 2.9% | 2.2% |
| Labour I: 1996–97 to 2000–01 | 3.1% | 2.2% | 3.0% | 3.3% | 2.4% |
| Labour II: 2000–01 to 2003–04 | 1.8% | 2.5% | 1.7% | 2.2% | 1.9% |
| Conservatives: 1978–79 to 1996–97 | 2.1% | 1.6% | 1.9% | 2.6% | n/a |

The pattern of growth in mean national income per head is broadly similar to that of mean HBAI income growth. Average annualised growth since 1996–97 (at 2.4% per year in real terms) and average growth across each of the two parliaments (at 3.0% and 1.7% respectively) are very similar to those revealed in the HBAI data. There are, however, some sizeable divergences in particular years, especially over the most recent years. This may not be surprising, however, since national income includes the income of companies and the government as well as the income of households.⁶

⁶ HBAI data will contain the income of companies that is distributed in dividends to households, but not the income that is distributed to pension funds or that is retained.

The series 'real household disposable income per head' from the National Accounts excludes the income of companies and the government. Average income growth under this measure tends to be slightly higher than HBAI income growth, showing average annualised income growth since 1996–97 of 2.9% per year. There are also some considerable divergences in the growth rates of these series for individual years, with less evidence of a clear slowdown in the most recent years than the HBAI data suggest.

The DWP has produced an adjusted version of the 'real household disposable income per head' measure, which is designed to be closer in its definition to the HBAI income measure (some of the adjustments include: excluding imputed income from owner-occupation from the National Accounts, excluding income that can be attributed to non-profit organisations such as universities and charities, and adding back in vehicle excise duty payments, amongst other things; see the Appendix). With the exception of 1998–99, growth in this series mirrors that in HBAI quite closely. Like HBAI, this series also shows the slowdown in average income growth in the most recent two years of data.

Despite differences between the series, all agree that income has grown by between 2% and 3% on an annualised basis for the period 1996–97 to 2003–04 as a whole, and that mean income growth was higher during Labour's first term than in its second term.

An alternative way of assessing how average living standards have changed involves comparing the change in gross incomes (before taxes are deducted) to an index known as the tax and price index (TPI). This comparison is presented in the Appendix.

2.3 Changes in average incomes of different family types and across regions

As well as considering changes to average incomes across the whole population, it is interesting to consider what has happened to the incomes of different family types over the two parliaments of the Labour government. In Table 3, we present the average annualised income growth for a range of different family types. The table shows that out of all of the family types shown, working-age adults without children had the highest household equivalised income on average in 2003–04 (a mean income of £471 per week), while lone parents had the lowest mean weekly income (£277).

Although lone-parent families are the poorest families on average, they have been catching up in recent years, with their income growth exceeding the national average, reflecting the significant financial resources directed to these groups by the government.⁷ Average pensioner incomes have also grown relatively strongly in recent years, with average annualised growth in the median pensioner income since 2000–01 of 2.8%.

Income varies markedly by region: it is highest on average in London (a mean income of £503 per week), the South-East (£480) and Eastern (£431), and lowest in the North-East (£338) and Wales (£341). Regions with a high mean income tend to have experienced faster income growth in the first parliament than in the second, while those with a lower mean

⁷ Chapter 7 of R. Chote, C. Emmerson, D. Miles and Z. Oldfield (eds), *The IFS Green Budget: January 2005*, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/budgets/gb2005/index.php>).

income tend to have benefited more in the second parliament. However, regional variation in prices is likely to mean that differences in living standards across regions are less marked than these numbers suggest, while differential inflation rates could affect the rate at which we think living standards have been changing.

Table 3. Annualised income growth by family type (BHC), 1996–97 to 2003–04

| | Mean income, by group | | | | Median income, by group | | | |
|-----------------------|-----------------------|------------|-------------|-------------------|-------------------------|------------|-------------|-------------------|
| | Term 1 (%) | Term 2 (%) | Overall (%) | 2003–04 Level (£) | Term 1 (%) | Term 2 (%) | Overall (%) | 2003–04 Level (£) |
| <i>Family type:</i> | | | | | | | | |
| Pensioner | 2.8% | 2.0% | 2.4% | £332 | 2.4% | 2.8% | 2.6% | £275 |
| Lone parent | 3.9% | 3.9% | 3.9% | £277 | 3.6% | 3.1% | 3.4% | £237 |
| Couple with children | 3.5% | 1.8% | 2.8% | £407 | 2.1% | 2.0% | 2.1% | £333 |
| Childless working-age | 2.9% | 1.3% | 2.2% | £471 | 2.2% | 1.7% | 2.0% | £405 |
| <i>Region:</i> | | | | | | | | |
| North-East | 0.5% | 2.6% | 1.4% | £338 | 2.4% | 2.6% | 2.5% | £299 |
| North-West | 2.1% | 3.6% | 2.7% | £379 | 2.4% | 2.4% | 2.4% | £317 |
| Yorkshire and Humber | 2.4% | 1.7% | 2.1% | £361 | 1.4% | 3.0% | 2.1% | £307 |
| East Midlands | 2.2% | 3.6% | 2.8% | £385 | 2.6% | 2.7% | 2.6% | £325 |
| West Midlands | 2.3% | 1.1% | 1.7% | £359 | 1.5% | 2.5% | 1.9% | £314 |
| Eastern | 3.9% | 0.0% | 2.2% | £431 | 2.7% | 0.8% | 1.9% | £352 |
| London | 5.8% | 0.8% | 3.6% | £503 | 4.4% | 1.8% | 3.3% | £374 |
| South-East | 2.9% | 1.3% | 2.2% | £480 | 2.2% | 1.8% | 2.0% | £390 |
| South-West | 2.4% | 2.0% | 2.2% | £382 | 2.3% | 2.0% | 2.2% | £327 |
| Wales | 0.8% | 2.8% | 1.7% | £341 | 1.2% | 1.8% | 1.4% | £292 |
| Scotland | 3.6% | 2.2% | 3.0% | £389 | 2.1% | 3.7% | 2.8% | £336 |
| All | 3.1% | 1.8% | 2.5% | £408 | 2.2% | 2.5% | 2.3% | £336 |

Note: Incomes have been measured before housing costs have been deducted.

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

3. Inequality

In the last section, we considered changes in average incomes. Here, we consider how equally (or otherwise) incomes are distributed, and how the degree of inequality has changed under Labour's time in government. In doing so, we will be adopting a relative notion of inequality. This means that should all incomes increase or decrease by the same proportional amount, we would conclude that income inequality had remained unchanged.

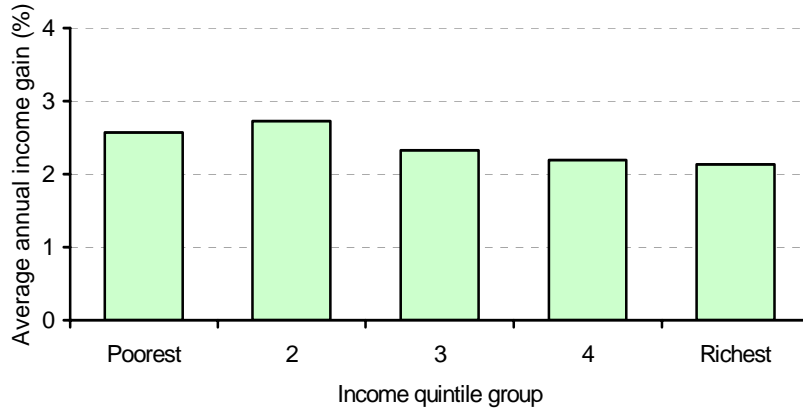
3.1 Income changes by quintile group

One common way to show how inequality has changed across the population is to consider average real income growth by quintile group (each quintile group contains 20% of the

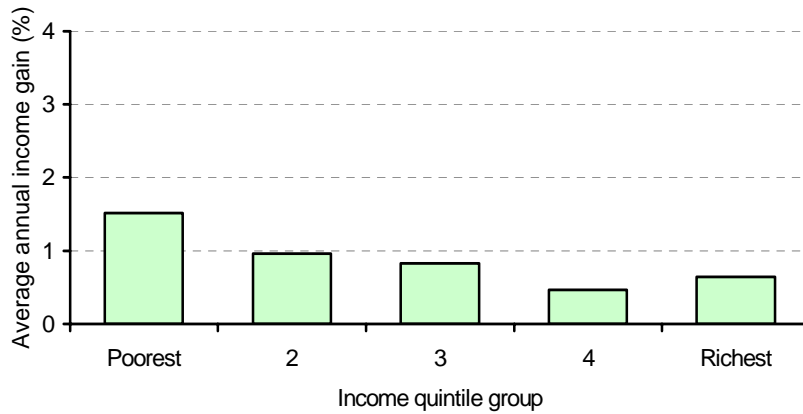
population, or around 11 million individuals). Figure 2 shows how incomes have changed in these different quintile groups under Labour and compares this with what happened under John Major between 1990 and 1996–97 and Margaret Thatcher between 1979 and 1990.

Figure 2. Real income growth by quintile group

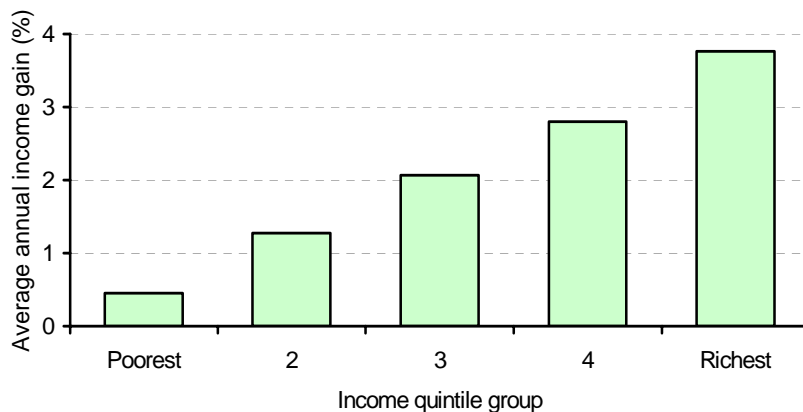
Blair: 1996–97 to 2003–04



Major: 1990 to 1996–97



Thatcher: 1979 to 1990



Notes: The averages in each quintile group correspond to the midpoints, i.e. the 10th, 30th, 50th, 70th and 90th percentile points of the income distribution. Incomes have been measured before housing costs have been deducted. Source: Authors' calculations using Family Resources Survey and Family Expenditure Survey, various years.

Taking the period 1996–97 to 2003–04 as a whole, all quintile groups have experienced income growth of above 2% on an annualised basis. The second quintile group fared best, with annual income growth of 2.7%, but there is relatively little difference across quintile groups. This is very different from what happened under previous governments, but it is important to remember that the pattern of income growth is strongly influenced by booms and recessions. Income growth was lower under Major for all quintile groups, but income grew most among the poorest quintile group. Under Thatcher, the pattern is completely reversed, with income growing faster the richer is the quintile group.

Table 4 gives income growth by quintile separately for each of Labour’s terms in office. During Labour’s first term, the second quintile experienced the fastest income growth (2.7% annualised), followed closely by the richest quintile (2.6%). In contrast, income has grown faster for poorer quintiles than richer ones during Labour’s second term: income among the poorest quintile grew by 2.8% annualised, compared with 1.6% for the richest quintile.

Table 4. Real income growth by quintile group, across parliaments and between 2002–03 and 2003–04

| Year | Income quintile group | | | | | Mean |
|---------------------------------|-----------------------|------|------|------|---------|-------|
| | Poorest | 2 | 3 | 4 | Richest | |
| Blair I (1996–97 to 2000–01) | 2.4% | 2.7% | 2.2% | 2.4% | 2.6% | 3.1% |
| Blair II (2000–01 to 2003–04) | 2.8% | 2.8% | 2.5% | 2.0% | 1.6% | 2.2% |
| 2002–03 to 2003–04 | 1.0% | 0.9% | 0.5% | 0.5% | –0.9% | –0.2% |
| Thatcher (1979 to 1990) | 0.4% | 1.3% | 2.1% | 2.8% | 3.8% | 2.9% |
| Major (1990 to 1996–97) | 1.5% | 1.0% | 0.8% | 0.5% | 0.6% | 0.8% |
| Conservatives (1979 to 1996–97) | 0.8% | 1.2% | 1.6% | 2.0% | 2.6% | 2.1% |
| Blair (1996–97 to 2003–04) | 2.6% | 2.7% | 2.3% | 2.2% | 2.1% | 2.5% |

Notes: The averages in each quintile group correspond to the midpoints, i.e. the 10th, 30th, 50th, 70th and 90th percentile points of the income distribution. Incomes have been measured before housing costs have been deducted. Source: Authors’ calculations using Family Resources Survey and Family Expenditure Survey, various years.

As discussed in Section 2.1, growth in mean and median income has slowed considerably in the past two years, and mean income actually fell slightly between 2002–03 and 2003–04. To begin to understand what was responsible for this, Table 4 also shows income growth by quintile between 2002–03 and 2003–04. The first and second quintile groups experienced growth of around 1%, while the third and fourth quintile groups saw growth of around 0.5%. In contrast, the richest quintile group saw the largest losses, averaging –0.9%.⁸ This suggests that the small fall in mean income was driven by incomes higher up the income distribution.

3.2 The Gini coefficient

The Gini coefficient is a popular measure of income inequality that condenses the entire income distribution into a single number between zero and one: the higher the number, the

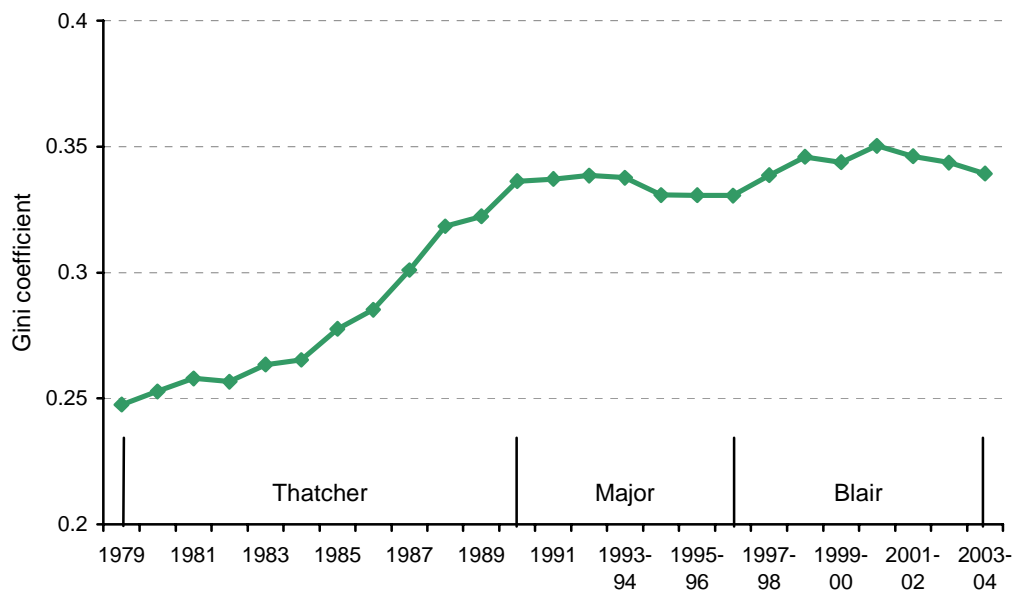
⁸ The pattern is very different when incomes are measured AHC. From poorest to richest quintile groups, we find growth rates of –0.9%, 2.6%, 1.3%, 1.3% and 1.2% respectively. None of these changes is statistically significant.

greater the degree of income inequality. A value of zero corresponds to the absence of inequality, so that having adjusted for household size and composition, all individuals have the same household income. In contrast, a value of one corresponds to inequality in its most extreme form, with a single individual having command over the entire income in the economy. See appendix B of Brewer et al.⁹ for more information about the Gini coefficient.

Figure 3 shows the evolution of the Gini coefficient since 1979. Inequality rose dramatically while Thatcher was Prime Minister and stabilised or fell slightly during Major's premiership. Over Labour's first term, the Gini coefficient increased by 2 percentage points. During Labour's second term, however, the Gini has been falling, so that inequality in 2003–04 is at a similar level to what it was in 1997–98 (the decline is not statistically significant at the 5% level, but is at the 10% level). Although the Gini coefficient is still higher than it was in 1996–97 (0.34 compared with 0.33), the actual increase over this period is not statistically significant at the 5% level. So, although we have seen some quite marked changes in income inequality under this government, the net effect of seven years of Labour government is to leave inequality effectively unchanged and at historically high levels.¹⁰

Figure 4 compares the Gini coefficient in the UK (not Great Britain) with that in a number of other OECD countries. The most recent data available are for the year 2000. Inequality in the UK is higher than in many other European countries, including Germany, France and the Scandinavian countries, but lower than in the USA. The increase in inequality in the UK

Figure 3. The Gini coefficient



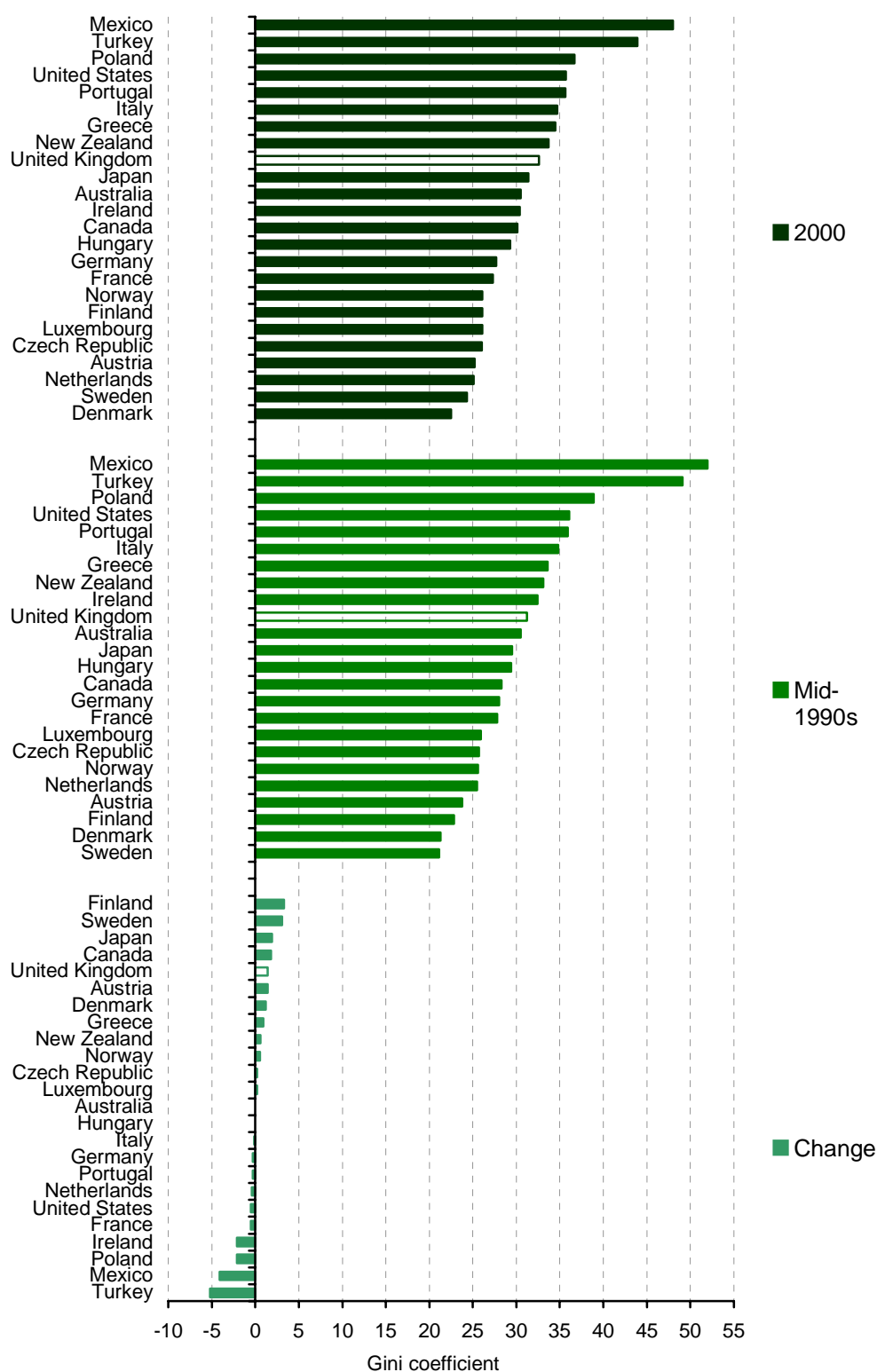
Note: The Gini coefficient has been calculated using incomes before housing costs have been deducted.

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

⁹ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

¹⁰ When incomes are measured after housing costs, the overall increase is smaller and, again, is not statistically significant.

Figure 4. Gini coefficient in selected OECD countries



Notes: '2000' data refer to the year 2000 in all countries except: 1999 for Australia, Austria and Greece; 2001 for Germany, Luxembourg, New Zealand and Switzerland; and 2002 for the Czech Republic, Mexico and Turkey. 'Mid-1990s' data refer to the year 1995 in all countries except: 1993 for Austria; 1994 for Australia, Denmark, France, Germany, Greece, Ireland, Japan, Mexico and Turkey; and 1996 for the Czech Republic and New Zealand. Sources: Data-chart EQ3.1 in OECD, *Society at a Glance: OECD Social Indicators – 2005 edition* (http://www.oecd.org/document/24/0,2340,en_2649_37419_2671576_1_1_1_37419_00.html). The original UK data source is the Family Expenditure Survey.

between the mid-1990s and 2000 has been larger than in most other countries, but it is important to remember that inequality in the UK has probably fallen since 2000.

3.3 Inequality and redistribution

Labour has introduced a package of redistributive policies. IFS Election Briefing Note no. 1¹¹ sets out how fiscal reforms have affected household incomes. It finds that tax and benefit reforms since 1997 have clearly been progressive, benefiting the less-well-off relative to the better-off. This is particularly true for policies introduced during Labour's second term, despite the fact that these were less generous on average than policies introduced in the first term.

Given the fact that Labour's tax and benefit reforms have tended to benefit poorer households at the expense of richer ones, it might seem surprising that income inequality is no lower than it was in 1996–97. To begin to understand why this is, we compare the observed change in inequality with what would have happened if the tax and benefit system had remained unchanged. We use the IFS tax and benefit model, TAXBEN, to calculate what incomes would have been under an appropriately uprated April 1996 tax and benefit system.¹² From this calculated income series, the Gini coefficient and other inequality measures may be constructed.

In Figure 5, we compare the actual Gini coefficient from 1996–97 to 2003–04 and the simulated Gini under the uprated April 1996 tax and benefit system.¹³ Our analysis here suggests that from 1996–97 to 1999–2000, the tax and benefit reforms of the Labour government did little to affect inequality compared with what would have been observed if it had simply uprated the April 1996 system. However, since 2000–01, there has been a notable departure between the actual pattern of inequality and the simulated pattern under the April 1996 system.¹⁴ This coincides with the introduction of large increases in means-tested benefits and tax credits, particularly those aimed at families with children and at pensioners. While the actual level of inequality as measured by the Gini coefficient is similar in 2003–04 to what it was six years earlier, the simulations suggest that the Gini coefficient would have increased considerably if the tax and benefit system had remained unchanged.¹⁵

¹¹ S. Adam, M. Brewer and M. Wakefield, *Tax and Benefit Changes: Winners and Losers*, IFS Election Briefing Note no. 1, 2005 (<http://www.ifs.org.uk/bns/05ebn1.pdf>).

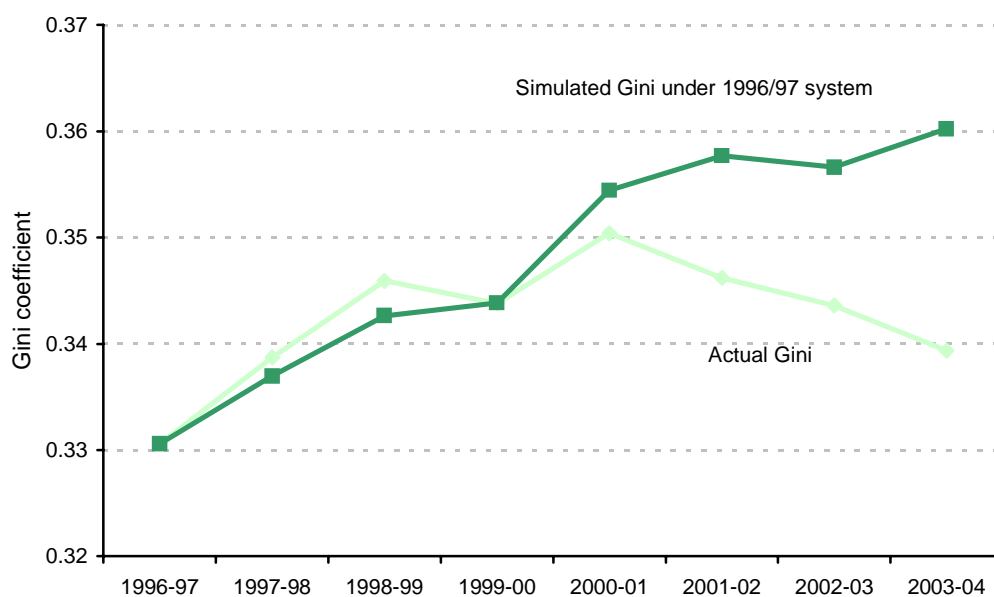
¹² In calculating these simulated incomes, individuals are awarded all benefits for which they appear eligible and no behavioural responses are allowed for. Because modelled incomes may differ from reported incomes under any observed tax and benefit system, calibration techniques are applied to the simulated income series. Only tax and benefit reforms directly affecting households are included in the simulation.

¹³ In uprating the tax and benefit system, it is assumed that council tax rises in line with the retail price index. When we instead construct the counterfactual using the observed increases in council tax, we obtain very similar results.

¹⁴ The same pattern emerges when considering incomes on an after-housing-costs basis.

¹⁵ Our estimate of inequality if the government had not made any tax and benefit changes has assumed that people's labour market behaviour does not depend on the tax and benefit system. This is, of course, untrue. If Labour's tax and benefit changes have induced behavioural changes that have acted to reduce inequality further, then we will be understating the extent to which Labour's changes have reduced inequality. In general, though, it is very hard to know whether any particular behavioural changes would act to reduce or increase inequality.

Figure 5. Simulated and actual Gini coefficient



Notes: Incomes have been measured before housing costs have been deducted. Simulated income series has been calibrated to align it to the actual income series.

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

Although one explanation for this pattern would be rising inequality in the underlying distribution of income, this does not appear to have been the case. Goodman et al.¹⁶ and Lakin¹⁷ show how the Gini coefficient for 'gross income' – that is, income before benefits and tax credits are added and taxes deducted – has also remained at a fairly steady level over this period. This suggests that had the tax and benefit system remain unchanged since 1996–97, it would have become less redistributive over time, as a result of economic and demographic changes (such as falling unemployment).

4. Poverty

Reducing poverty amongst pensioners and families with children has formed an important part of the Labour government's agenda, particularly during its second term in office. In this section, we summarise the trends since 1996–97 in some of the government's main income-based poverty indicators, which are all derived from HBAI data.

In Section 4.1, we analyse recent changes in relative poverty for the population as a whole. Sections 4.2 to 4.4 focus on subgroups of the population, examining poverty amongst the government's favoured target groups of children and pensioners, and amongst working-age adults without children. In these four sections, poverty is measured by counting the number of

¹⁶ A. Goodman, J. Shaw and A. Shephard, 'Understanding recent trends in income inequality', in S. Delorenzi, J. Reed and P. Robinson (eds), *Maintaining Momentum: Promoting Social Mobility and Life Chances from Early Years to Adulthood*, Institute for Public Policy Research, London, 2005.

¹⁷ C. Lakin, 'The effects of taxes and benefits on household income, 2002–03', in *Economic Trends*, June 2004, no. 607, pp. 39–84 (http://www.statistics.gov.uk/downloads/theme_economy/ET607.pdf).

individuals whose household income is below 60% of that of the median individual – the individual in the middle of the income distribution. This is the measure against which the government assesses progress towards its 2004–05 child poverty target. It is called a ‘relative’ measure of poverty because the poverty line moves with average income growth each year. Brewer et al.¹⁸ give estimates of poverty using other relative poverty lines (50% and 70% of the median) and present examples of the level of the poverty line for different family types.

In Section 4.5, poverty is measured by counting the number of individuals whose household income is below 60% of median 1996–97 income (uprated for inflation). It is an ‘absolute’ measure of poverty because the poverty line is fixed in real terms. *Opportunity for All*, the government’s annual audit of poverty,¹⁹ also includes measures that count individuals with persistent low incomes, and a wide range of other indicators that are not income-based. We do not consider any of these here.

Since the size of the population can change over time, it is often better to measure trends in poverty by the fraction of individuals that it affects, rather than by the number of individuals. Nevertheless, most of the following tables and graphs present both the number of people who are poor and the percentage of the population they represent. We also report estimates of whether changes in poverty are statistically significant.²⁰

4.1 The whole population

Figure 6 shows relative poverty in Britain since 1979, illustrating the well-known trend that poverty rates increased dramatically during the 1980s, more slowly in the early 1990s, and then stabilised or fell from the mid-1990s. The graph also shows the historical tendency for poverty rates measured after housing costs to be higher than those measured before housing costs; this is because the distribution of incomes is more heavily skewed towards the lower end when measured AHC.

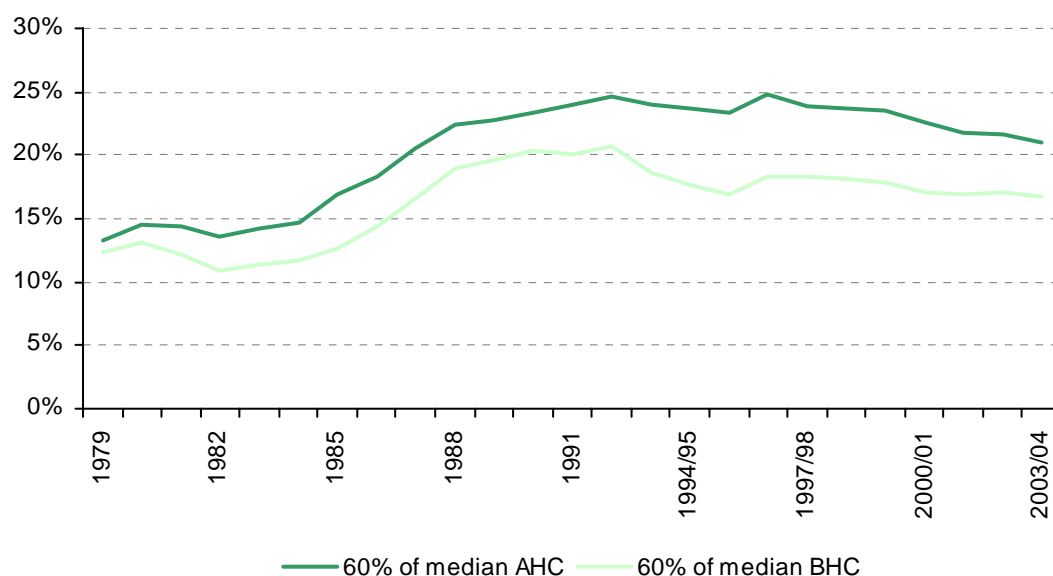
Tables 5 and 6 contain more detailed information on poverty since 1996–97 for the population as a whole (the last column) and various subgroups (the other columns). Poverty among the whole population has been on a downward trend over both parliamentary terms of the current government. Compared with 1996–97, it is now 3.8 percentage points lower measured AHC and 1.6 percentage points lower measured BHC, and both of these falls are statistically significant. Poverty seems to have fallen more during Labour’s first term in office than it has so far in its second, but it is important to remember that we only have three years of data for the second parliament compared with four for the first parliament. Much of the fall in poverty in the first parliament was due to a large single-year decline between 1999–2000 and 2000–01.

¹⁸ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

¹⁹ Most recently, Department for Work and Pensions, *Opportunity for All: Sixth Annual Report*, Cm. 6239, TSO, London, 2004.

²⁰ These were calculated by bootstrapping the changes. This involves recalculating statistics for each of a series of random samples drawn from the original sample, as a way of approximating the distribution of statistics that would be calculated from different possible samples out of the underlying population. See A. C. C. Davison and D. V. Hinkley, *Bootstrap Methods and their Application*, Cambridge University Press, Cambridge, 1997.

Figure 6. Relative poverty in Britain: percentage of individuals in households with incomes below 60% of median income



Note: Data from 1993 onwards are for financial years, i.e. 1993–94 etc.

Source: Authors' calculations based on Family Expenditure Survey and Family Resources Survey, various years.

Table 5. Relative poverty in Britain: percentage and number of individuals in households with incomes below 60% of median AHC income

| | Children | | Pensioners | | Working-age parents | | Working-age non-parents | | All | |
|--------------------------------------|----------|---------|------------|---------|---------------------|---------|-------------------------|---------|------|---------|
| | % | Million | % | Million | % | Million | % | Million | % | Million |
| 1996–97 | 33.3 | 4.2 | 27.9 | 2.8 | 25.8 | 3.2 | 17.4 | 3.6 | 24.8 | 13.8 |
| 1997–98 | 32.4 | 4.1 | 27.4 | 2.7 | 25.2 | 3.1 | 16.1 | 3.3 | 23.8 | 13.3 |
| 1998–99 | 32.5 | 4.1 | 27.3 | 2.7 | 25.2 | 3.1 | 15.6 | 3.3 | 23.7 | 13.2 |
| 1999–00 | 31.9 | 4.1 | 26.1 | 2.6 | 24.9 | 3.0 | 16.4 | 3.5 | 23.5 | 13.2 |
| 2000–01 | 30.3 | 3.8 | 24.4 | 2.5 | 24.0 | 2.9 | 16.3 | 3.5 | 22.6 | 12.7 |
| 2001–02 | 29.6 | 3.7 | 23.2 | 2.3 | 23.7 | 2.9 | 15.7 | 3.4 | 21.9 | 12.3 |
| 2002–03 | 28.3 | 3.6 | 22.1 | 2.3 | 22.9 | 2.8 | 16.7 | 3.6 | 21.6 | 12.2 |
| 2003–04 | 27.8 | 3.5 | 19.7 | 2.0 | 22.7 | 2.7 | 16.9 | 3.7 | 21.0 | 12.0 |
| <i>Change:</i> | | | | | | | | | | |
| Labour I & II: 1996–97 to 2003–04 | –5.5 | –0.7 | –8.2 | –0.7 | –3.1 | –0.4 | (–0.5) | (0.1) | –3.8 | –1.8 |
| Labour I: 1996–97 to 2000–01 | –3.0 | –0.4 | –3.5 | –0.3 | –1.7 | –0.3 | –1.1 | (–0.1) | –2.2 | –1.1 |
| Labour II: 2000–01 to 2003–04 | –2.5 | –0.4 | –4.7 | –0.4 | –1.3 | –0.2 | (0.6) | 0.2 | –1.6 | –0.7 |

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding.

Changes in parentheses are not significantly different from zero at the 5% level.

Sources: Authors' calculations based on Family Resources Survey, various years.

Table 6. Relative poverty in Britain: percentage and number of individuals in households with incomes below 60% of median BHC income

| | Children | | Pensioners | | Working-age parents | | Working-age non-parents | | All | |
|--------------------------------------|----------|---------|------------|---------|---------------------|---------|-------------------------|---------|--------|---------|
| | % | Million | % | Million | % | Million | % | Million | % | Million |
| 1996–97 | 24.9 | 3.2 | 22.1 | 2.2 | 18.8 | 2.3 | 12.3 | 2.5 | 18.4 | 10.2 |
| 1997–98 | 24.7 | 3.1 | 22.7 | 2.3 | 18.9 | 2.3 | 12.0 | 2.5 | 18.3 | 10.2 |
| 1998–99 | 24.5 | 3.1 | 23.7 | 2.4 | 18.3 | 2.2 | 11.8 | 2.5 | 18.2 | 10.2 |
| 1999–00 | 23.4 | 3.0 | 22.6 | 2.3 | 18.2 | 2.2 | 12.2 | 2.6 | 17.9 | 10.0 |
| 2000–01 | 21.0 | 2.7 | 21.9 | 2.2 | 16.5 | 2.0 | 12.7 | 2.7 | 17.0 | 9.6 |
| 2001–02 | 20.7 | 2.6 | 22.8 | 2.3 | 16.6 | 2.0 | 12.1 | 2.6 | 16.9 | 9.6 |
| 2002–03 | 20.8 | 2.6 | 22.2 | 2.3 | 16.5 | 2.0 | 12.8 | 2.8 | 17.0 | 9.7 |
| 2003–04 | 20.5 | 2.6 | 21.0 | 2.2 | 16.5 | 2.0 | 12.9 | 2.8 | 16.8 | 9.6 |
| <i>Change:</i> | | | | | | | | | | |
| Labour I & II: 1996–97 to 2003–04 | –4.4 | –0.6 | (–1.1) | (0.0) | –2.3 | –0.3 | (0.6) | 0.3 | –1.6 | –0.7 |
| Labour I: 1996–97 to 2000–01 | –3.9 | –0.5 | (–0.2) | (0.0) | –2.3 | –0.3 | (0.4) | (0.2) | –1.4 | –0.6 |
| Labour II: 2000–01 to 2003–04 | (–0.5) | (–0.1) | (–0.9) | (–0.1) | (0.0) | (0.0) | (0.2) | (0.1) | (–0.2) | (0.0) |

Notes: Reported changes may not equal the differences between the corresponding numbers due to rounding.

Changes in parentheses are not significantly different from zero at the 5% level.

Sources: Authors' calculations based on Family Resources Survey, various years.

Under the 60% of median income poverty definition, there are now 12.0 million individuals in poverty measured AHC and 9.6 million measured BHC, down from 13.8 million and 10.2 million respectively in 1996–97.

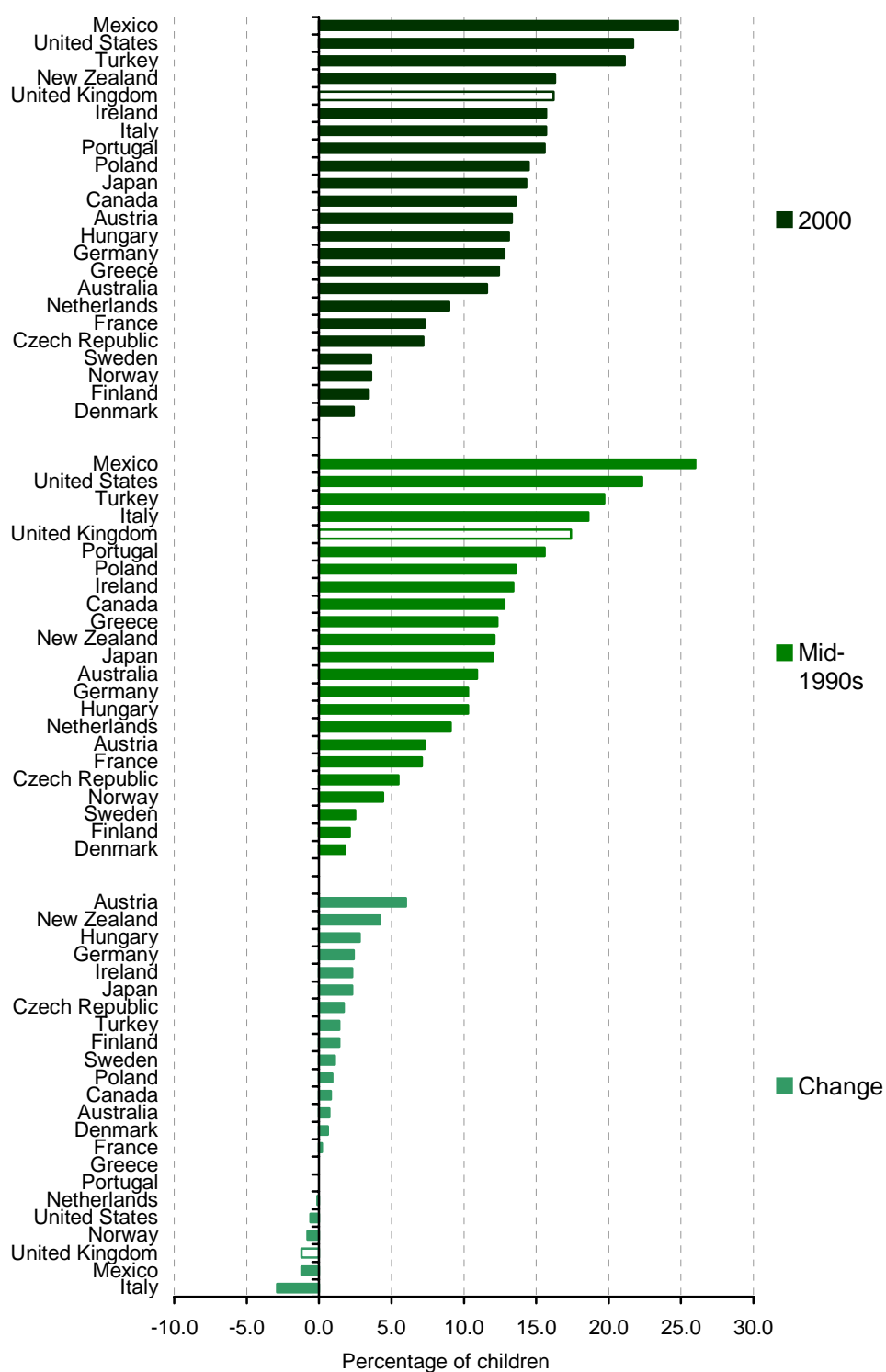
4.2 Child poverty and the 2004–05 target

Tables 5 and 6 also show the proportion of children in poverty. Child poverty has been on a downward trend since 1998–99, following a large rise in child poverty during the 1980s and early 1990s.²¹ Child poverty is statistically significantly lower in 2003–04 than in 1996–97, and fell by more during the four years of Labour's first term in office than it has in the three years of data we have covering the second parliament. Indeed, measured BHC, there has been little change in child poverty since 2000–01. With the poverty line at 60% of median income, child poverty is now at its lowest level since 1989 (AHC) or 1988 (BHC).

Figure 7 shows that child poverty in the UK (not Great Britain) – defined as those living in households with less than 50% of median BHC income – was higher than in most other

²¹ Not shown here. See M. Brewer, T. Clark and A. Goodman, *The Government's Child Poverty Target: How Much Progress Has Been Made?*, Commentary no. 88, Institute for Fiscal Studies, London, 2002 (http://www.ifs.org.uk/publications.php?publication_id=1946), or M. Brewer, T. Clark and A. Goodman, 'What really happened to child poverty in the UK under Labour's first term?', *Economic Journal*, 2003, vol. 113, pp. F240–57.

Figure 7. Share of children 17 years and under living in households with equivalised disposable income less than 50% of median income in selected OECD countries



Notes: '2000' data refer to the year 2000 in all countries except: 1999 for Australia, Austria and Greece; 2001 for Germany, Luxembourg, New Zealand and Switzerland; and 2002 for the Czech Republic, Mexico and Turkey. 'Mid-1990s' data refer to the year 1995 in all countries except: 1993 for Austria; 1994 for Australia, Denmark, France, Germany, Greece, Ireland, Japan, Mexico and Turkey; and 1996 for the Czech Republic and New Zealand.
 Source: Data-chart EQ3.1 in OECD, *Society at a Glance: OECD Social Indicators – 2005 edition* (http://www.oecd.org/document/24/0,2340,en_2649_37419_2671576_1_1_1_37419_00.html).

OECD countries in 2000, including all EU countries in the graph, but lower than in the USA. However, the UK appears to be one of the few countries in which child poverty has fallen since the mid-1990s. It is also the case that the UK has improved its rank relative to other EU countries on a 60% median income measure (see Brewer et al.²² for more details).

The government has a quantified Public Service Agreement (PSA) target for child poverty in 2004–05 to be a quarter lower than its level in 1998–99, using a poverty line of 60% of median income.²³ The government has not explicitly stated whether it has a preference for measuring income before or after housing costs, and so it has become common to measure progress against both.

Measured AHC, there were 4.1 million children in poverty in 1998–99 on this definition, so there will need to be 3.0 million or fewer children in poverty in 2004–05 for the government to meet its target, assuming that HBAI continues to report estimates of child poverty rounded to the nearest 100,000. When poverty is measured BHC, there were 3.1 million children in poverty in 1998–99, so the target is for 2.3 million children or fewer to be in poverty in 2004–05.

Although the financial year 2004–05 is now over, the data will not be available to allow us to assess whether or not the target has been met until early 2006. The respective levels of child poverty in 2003–04 on the target AHC and BHC measures are 3.5 million and 2.6 million, implying that the rounded level of child poverty reported in HBAI needs to fall by 500,000 children AHC and 300,000 children BHC in one year for the government to meet its 2004–05 target.

Table 7. Discretionary changes in spending on tax and benefit policies affecting families with children

| New policies with full effect in financial year: | |
|---|---------|
| 2002–03 | £1,105m |
| 2003–04 | £2,585m |
| 2004–05 | £750m |

Source: HM Treasury, *Financial Statement and Budget Report*, various years.

In early 2004, it was widely believed that the government was on track to meet its child poverty targets in 2004–05. Our own assessment was that child poverty would fall by 500,000 between 2002–03 and 2004–05.²⁴ Child poverty was projected to fall primarily because of a substantial increase in spending on tax credits in 2003–04 and 2004–05. But, as Table 7 shows, the majority of that extra spending (77%) took effect in 2003–04, meaning that there is

²² M. Brewer, A. Goodman, M. Myck, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2004*, Commentary no. 96, Institute for Fiscal Studies, London, 2004 (<http://www.ifs.org.uk/comms/comm96.pdf>).

²³ See HM Treasury, *Technical Note for HM Treasury's Public Service Agreement (PSA) 2003–2006*, 2002 (http://www.hm-treasury.gov.uk/mediastore/otherfiles/tech_notes.pdf).

²⁴ See M. Brewer, *Will the Government Hit Its Child Poverty Target in 2004–05?*, IFS Briefing Note no. 47, 2004 (http://www.ifs.org.uk/publications.php?publication_id=1795). The government's assessment is presented in HM Treasury, *Pre-Budget Report 2003: The Strength to Take the Long-Term Decisions for Britain: Seizing the Opportunities of the Global Economic Recovery*, Cm. 6042, TSO, London, 2003. Earlier, researchers suggested the government's policies up to 2003–04 would reduce child poverty by a quarter of its 1998–99 level by 2004–05 (see H. Sutherland, D. Piachaud and T. Sefton, *Poverty in Britain*, Joseph Rowntree Foundation, York, 2003).

relatively little ‘new’ money yet to be reflected in HBAI data. This suggests that most of the fall in child poverty should have happened between 2002–03 and 2003–04. But child poverty fell by only 100,000 AHC and did not fall at all BHC, measured to the nearest 100,000. The fact that child poverty fell so little is even more surprising given that median income hardly grew (see Section 2).

Reasons why poverty fell by less than expected are explored in detail in Brewer et al.²⁵ The two main explanations seem to be:

- Administrative problems in the months following the introduction in April 2003 of the child and working tax credits meant that many families had lower-than-expected incomes in the first quarter of 2003–04.
- According to HBAI, the number of children living in families where no adult works increased, reducing the fall in child poverty because a high proportion of children in workless families are classed as poor. Other data sources, however, do not support the increase in worklessness, suggesting that the HBAI evidence may be due to sampling error.

Administrative problems were not repeated in 2004–05 and spending on the new tax credits was increased. Furthermore, there is evidence that tax credit take-up continued to rise. Taken together, these factors suggest that poverty will have fallen in 2004–05. Sampling error means that little can be inferred from a single data point, but the likelihood of hitting the targets seems a little lower than a year ago. Measured BHC, child poverty should probably fall to levels close to the government’s target; measured AHC, though, the issues identified above do not alone seem sufficient for child poverty to meet its target.

4.3 Pensioner poverty

Tables 5 and 6 also set out poverty rates amongst pensioners since 1996–97.²⁶ Measured AHC, pensioner poverty has declined rapidly. The 8.2 percentage point fall since 1996–97 at 60% of median AHC income constitutes a cut in poverty of more than a quarter. The downward trend is less clear when poverty is measured BHC, but the fall since 2002–03 means that poverty is now lower than at any point since the Labour government took office (though not by a statistically significant amount). In contrast to children and the population as a whole, poverty amongst pensioners may have fallen more during Labour’s second term than during its first.

The 2003–04 poverty rates imply that there are now 2.0 million pensioners in AHC poverty, down from 2.8 million in 1996–97. BHC pensioner poverty remains unchanged at 2.2 million (but note that the size of the pensioner population has been increasing). A pensioner chosen at random in 2003–04 is less likely to be in poverty than an individual selected at random from the rest of the population – the first time this has occurred since the recession in the early 1980s (when it happened as a one-off blip).

²⁵ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

²⁶ They show the poverty rate amongst individuals above the current pension age – 65 for men and 60 for women – regardless of who else lives in their household.

4.4 Poverty among other groups

Poverty among the remainder of the population – working-age adults – has changed little since 1996–97. However, given the methodology of HBAI, it is more informative to consider working-age adults without children separately from working-age parents. This is because income is measured at the household level, so poverty among working-age parents is likely to follow a similar path to that among children. This approach is different from what is done in *Opportunity for All*,²⁷ which only presents poverty rates for working-age individuals as a whole.

For working-age adults without children, a group that makes up 39% of the population (21.9 million individuals), poverty is lower than that it is among pensioners or children, but unlike for pensioners and children, it has not fallen in recent years (see Tables 5 and 6). In fact, aside from the drop between 2000–01 and 2001–02, there has been a slight upward trend since 1998–99. This is perhaps not surprising given the focus of government policy on pensioners and children.

4.5 Absolute poverty

All the poverty figures presented so far are based on relative measures of poverty: that is, the poverty line moves each year in line with median income growth. Table 8 sets out absolute

Table 8. Absolute poverty in Britain: percentage of individuals in households with incomes below 1996–97 median income

| | Percentage of the population | | | | | |
|--------------------------------------|------------------------------|------------|-------|----------------------|------------|------|
| | After housing costs | | | Before housing costs | | |
| | Children | Pensioners | All | Children | Pensioners | All |
| 1996–97 | 33.3 | 27.9 | 24.8 | 24.9 | 22.1 | 18.4 |
| 1997–98 | 31.8 | 26.3 | 23.2 | 23.9 | 21.6 | 17.6 |
| 1998–99 | 30.8 | 24.3 | 22.1 | 22.3 | 21.5 | 16.7 |
| 1999–00 | 28.0 | 20.0 | 20.1 | 19.0 | 18.5 | 14.8 |
| 2000–01 | 23.4 | 15.4 | 17.4 | 15.7 | 16.2 | 13.0 |
| 2001–02 | 20.1 | 11.8 | 14.8 | 12.4 | 14.4 | 11.1 |
| 2002–03 | 17.7 | 9.7 | 13.5 | 11.8 | 12.2 | 10.4 |
| 2003–04 | 17.2 | 8.8 | 13.3 | 11.4 | 11.0 | 10.1 |
| <i>Change:</i> | | | | | | |
| Labour I & II: 1996–97 to 2003–04 | –16.1 | –19.1 | –11.5 | –13.5 | –11.1 | –8.3 |
| Labour I: 1996–97 to 2000–01 | –9.8 | –12.6 | –7.4 | –9.2 | –5.9 | –5.3 |
| Labour II: 2000–01 to 2003–04 | –6.2 | –6.5 | –4.2 | –4.4 | –5.2 | –3.0 |

Note: Reported changes may not equal the differences between the corresponding numbers due to rounding. All changes are significantly different from zero at the 5% level.

²⁷ The government's annual audit of poverty – most recently, Department for Work and Pensions, *Opportunity for All: Sixth Annual Report*, Cm. 6239, TSO, London, 2004.

poverty – where the poverty line is fixed in real terms at 60% of 1996–97 median income – for the population as a whole, and separately for children and pensioners.

Absolute poverty has fallen sharply since 1996–97 for all groups. Not surprisingly, the fall is larger for children and pensioners than for the whole population. It is also larger AHC than BHC, and larger in Labour’s first term than in its second.

5. Looking forward

All three parties’ manifestos contain policy proposals that would affect household incomes, inequality and poverty. The impact of the different parties’ reforms to taxes, benefits and tax credits on average household incomes, and on the distribution of income, will be assessed in another IFS Election Briefing Note.

In addition to their proposed fiscal reforms, the parties have also made statements about child poverty:

- Labour has been the most specific about its future child poverty aims. The government has a specific target to halve child poverty relative to its 1998–99 level by 2010–11, and a stated aim to eradicate it by 2020 (where ‘eradicating child poverty’ might be interpreted as ‘having a material deprivation child poverty rate that approached zero and being among the best in Europe on relative low incomes’).²⁸
- The Liberal Democrats suggest that they would also aim to ‘eradicate’ child poverty by 2020. Their Manifesto for Families states that ‘... anti-poverty measures have yet to gain a high enough profile and do not sufficiently address the human dimension of poverty, which is necessary to meet the target of eradicating child poverty by 2020’.²⁹
- The Conservatives have not said whether they would keep any child poverty targets or abandon them. David Willetts, the Shadow Secretary of State for Work and Pensions and Welfare Reform, stated on 6 January 2005 that ‘a future Conservative Government will continue to produce data measuring poverty as 60% of median income and will accept that this is a powerful measure of our performance in tackling poverty. Putting such a measure centre stage will show the world we are serious about tackling poverty’. This suggests that a future Conservative government might continue to target relative child poverty, though it is not clear that it would keep to the same targets as a Labour government.

Brewer et al.³⁰ have highlighted the numerous uncertainties surrounding estimates of the costs of meeting particular child poverty targets; however, this work also pointed out that it is very likely that reducing relative child poverty beyond 2005–06 will require additional fiscal reforms. The authors estimated that in order to be on track to reduce child poverty by one half from its 1998–99 level by 2010–11, this might cost around an additional £1.4 billion per year

²⁸ See Department for Work and Pensions, *Measuring Child Poverty*, London, 2003.

²⁹ Liberal Democrats, General Election 2005: Liberal Democrat Manifesto for Families, 2005 (<http://www.libdemers.org.uk/media/documents/policies/FamiliesManifestoWord.doc>).

³⁰ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

by 2007–08 – given a range of economic and demographic assumptions. This estimate is based on achieving poverty reduction through increases in the per-child element of the child tax credit; such a measure would reduce poverty but would come at the cost of worsening financial work incentives for parents.³¹ All of this work assumed that the government meets its child poverty target in 2004–05. If that target has been missed, then meeting future targets would be more expensive.

Although such additions are small relative to the extra spending on child-related benefits and tax credits introduced by Labour so far, without reductions in public spending elsewhere they would impact on the public finance position of any government that chose to enact them.

Finally, it is noteworthy that the parties have considerably less to say about inequality than about poverty and living standards.

6. Conclusions

This Election Briefing Note has shown that living standards have risen over the period of Labour's two governments, though growth in average income has been slower in recent years than over the rest of the two parliaments. Taking Labour's period in office to date as a whole, living standards have risen more quickly than under the Conservatives since 1979, though it is important to remember that the average over Labour's time in office does not contain any periods of economic downturn, whilst the longer Conservative period contained both periods of growth and periods of recession.

Inequality, measured by the Gini coefficient, remains roughly the same as when Labour took office, though this overall lack of change is the combination of rising inequality over the early part of Labour's first parliament and then an apparent, though not yet statistically significant, decline over the second. Our analysis suggests that in the absence of Labour's redistributive tax and benefit policies, inequality might have continued to rise, though perhaps not as sharply as it did under Margaret Thatcher's governments.

Relative poverty rates have fallen under Labour for families with children and for pensioners, but not for the remainder of the population – namely, working-age adults who do not have children. Under the Conservatives between 1979 and 1997, child poverty rose significantly, whilst pensioner poverty fluctuated quite markedly in line with the economic cycle. The government appears on course to meet one of its two short-term child poverty targets (based on BHC income), but it looks less likely that the other (based on AHC income) will be met.

Appendix. Income growth in the National Accounts

The National Accounts record economic activity in the UK. A commonly used measure of economic activity from the National Accounts is real gross domestic product (GDP), which describes the income of the whole economy. This measures something different from income

³¹ For an analysis of how financial work incentives for parents have changed since 1997, see M. Brewer and A. Shephard, *Has Labour Made Work Pay?*, Joseph Rowntree Foundation, York, 2004 (http://www.ifs.org.uk/publications.php?publication_id=3155).

in HBAI since it includes the income of companies and the government as well as that of households. A series much closer to the HBAI definition of income is 'real household disposable income per head'. This series, however, is still not directly comparable to HBAI. In particular, the National Accounts are constructed differently:

- HBAI relates to Great Britain while the National Accounts are for the United Kingdom.
- The National Accounts do not rely on a sample in the same way as HBAI does.
- The definition of a household is broader in the National Accounts.
- The household sector in the National Accounts is combined with non-profit institutions serving households (charities, universities, trade unions, religious societies, etc.).

The definition of income is also different:

- The components summed to give total income are not the same: there are differences in the treatment of housing costs, insurance, vehicle taxation and international or charitable transfers.
- HBAI asks about current income whereas the National Accounts cover income received over the whole year (or quarter).
- Income in HBAI is household income whereas in the National Accounts it is income per capita.
- Income is adjusted in HBAI to take account of household size and composition; this does not happen in the National Accounts.
- Income is deflated on slightly different bases.

The Department for Work and Pensions has devised an adjustment to make the real household disposable income series more comparable to HBAI. This involves excluding imputed income from owner-occupation and income that can be attributed to non-profit organisations such as universities and charities, and adding back in vehicle excise duty payments (among other things). The DWP series also makes adjustments for household size. This yields a series that is closer in definition to HBAI, but even so, many differences remain.

An alternative indicator is the tax and price index (TPI), an index produced by the Office for National Statistics that measures how much an 'average' individual's gross income needs to change to be able to purchase a given basket of goods and services, allowing both for changes in prices and changes in taxes. The TPI is compared against gross income: if gross income rises faster than the TPI, then the real purchasing value of income has increased.

Restrictions are made to the coverage of the index in an attempt to make it more representative of the impact of tax changes. Non-taxpayers are excluded, since the TPI is intended to add taxes to the domestic costs covered by the retail price index. The top 4% of tax units are also excluded, because their tax payments are judged to be different from those for the majority of taxpayers. The taxes reflected by the TPI (aside from those that affect prices, such as VAT) are income tax, National Insurance and the negative taxation component

of tax credits.³² Although the main source of income for most people is earnings, income is also derived from a number of other sources, such as benefits, investments and pensions. The sources of income included in TPI calculations are earnings, self-employment income, pensions and investment income.

Table A1 compares growth in the TPI with growth in gross income. The measure of gross income we use is HBAI gross income, measured in nominal terms and unequivalised.³³ This seems more satisfactory than using an index of average earnings growth since we are interested in income derived from all sources, not just earnings. However, the TPI is not directly comparable to HBAI gross income. In particular, HBAI does not exclude individuals at the top and bottom of the income distribution, and tax credits are treated differently. Inferences based on the TPI should therefore be interpreted with care. Table A1 shows that the difference between growth in gross income and in the TPI has become considerably smaller in the last two years, suggesting, like Table 2, that growth in disposable income has slowed considerably recently.

Table A1. Growth in TPI and HBAI gross income

| Year | Tax and price index | HBAI gross income | Difference |
|-------------|----------------------------|--------------------------|-------------------|
| 1996–97 | 1.0% | 4.7% | 3.7% |
| 1997–98 | 2.5% | 6.0% | 3.5% |
| 1998–99 | 3.1% | 7.7% | 4.6% |
| 1999–00 | 1.0% | 2.8% | 1.8% |
| 2000–01 | 3.0% | 7.8% | 4.8% |
| 2001–02 | 0.1% | 6.0% | 5.9% |
| 2002–03 | 2.1% | 3.6% | 1.5% |
| 2003–04 | 3.6% | 2.1% | -1.5% |

³² Tax credits are treated as negative taxation so long as the credit is less than or equal to the tax liability. Any part of the credit that exceeds the tax liability is treated as a benefit payment.

³³ More details on how the gross income measure is constructed are available from the authors.