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CLARIFYING INCOME DISTRIBUTION

An issue of equality or need?

Policy Exchange

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Context and objectives

Claims that income inequality has never been greater are not only societally divisive, they are also largely untrue. Rather, on standard measures, the large-scale trend of income inequality in the UK over the past thirty years is usually regarded as flat. Moreover, while it is often assumed that the least well off people in society are hit the hardest during times of general economic difficulty, this has not — in terms of household disposable income — been the case here following the recent Great Recession. The poorest quintile is the only one within the distribution not to have seen incomes fall since then; the incomes of the richest have not yet returned to pre-downturn rates.

Contrary claims are commonly left unchallenged, however. This is owing — understandably — to the complicated nature of such assessments, and — sadly — to political expediency. Few would disagree that it is important to be aware of the dispersal of income within a society and how that changes over time. But misunderstandings and misdirected interpretations of the complex data used to describe these matters contribute to an unnecessarily contentious public debate. This debate is driven by the way in which the left's age-old fixation on income inequality has been renewed by the popular and politically-engaged work of economists such as Thomas Piketty and Joseph Stiglitz, and campaigns against the '1 per cent'.

An all-out emphasis on distribution also risks overlooking more essential and nuanced considerations. Income equality does not necessarily equate to high overall living standards; inequality and poverty are often wrongly confused and conflated.

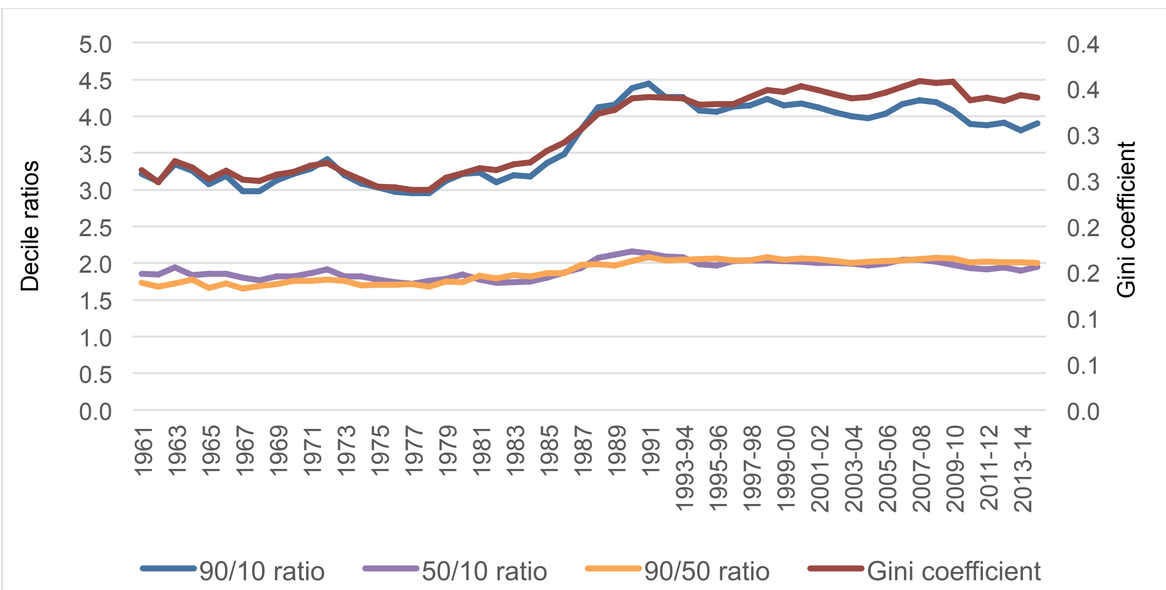
The intention of this report is to clarify the situation by providing an accurate summary of the latest information on the distribution of income in the UK, with a secondary focus on the distribution of wealth and consumption. Consideration is given to the income that arises from market transactions, and the way in which that income is modified through various stages of government intervention, with the effect of making its dispersion more equal. Indeed, too many people seem unaware of the extensive influence that such intervention — through cash benefits and direct taxation — has on income inequality. It is important, too, to recognise the many static and changing measures within the overall income-inequality trend, including those evident from comparisons between gross and net income, different ratios in the distribution, and variables such as location, gender, and age.

The report also aims to assess where its findings sit in relation to the role of equality within a society, and the duties of the state towards the least well off. Greater clarity on all of these issues — both in terms of the actual facts of the matter, and in advancing the case for concentrating on living standards over income distribution — would help to relieve public uncertainty and societal division.

Short overview of recent developments

Although the accuracy of such pronouncements is famously complicated by questions of measurement, the large-scale trend of income inequality in the UK over the past thirty years is usually regarded as flat. This assessment is explained by a story involving both ups and downs. Regardless of the overall benefits of the economic transformation of the 1970s and 1980s, a downturn in manufacturing alongside an unleashing of the financial-services industry led to clear increases in unemployment and inequality. An extension of state intervention during the 1990s, in terms of taxation and welfare transfers, countered that shift in inequality. A subsequent gradual decline means that levels are now generally considered to be similar to those of the 1980s.

Figure 1: Inequality in Great Britain, household disposable income, before housing costs, 1961 – 2013-14 (IFS)



Over the same period, the '1 per cent' have pulled away at the top of distribution, even though they were the hardest hit during the economic crisis of the late 2000s. The most convincing explanation is that, in an increasingly digitalised and globalised world, 'superstar' workers are worth ever more than their next competitors. This group's relative success does not seem to have hurt median living standards, however — rather, it may even have advanced them. Any widening of the distribution nonetheless provides a strong narrative for those keen to criticise on the grounds of equality's intrinsic societal value. All of this is compounded by the global uncertainty of recent times. A series of economic shocks has added to the precariousness of a era in which UK productivity — to which work remains coupled — has been notably stagnant for both individuals and companies, and changes to the makeup of the workforce have left it no better prepared to deal with the current rise of automation.

There have been positive recent developments, however:

- In 2016, median gross weekly earnings increased at the joint highest rate since the 2008 downturn, with those at the bottom of the distribution growing the fastest.
- UK median equivalised household disposable income was £26,300 in the financial year ending 2016 — higher than the pre-downturn figure for the first time.
- Employment remains at an all-time high.

1

Introduction: should we focus on income distribution or living standards?

Keeping track of income distribution seems inherently important. Yet any argument suggesting that this should be the principal factor on which to assess a society's economic performance is mistaken. It must be mistaken if we see, in a classically liberal sense, that an economy's primary aim is in maximising economic welfare for those partaking in it, yet that state power is predicated on the consent of the governed, who participate in ordered society to gain the essential protection they cannot provide for themselves. Therefore, an economy's performance should be judged on its capacity to generate the standards of living and freedom expected within a fair society. How best to attain such results is a key focus of the public policy of modern advanced economies.

Competing narratives

It is clear that assessments of economic 'success' should be informed by the living standards that people enjoy, rather than how evenly their income is spread. This is an increasingly less commonly held view, however. The late Tony Atkinson — who spent much of his career working on these issues — comments at the start of his 2015 book, *Inequality*, that 'when the Pew Research Centre's Global Attitudes Project asked respondents in 2014 about the "greatest danger in the world", it found that in the United States and Europe, 'concerns about inequality trump all other dangers'.[1]

Competing narratives complicate this fixation, and misleading claims about income distribution are often used to prop up divisive political agendas. In times of economic uncertainty — not least following the Great Recession, the worldwide commodity crunch, ongoing questions over public-finance rates, and, of course, Brexit — better and more widely disseminated clarification is essential.

A key aim of this clarification must be to counter the misconception that income equality necessarily equates to high overall living standards: many people confuse and conflate the issues of inequality and poverty. A

[1] Anthony B. Atkinson, Inequality: What can be done?, Harvard University Press, 2015

recent Manhattan Institute report by Scott Winship, *Inequality Does Not Reduce Prosperity: A Compilation of the Evidence Across Countries*, neatly rebuts the relevance of Joseph Stiglitz's famous claim that American income inequality is verging on the levels seen in 'dysfunctional societies', such as Iran, Jamaica, Uganda, and the Philippines. Winship's report points out that Americans in the bottom quintile of their national income distribution earn 4.5 to 34 times more than their counterparts in those 'dysfunctional societies'.[2]

Box A: Historic example

In 1990, the East-German German Democratic Republic was much more 'economically successful' in terms of ensuring a narrow dispersion of incomes than the West-German Federal Republic of Germany. Yet, between 1949 and 1990, West Germany was immensely more successful in raising living standards for households across the income distribution, and gave its citizens vastly greater freedom and choice over decisions regarding consumption, saving, borrowing, and investment.

What do we mean by 'equality'?

It is distracting to focus on equality in the impossible sense of identicality, rather than the promotion of fair access to opportunity. Not only is 'levelling out' less preferable than addressing problems at their source, it also ignores people's needs and desires as individuals. As Nobel Laureate James Meade explains in his 1979 volume, *The Just Economy*, 'if needs and tastes were the same for everyone, then equality of actual income and wealth if it were achieved would lead to equality of welfare and enjoyment. But where needs are different, an unequal distribution of income may be needed to provide an equal welfare and enjoyment of life'.[3]

While it easy to understand the fears of those who claim that extreme disparity of assets brings social and political unrest and injustice, inequality — in that sense of the disparity of assets — is rarely the most important problem. As McGill economist William Watson points out in his recent book, *The Inequality Trap*, 'inequality can be good, it can be bad, and it can be neither good nor bad but benign'.[4] Few would disagree, for instance, that a society would be suffering from a bad form of inequality if its citizens were marginalised by the state on the grounds of characteristics such as gender or race. But with respect to income levels, we are considering equality largely in relation to the distribution of goods. In grand terms, it must be better to live in a society where there is some degree of income disparity, but also an acceptable average standard of

[2] Scott Winship, Inequality Does Not Reduce Prosperity: A Compilation of the Evidence Across Countries, Manhattan Institute, 2014
[3] J.E.Meade, The Just Economy, George Allen & Unwin, 1976
[4] William Watson, The Inequality Trap: Fighting capitalism instead of poverty, University of Toronto Press, 2015

living, and the freedom required for people — who are treated as equals — to pursue their own ends. Successful modern economies do not represent stylised zero-sum worlds in which everyone is paid the same, but, rather, ones in which pay rewards effort, skill, and the accumulation and application of human capital.

The aim and structure of this report

This research report aims to explore and clarify the situation regarding the current dispersion of income in the UK. We shall examine and assess the validity of various calculations of individual and household incomings and outgoings, with a focus on equivalised average household disposable income.

We shall also, in passing, address complications including the rise of the gig economy, regional inequalities, the growing cost of housing, an ageing population, and the introduction of measures such as the National Living Income. But our emphasis will be on assessing the present distribution of UK income, and on considering the relevance of our findings. We shall review different methods of comparing the distribution of income — historically and internationally — not least, the Gini coefficient, which remains the standard, yet by no means faultless, comparator of societal equality. We shall also examine the spread of UK wealth and consumption, the situations regarding which are also in need of clarification.

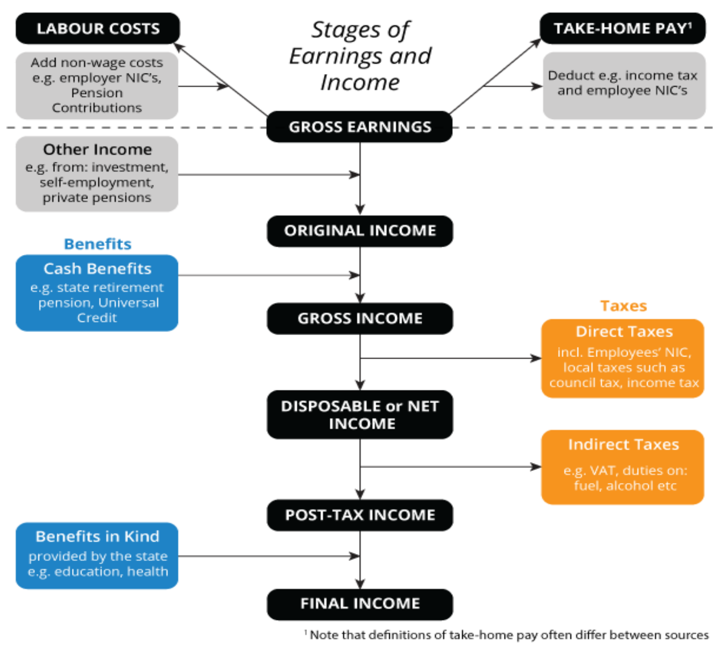
We shall conclude with a brief discussion about where our findings sit in relation to the role of equality within a society, and the duties of the state towards the least well off. To what extent should a 'just' society be predicated on striving for a relatively equal distribution of income? What is the strength of argument for serious state intervention in order to attain that goal? If our instinct is that a greatly increased level of intervention is not justifiable — owing to the resultant cost for those on middle and higher incomes, and the fact that state support already has a substantial impact in this area — it seems sensible to interrogate the arguments of those people who are attracted to such propositions. What an 'acceptable' average standard of living might be within a free society is a contentious and much debated matter, about which there is little agreement. Finally, we shall briefly consider answers to that in relation to the concept of a 'social minimum' — both from the point of view of the promotion of equality, and from that of a needs-based assessment.

2

The current situation: earnings, costs, and incomes

There are many ways to measure economic welfare. Nonetheless, specific income levels can be quantified empirically, and organisations such as the Office for National Statistics (ONS) regularly publish statistics measuring those levels. The challenge lies in how to interpret and analyse the data produced. To assess relative levels of disposable income within a society, considerations include those associated with general financial incomings — such as current real wage growth, and welfare transfers — and those associated with general outgoings — such as tax rates, living costs, and purchasing power.

Figure 2: *Stages of Earnings and Income*, ONS[5]



Standard measures and assessments take these things into account to various degrees: some using gross figures, some net, some reflecting inflation, some not, and some focusing solely on a single area, such as

[5] ONS, A guide to sources of data on earnings and income, 2016

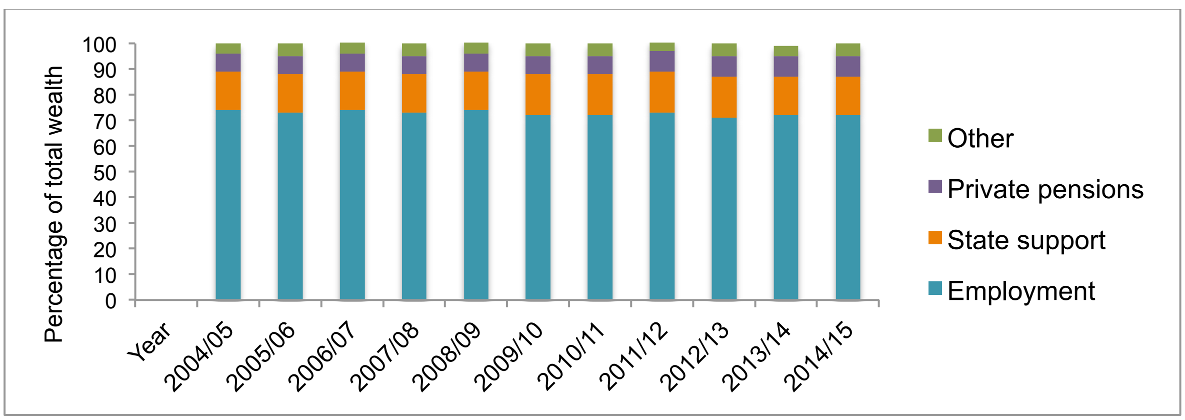
employee earnings.

It is also important to note which form of 'average' is being used. The ONS's *Household Disposable Income and Inequality in the UK* (HDI) series uses both the median and mean, for instance: the former to examine the income of a group of households; the latter when looking at the sources of overall income. As ever, the mean is easily skewed by significant outliers; the median — since it presents the 'middle' — is seen as more likely to provide 'typical' results. The HDI bulletin provides a useful annual estimate of the current and historically contextual situation regarding UK household incomes, and how equally they are dispersed.

2.1 Earnings

For most people in the UK, what they earn is the most significant part of their incomings. The most recent ONS *Family Resources Survey* (FRS) points out that, in 2014-15, income from employment made up 72 per cent of the UK's gross weekly household income.[6] For those in the top quintile of the distribution, 81 per cent of their income came from earnings; for those in the bottom, that decreased to 37 per cent.

Figure 3: Sources of UK total gross household income, 2004-05 to 2014-15 (ONS)



The Annual Survey of Hours and Earnings

The government's key earnings indicator is the ONS *Annual Survey of Hours and Earnings* (ASHE) time series, which has been running since 1997. In 2004, it replaced the *New Earnings Survey* as the principal statistical release reporting the levels and distribution of earnings in the UK. The survey's headline measure is full-time

[6] ONS, Family Resources Survey: financial year 2014-15, 2016

employees' median weekly earnings; it looks at earnings by occupation, location, age, and tenure, and is the principal data source of the gender pay gap.

The most recent ASHE provisional release was published in November 2016. Although its results only go as far as April 2016, which was in advance of the EU referendum, these results were particularly keenly awaited by those wanting to assess the resilience of the British economy before the vote's effects — and Brexit's opportunities and challenges — became clearer.

At first glance, the survey's news is highly positive. Median gross weekly earnings for full-time employees are up 2.2 per cent on 2015, which is the joint highest rate of growth since the 2008 Great Recession; in real terms, earnings increased by 1.9 per cent.[7] This compounds last year's progress, when, in real terms, weekly earnings also increased by 1.9 per cent on the previous year — the first increase since 2008.[8] The government's shorter-term earnings indicators had been disclosing similar findings, although we should note that February 2017's *UK labour market* release shows that, between October - December 2015 and October - December 2016, the growth in regular pay increased at a 'slightly lower rate' (down 0.2 per cent) than the previous comparable period (September - November 2015 and 2016).[9]

ASHE data also shows the gender pay gap to be at a historic low, that earnings for part-time workers have risen by 6.6 per cent on 2015, and that earnings at the bottom of the distribution have grown the fastest: the fifth percentile grew by 6.2 per cent; the 95th percentile by 2.5 per cent.[10] However, much of the immediate response to the ASHE earnings data focused on the fact that earnings had not yet reached pre-downturn heights: The Sun led with the headline that 'Brits are being paid less than they were 12 years ago even after taking into account inflation shocking new research has revealed'.[11] And the survey's findings were also criticised for not including information on the self-employed — an increasingly significant group, which contains disproportionate clusters both at the top and the bottom of the pay scale. The Social Market Foundation has recently estimated that 45 per cent of self-employed workers earn less than the National Living Wage.[12]

Employment

Before we focus on the detail, it is important to consider this debate about the ASHE data in its wider labour-

[7] ONS, Annual Survey of Hours and Earnings: 2016 provisional results, 2016
[8] ONS, Annual Survey of Hours and Earnings: 2015 provisional results, 2015
[9] ONS, UK labour market: Feb 17, 2017
[10] ONS, Annual Survey of Hours and Earnings: 2016 provisional results, 2016
[11] Guy Birchall, The Sun, 26/10/16
[12] Nina Broughton, Ben Richards, Tough Gig, Social Market Foundation, 2016

market context. Alongside the obvious effects of low inflation, these results are a counterpart to a successful employment story. The bulletin announces that employment has never been higher (since 1971, when comparable records began), and that is owing, not least, to a realistic adjustment of real pay following the devastating effects of the Great Recession, when output fell by 6.3 per cent**.**

The February 2017 ONS *UK labour market* release shows that the number of people in work continues to increase, and that while unemployment rates are more stagnant, they are at their lowest since 2005.[13] It has been widely commented, however, that much of the past year's employment increase relates to non-UK nationals: over three times as many (233,000) gained employment between October and December 2016, than UK nationals (70,000).[14]

We should also recognise the consternation that has arisen over an increase in the amount of in-work poverty. While this is certainly something to be examined, it is dependent on increased employment, too. As the most recent ONS *Households Below Average Income* (HBAI) report outlines, 'working age adults in working families face a much lower risk of relative low income than those in families where no-one is in work. However, because a high proportion of adults are in working families, the majority of those in relative low income are from working families'.[15]

Moreover, ASHE data is only part of the story. The survey's results simply tell us what individuals can get — regarding employment — from the labour market. Bigger-picture assessments are usually considered on more comprehensive measures, such as household disposable income, which can fully take into account other forms of earned income, living costs, tax, and social-security transfer payments**.**

Self-employment

The ASHE data does not cover the self-employed. Around 85 per cent of the workforce is employed, however, so ASHE provides a benchmark that people can use to evaluate their income; the average wage of those in full-time employment is a basic comparator for us all. Nonetheless, a growing focus on the 'gig economy' correlates with an increase in the number of people involved in it: almost 15 per cent of workers are now self-employed, a proportion that has grown by around 25 per cent over the past couple of decades.[16] And, although many self-employed workers accept the trade-off between security and freedom — and are, therefore, happy to sacrifice some earnings potential for increased flexibility — they are, on

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[13] ONS UK labour market: Feb 17, 2017
[14] ibid
[15] ONS, Households below average income: 1994/95 to 2014/15, 2016
[16] Nina Broughton, Ben Richards, Tough Gig, Social Market Foundation, 2016

average, paid substantially less than the employed.

The National Living Wage

A new feature in the most recent ASHE data is the bulletin's first information about the National Living Wage (NLW), which was introduced in April 2016. This builds on increases to the National Minimum Wage (NMW) over the past few years, and, specifically, the increases initiated in October 2015. The NLW raises wages for the lowest-paid workers. However, its mechanism presents difficulties for smaller businesses, is poorly targeted at low-income households, and also compresses pay differentials in a way that could risk Britain's flexible labour market and record employment performance. We should also remember that, in the years following the Great Recession, it was social-security transfer payments — which rose in line with inflation, during a period in which inflation was relatively high — targeted on household income, that ensured that the dispersion in household income diminished, while earnings from employment grew slowly. Indeed, this slow growth in earnings allowed the labour market to adjust, and partly explains the strong employment performance.

The gender pay gap

The gender pay gap is now the lowest since ASHE began in 1997.[17] The 2016 figures show a bigger growth in pay for women than men, and February 2017's *UK labour market* release reveals that recent increases in the employment rate are largely owing to an increased number of women in work. The female employment rate (70 per cent) is at its highest since comparable records began in 1971; the male employment rate remains steady, at almost 80 per cent.[18] ASHE findings have displayed relatively little change regarding the pay gap over the past decade, however — it has decreased by 0.2 per cent on 2015, but, overall, a similar disparity between the genders remains.

We must bear in mind, however, that ASHE does not show differences in pay for comparable jobs; the compositions and behaviours of the overall male and female workforces are not the same. That women, on average, experience more career interruption than men, for instance, is particularly relevant, because ASHE's figures show that longer tenure is associated with higher pay increases. The introduction of the NLW is also significant, here. As the Resolution Foundation identified, 'earnings in 2016 grew fastest for those in their 20s, women, part-time employees, and those in occupations including sales, customer services and cleaning. Given low earners tend to be concentrated in these groups, this is largely a reflection of the

[17] ONS, Annual Survey of Hours and Earnings: 2016 provisional results, 2016
[18] ONS, UK labour market: Feb 2017, 2017

positive distributional story connected to the NLW's introduction'.[19]

The question of the gender pay gap is, therefore, complicated by other variables. Attending to it is also dependent on finding ways to accommodate the choices of individual workers. Clever flexible solutions are needed, not least regarding issues such as childcare and the return to work: it is unsurprising that the point at which pay rates for men and women separate is during their late twenties. Distributive justice is essential, in the sense of addressing cases in which people are unjustifiably being treated unequally. But that also means recognising that intervention in terms of positive discrimination — with quotas, for instance — is not only often counterproductive, it is also unfair to those against whom it discriminates.

Regional disparity

ASHE earnings data is especially useful for comparing regional levels of pay. However, the survey reports the average pay of jobs in a given location, rather than that of the people who live there. The relevance of this distinction is seen in areas of clear disadvantage where there are, nonetheless, a good number of highly-paid jobs — jobs that are held by those living elsewhere.

In April 2016, London had the highest median earnings for full-time employees by place of work — £671 per week. Employees in London earned £105 more per week than the next highest — the South East (£566) — and £132 more than the median for the whole of the UK (£539).[20] Pay in London reflects the high proportion of its labour force employed in high-paying industries and occupations, and that many employees receive allowances for working in the capital. Such allowances are typically referred to as 'London weighting', benchmark rates of which used to be formally recommended by the London Pay Board. As a recent Unison report points out, however:

> The public sector often did not have the resources to follow [rate] changes, and instead ended up targeting specific groups of workers, or locations, with special pay supplements. However, labour shortages and the high cost of living in London, with its knock-on recruitment and retention problems, subsequently forced most organisations to adopt some form of London allowance.[21]

While London weighting remains widespread — the Unison report claims that over 90 per cent of employers

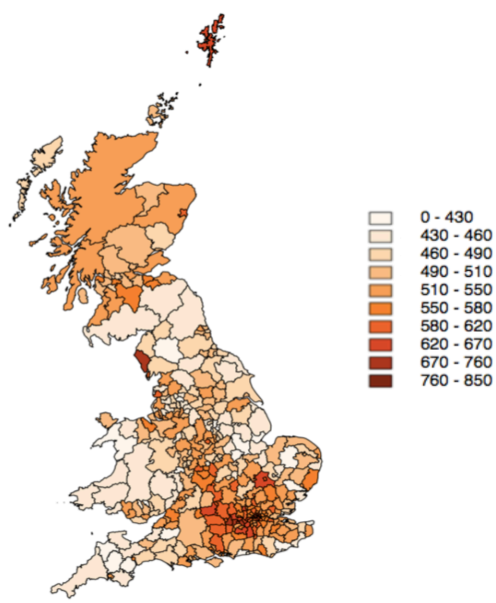
[19] Laura Gardiner, Five things we learned from today's earnings figures, Resolution Foundation, 2016
[20] ONS, Annual Survey of Hours and Earnings: 2016 provisional results, 2016
[21] Unison, London Allowances, 2014

pay higher rates for employees in the capital — it is not an official practice, and there is much debate over its effectiveness in countering increased living costs. In his 2016 paper, *London Weighting and London costs — a fresh approach?*,[22] Loughborough academic, Donald Hirsch, summarises:

> Today, both public and private employers generally pay London staff more than their equivalents elsewhere. However, such London Weightings vary greatly across employers, have no systematic relationship with additional costs in London and have declined in value relative to those costs. In addition many Londoners have limited understanding of the concept, particularly since there is no longer a body which is responsible for its calculation or promotion.

There is no simple way to adjudicate how much London's higher living costs should be taken into account when calculating net living costs, and to what extent its higher rents reflect the extra consumption value of living in a world-leading city. Indeed, when considering regional differences, we must note that the data takes no account of regional price indices, or differences in other expenditure, such as housing costs. We should also recognise regional differences in the overall composition of earnings: in London in 2014-15, 80 per cent of all gross income came from employment, whereas, at the other end of the scale, in the North East, only 63 per cent came from employment.[23]

Figure 4: Regional gross weekly earnings, UK pounds (ONS)



[22] Donald Hirsch, London Weighting and London costs - a fresh approach, Loughborough University and Trust for London, 2016
[23] ONS, Family Resources Survey: financial year 2014/15, 2016

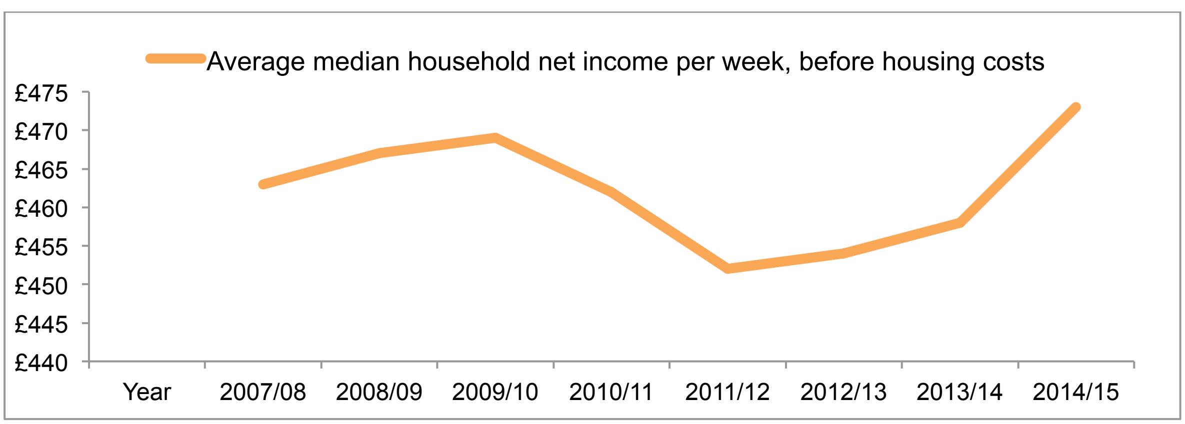
2.2 Average household disposable income

What matters most for living standards is not market earnings, however, but final net incomes. An individual's economic welfare does not simply depend on their own income, but also on the circumstances of the household in which they live. Moreover, government intervention — in terms of taxation, and the provision of benefits in cash and kind — takes account of those household circumstances, and significantly modifies the dispersion of the individual incomes initially resulting from market transactions.

Standard measures and assessments of household economic welfare take account of incomes and expenses to various degrees — some using gross figures, some net, some allowing for inflation, some not. It is also necessary to note which form of average is being used. But the general aim is to work out the average disposable income of a household — that is, the overall income of one or more people who live at the same address, following certain deductions and additions.

The *Household Disposable Income* (HDI) bulletin that covered the 2014-15 financial year revealed the UK's median household disposable income to be £25,700. Notably — after some years of difficulty — this was similar to its pre-downturn value. The figures in this January's bulletin, which reports on 2015-16, follow that trend, showing income to have, with a 2.2 per cent increase on 2014-15, reached a level (£26,300) that is almost £1000 higher than 2007-08.[24]

Figure 5: Average UK median household net income per week, before housing costs, 2007-08 – 2014-15 (ONS)

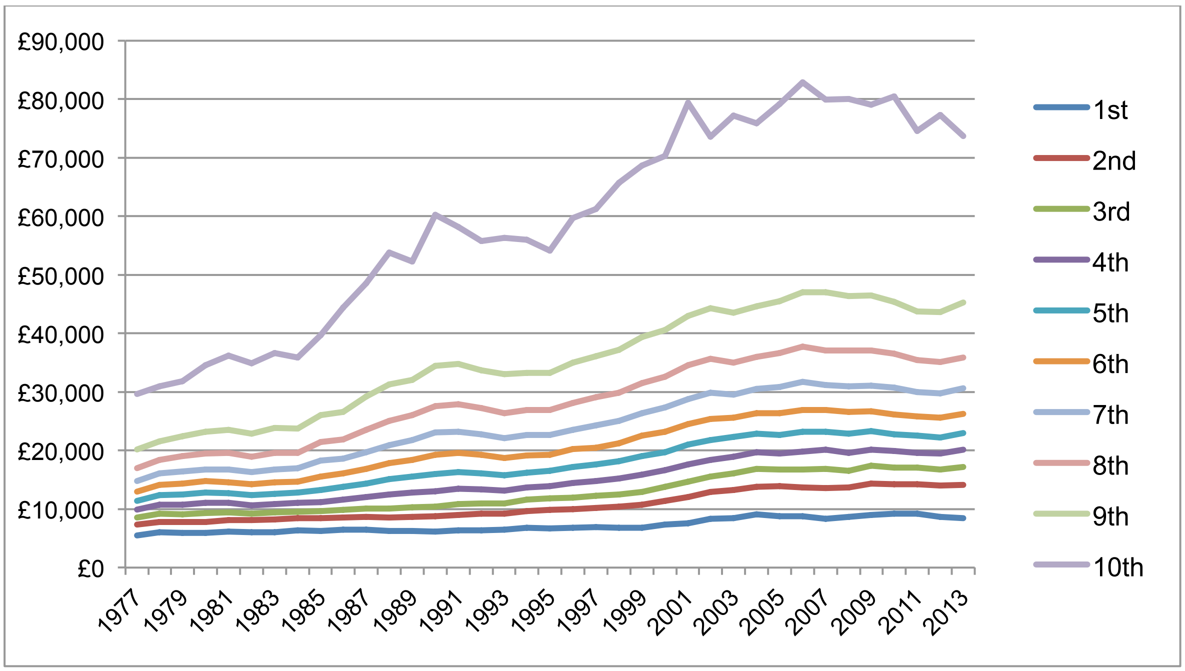


[24] ONS, Household disposable income and inequality in the UK: financial year ending 2016, 2017

In terms of a longer historical perspective, the bulletin summarises:

> [The current] year-on-year growth rate is broadly in line with the average growth rate per year for the past 40 years with median household income growing from £12,300 at an average rate of 2.1 per cent per year between 1977 and 2015-16.

Figure 6: Real UK equivalised disposable household incomes by decile, 1977-2013 (ONS)



The average growth-rate figure does not tell the whole story, however. Recent despondency has been aggravated by the way in which the past decade's stagnation followed a long period in which households could expect reliable increases to their incomes: during the previous two decades, household incomes increased by 35 per cent and 36 per cent, respectively.[25] Those prosperous decades tilt the positive 40-year rate.

As Policy Exchange's *New Industrial Strategy* report explains:

> Since 2003 or so, Britain has suffered a 'perfect storm' hurting real incomes: the financial crisis,

[25] ibid

> higher pension costs, increased taxes and significant inflation from a global commodities crunch. […] While employment and the labour market have continued to be a success story, productivity has failed to grow. After two decades of delivering lower consumer prices, globalisation and high demand from emerging economies saw commodity prices spike nearly three times over between 2003 and 2013.[26]

It is of particular significance, therefore, that, following a period of uncomfortable adjustment, real household incomes are now back to pre-downturn levels.

Retirement

The UK's ageing population skews the general impression of income improvement. As January's HDI bulletin describes, although retired households' incomes have 'soared in recent years, non-retired households still have less money, on average, than before the crash'.[27] The average pensioner household used to be relatively poor, but a sustained policy — by successive governments — of generously uprating pensions has ensured that it is now relatively well off.

A recent key driver of this has been the 'triple-lock' pension policy. That state pensions, since 2010, have been guaranteed to rise at the same rate as the highest of three measures — the rise in average earnings, CPI, or 2.5 per cent — has generated an overall increase in the state pension of £1,100 over the past six years. The *Households Below Average Income* (HBAI) bulletin shows that, over the past year, the amount of pensioners in absolute low income has decreased from 15 to 13 per cent.[28]

That these figures take housing into account is significant because pensioners' relative income security is related to their relatively low costs in that area. As HBAI outlines, 'nearly three quarters of pensioners live in homes that are owned outright (compared to roughly 1 in 5 of the working age population)'.[29] This is unsurprising, but not insignificant.

2.3 The cost of living: housing

Over the past decade, household bills and the cost of living have continued to increase. Utility prices have

[26] Jonathan Dupont and Richard Howard, The New Industrial Strategy, Policy Exchange, 2016
[27] ONS, Household disposable income and inequality in the UK: financial year ending 2016, 2017
[28] ONS, Households below average income: 1994/95 to 2014/15, 2016
[29] ibid

doubled,[30] and the latest ONS *Family spending in the UK* bulletin shows that low-income households spend a higher proportion of expenditure on food and energy than the rest of the distribution.[31] However, of the many factors that affect households' genuinely disposable income, housing has particular weight.

This has been affected, not least, by a change in tenure composition. As the 2014-15 *Family Resources Survey* identifies, since 2004-05, the percentage of households with a mortgage has declined from 39 per cent to 30 per cent, and the percentage renting privately has increased from 12 per cent to 19 per cent.[32] The latest ONS *House Price Index* release, which shows monthly house-price inflation, reveals that average UK house prices increased by 7.2 per cent between December 2015 and December 2016.[33]

Although average household incomes are increasing both before and after housing costs,[34] it is particularly important to note that — as the recent House of Commons Library briefing paper, *Income Inequality in the UK*, points out — 'there is more inequality in income after housing costs than in income before housing costs, as poorer households tend to spend a higher share of their income on housing than those higher up the income distribution'.[35]

Regional and more localised disparities must also be taken into account. Although pay in London reflects the high proportion of its labour force employed in high-paying industries and occupations, and many employees receive allowances for working in the capital, the *Family spending in the UK* bulletin shows that the average weekly amount spent on rent in London is currently more than double the average throughout most of the rest of the UK.[36] And the *House Price Index* release shows that while the average UK house price is now £263,000, the average price in London is £484,000, in comparison with £129,000 in the North East.[37] That release also shows that the North East has, since 2004, continually been the UK region with the lowest average house price.

These regional comparisons are useful for a big-picture view, but, as Tom Forth points out on his economics website, there can be a high degree of difference between price changes within regions. Using the median house price of wards in Newcastle and Gateshead between 2007 and 2016 as an example, Forth shows that although overall growth is 0 per cent, prices have, for instance, increased by 28 per cent in East Gosforth,

[30] Jonathan Dupont and Richard Howard, The New Industrial Strategy, Policy Exchange, 2016
[31] ONS, Family spending in the UK: financial year ending March 2016, 2017
[32] ONS, Family Resources Survey: financial year 2014/15, 2016
[33] ONS,House price index, UK: Dec 2016, 2017
[34] ONS, Households below average income: 1994/95 to 2014/15, 2016
[35] House of Commons Library, Income inequality in the UK, 2016
[36] ONS, Family spending in the UK: financial year ending March 2016, 2017
[37] ONS, House price index, UK: Dec 2016, 2017

while decreasing by 26 per cent in Elswick.[38]

Key findings

- In 2014-15, income from employment made up 72 per cent of gross weekly household income, although this varies from 81 per cent for those in the top quintile of the distribution, to 37 per cent for those in the bottom.
- There is also regional disparity: for those in London, earnings accounted for 80 per cent of their total income; for those in the North East, this was 63 per cent.
- In 2016, median gross weekly earnings for full-time employees rose 2.2 per cent, nominally (or 1.9 per cent, in real terms) on 2015 — the joint fastest rate of growth since the 2008 Great Recession. However, the past few months have seen a slightly lower increase in the growth of regular pay.
- Employment is at an all-time high, and increasing steadily. While unemployment rates are more static, they are at their lowest since 2005.
- In the financial year ending 2016, the median equivalised UK household disposable income was £26,300 — higher than the pre-downturn figure for the first time.
- The current growth rate correlates with the 40-year average, although that average is skewed by the more successful decades.
- Low-income households continue to spend proportionately more on the cost of living, especially housing.

[38] Tom Forth, City Wards Explorer, tomforth.co.uk, (and comments on Twitter), 2017

3

The current situation: distribution

'There has been a gradual decline in income inequality in the last 10 years, with levels similar to those seen in the mid to late 1980s.' [39] (ONS)

Few people would disagree with the proposition that it is important to be aware of the dispersal of income within a society and how that changes over time. Misunderstandings and misdirected interpretations of the complex data describing this, however, contribute to an unnecessarily contentious public debate that not only drives despondency, but can also be societally divisive. Often, it is assumed that the poorest people in society are hit the hardest during times of general economic hardship, and that the richest benefit the most during times of general prosperity. Contrary to that narrative, this has not — in terms of the ONS calculations regarding disposable income — been the case in Britain, following the recent Great Recession.

3.1 Low and high incomes

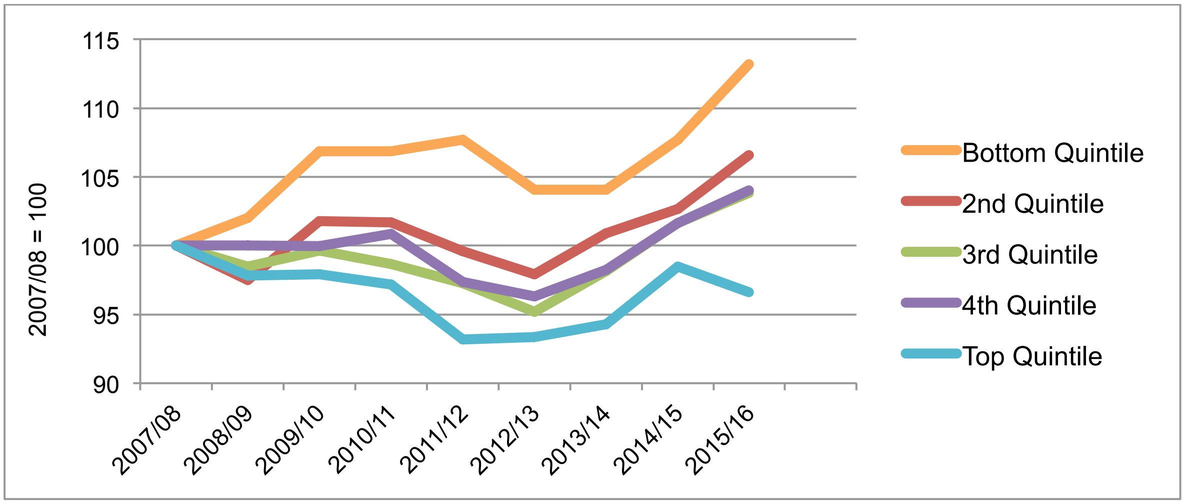
It is essential to note that it is only households in the bottom fifth of the distribution that have not experienced a fall in disposable income in the years following the Great Recession. Having remained consistently above pre-downturn levels, their disposable income has increased by over 13 per cent.[40] Contrastingly, it was the richest fifth's that fell the most in the aftermath: their disposable income has still not returned to its 2007-08 height, and is currently over 3 per cent lower.[41]

While those at the bottom saw decreases between 2011-12 and 2013-14, and a proportionally smaller increase than much of the distribution between 2013-14 and 2014-15, the results reported in January 2017's *Household disposable income and inequality in the UK: financial year ending 2016* bulletin show a return to the 2007-08 – 2011-12 trend:

[39] ONS, Household disposable income and inequality in the UK: financial year ending 2016, 2017
[40] ibid
[41] ibid

Median disposable income for the poorest fifth of households rose by £700 (5.1 per cent) between 2014-15 and 2015-16; in contrast the income of the richest fifth of households fell by £1,000 (1.9 per cent) over the same period.[42]

Figures 7.1 and 7.2: UK quintile median equivalised household disposable income, against 2007-08 rates (ONS)



Quintile	Bottom	2nd	3rd	4th	Top
2007/08	100	100	100	100	100
2008/09	102.03	97.49	98.5	100.02	97.82
2009/10	106.84	101.76	99.65	99.96	97.92
2010/11	106.88	101.7	98.64	100.85	97.18
2011/12	107.72	99.61	97.27	97.37	93.18
2012/13	104.08	97.9	95.19	96.31	93.36
2013/14	104.05	100.92	98.14	98.26	94.29
2014/15	107.69	102.65	101.63	101.64	98.46
2015/16	113.21	106.65	103.85	104.01	96.63

Moreover, the bulletin shows that, regarding original income (before taxes and transfers are taken into account), the ratio between those top and bottom quintiles has fallen slightly over the past year, from 14:1 to 12:1.[43]

[42] ibid
[43] ibid

The ONS *Households Below Average Income* publication focuses on disposable income and those living in low-income households. In 2014-15, its headline stories included decreases in absolute low-income levels, and that 'relative low income levels are generally in line with long-term trends across the population'.[44] Again, it is necessary to note, however, the ways in which 'low' and 'high' are calculated. Relative low-income status is afforded to the proportion with a lower income than a chosen threshold of the UK's average income each year; absolute low income is set at a proportion of average income in relation to one specific year (accounting for inflation). The poverty line is set at 60 per cent of median income: families receiving less than that amount are considered to be in 'income poverty'.

Any suggestion that we should examine what a non-relative assessment of income might show regarding the living standards of those at the bottom of the distribution only serves to strengthen the case against an all-out focus on equal distribution.

High income

The large number of individuals who have the highest incomes — and extensive wealth — within the UK distribution are, increasingly, the subject of criticism. Economists who attract a popular following, including the politically-engaged Thomas Piketty, have driven an emphasis on these 'elites'. Although it seems important to be aware of the relative income and wealth of those at the top, this emphasis can distract our attention from average living standards, and those of the least well off. As the New Yorker's John Cassidy summarises:

> For a long time, [the] debate was almost entirely focussed on what was happening to median incomes. That inevitably led to discussions of globalization, skill-biased technical change, and policies focussed on education and retraining. Now, thanks to Piketty et al., the remarkable gains of those at the very top can't be avoided. And this means that the issues of politics and redistribution can't be avoided either.[45]

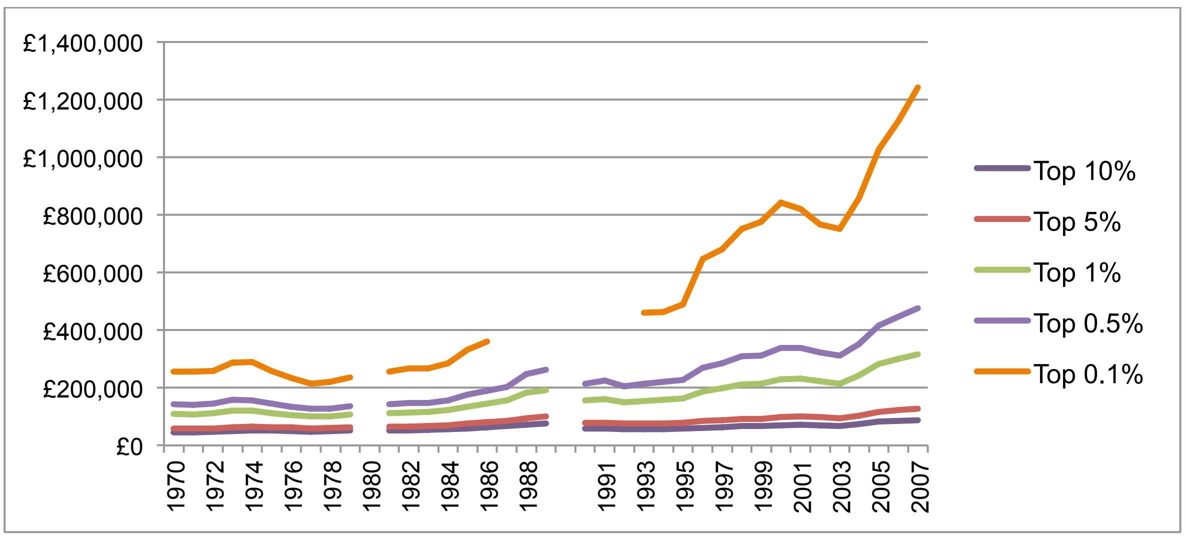
In *The Equality Trap*, William Watson points out that we should not forget the constitution of 'the 1 per cent'. Not everyone in that bracket, he points out, is 'a genius computer designer, a star hockey player, a swindler extraordinaire, the head of America's largest bank, or, literally, a lottery winner'. As well as the 'business people' (from executives to entrepreneurs) who make up around half of the bracket, Watson also lists the increasing percentages of teachers, scientists, and those in the arts, who feature, too. He adds that

[44] ONS, Households below average income: 1994/95 to 2014/15, 2016
[45] John Cassidy, Piketty's inequality story in six charts, New Yorker, 2014

'it's probably also surprising that people in the medical profession account for roughly one in seven'.[46]

Regardless of the particularly detrimental impact that the economic downturn had upon high-earning individuals, it is universally accepted that the 1 per cent, the 0.1 per cent, and on, have a greater share of UK income than in the past. Indeed, between 1980 and 2010, the 1 per cent's share of the national income rose from 6.7 to 14.7 per cent.[47] However — and a more comprehensive discussion can be found in Policy Exchange's recent *No Worker Left Behind* report — there is little to suggest that this development has affected median living standards. As the report identifies, this is not least because the increased share at the top has been compensated for by faster growth, and more generous welfare provision.[48]

Figure 8: Average top incomes in the UK, 1970 - 2007 (Top Incomes Database)



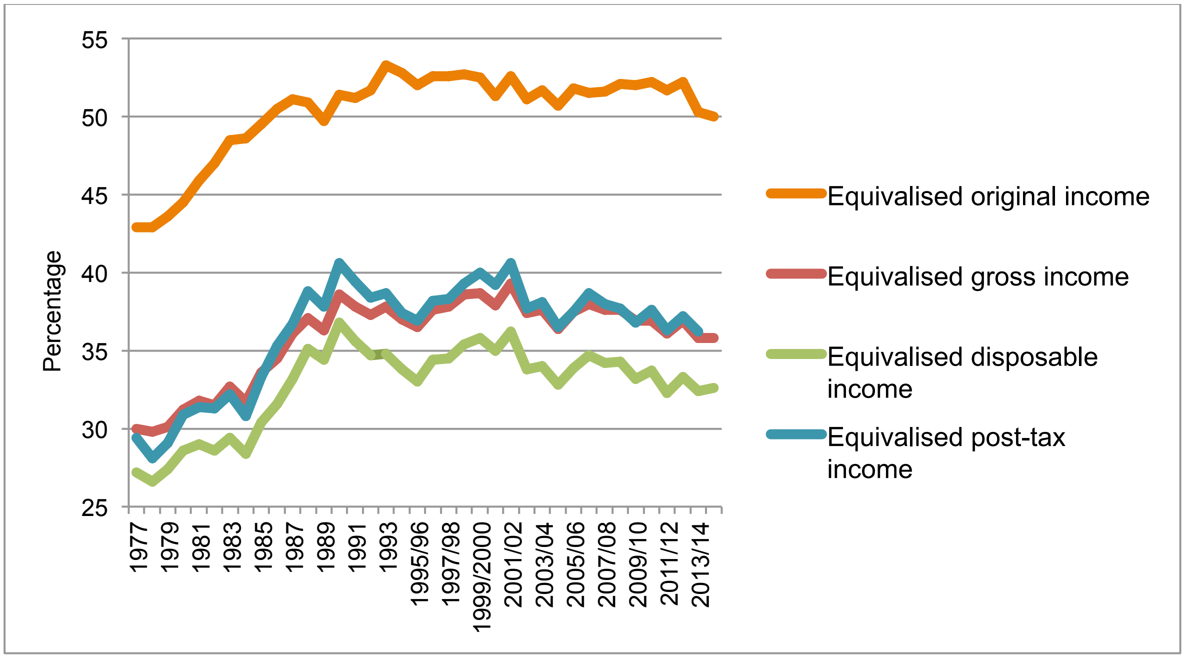
3.2 The impact of welfare transfers and taxes

Indeed, the greatest influence on income inequality continues to be government intervention — and specifically, cash benefits and direct taxation. The ONS's recent statistical bulletin, *The effects of taxes and benefits on income inequality: 1977 to financial year ending 2015*, calculates that cash benefits reduced the UK's Gini coefficient score by 14.2 percentage points in 2014-15, and that direct taxes reduced it by a further 3.2 points. The bulletin does, however, emphasise the increasingly regressive nature of indirection taxation

[46] William Watson, The Inequality Trap: Fighting capitalism instead of poverty, University of Toronto Press, 2015
[47] Jonathan Dupont, No worker left behind: how to improve pay and work for the low paid, Policy Exchange, 2015
[48] ibid

in the UK: this currently causes a 3.5 point increase in the Gini score.[49]

Figure 9: The effects of taxes and benefits on UK income inequality, 1977 – 2013-14 (ONS)



Unsurprisingly, poorer households tend to receive more benefits then their richer counterparts, whereas the richer pay more — and proportionally more — in terms of direct tax. The effect of this can be seen most clearly through a comparison of the ratios between the richest and poorest quintiles, regarding both original and disposable income, as shown in the latest HDI bulletin:

> Original income (before cash benefits and direct taxes) for the richest fifth of households was around 12 times higher than the poorest fifth (£85,000 and £7,000 per year respectively) while disposable income (after cash benefits and direct taxes) for the richest fifth was 5 times higher than the poorest fifth (£62,400 and £12,500 per year respectively).[50]

The most recent *Family Resources Survey* points out that in 2014-15, 15 per cent of national gross income came from the state, and that 57 per cent of families received some form of such support. This was the case for 53 per cent of those in the bottom quintile of the distribution, as opposed to only 3 per cent in the top.

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[49] ONS, The effects of taxes and benefits on income inequality: 1977 to financial year ending 2015, 2016

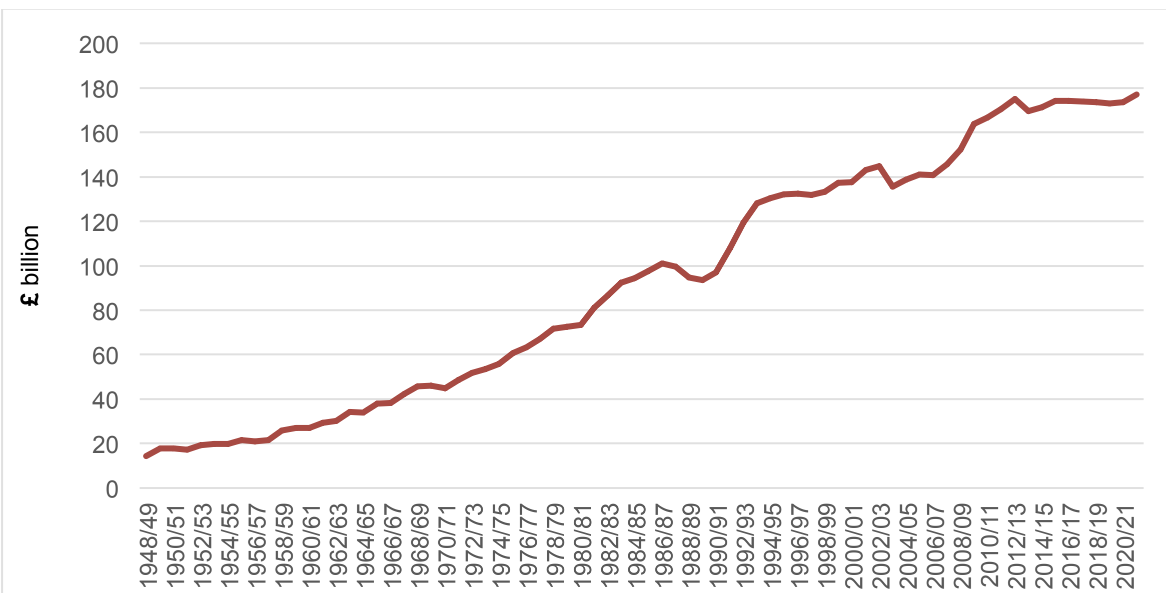
[50] ONS, Household disposable income and inequality in the UK: financial year ending 2016

Again, there are regional issues to note: during 2014-15, the North East had the highest percentage of income from state support (22 per cent).[51] We must also note, once more, the UK's ageing population. The survey explains that, owing to the role of the state pension, almost all families whose head was over 65 received a non-income-related benefit — and all did, whose head was more than 85.[52]

Therefore, any discussion about UK income inequality is lacking without proper awareness of the extent to which the government already intervenes to modify original market incomes. Social security — which includes benefits ranging from income support to the state pension — is UK public spending's biggest programme. As the IFS chronicles, this has:

> […] steadily increased in real terms and as a share of national income since the modern welfare state was introduced after the Second World War. In 1948–49, social security spending accounted for around 3.3 per cent of national income; by 2009–10, it had reached 12.5 per cent. Social security has also taken up an ever-increasing proportion of public spending: in 1948–49 it accounted for around a tenth of all spending, whereas today it accounts for closer to 30 per cent.[53]

Figure 10: UK real welfare spending, 1948-49 – 2020-21 (DWP)



[51] ONS, Family Resources Survey: financial year 2014/15, 2016
[52] ibid
[53] IFS, Social Security Spending, 2015

3.3 Measures

The Gini coefficient

The Gini coefficient remains the usual measure for comparing societies' inequality levels, against themselves and each other. It provides a number (between 0 and 1, or 0 and 100) for ranking purposes. To attain a country's number, its citizens' income is assessed in relation to the 'line of equality'. This line is calculated by graphing the population (ranked by percentage, from poorest to richest), against a country's cumulative income (also in percentage terms), in which the diagonal line from bottom left to top right (x=y), which divides the square area enclosed by those axes, is the 'line of equality'. When a society's figures produce that line, then its poorest n per cent earns n per cent of the country's income.

In reality, however, societies' figures produce curves bending below that line (that is, rather than the poorest 50 per cent earning 50 per cent of the income, they earn, perhaps, 30 per cent). The ratio of the area of the space between the equality line and a country's curve, divided by the area of the whole space below the equality line (the diagonally-cut half of the square), gives us the Gini coefficient, with results closer to 1 (or 100) representing more unequal societies.

Again, we must be aware which data is being presented in these charts — often the most important question is whether or not redistribution is being taken into account. Neither should we forget the other diverse factors that can affect countries' scores. In *The Inequality Trap*, Watson counters those who claim that increased Gini scores prove the shortcomings of a so-called neoliberal approach, by demonstrating the varying effects of education, different forms of government intervention, an established 'inventor class', and assortative mating, to show that the coefficient 'can change for many different reasons, none having anything to do with the supposed failings of capitalism (unless a decentralized, free-choice marriage market is considered capitalist)'.[54]

The UK position, as illustrated by the Gini coefficient

Nonetheless, Gini scores can, in context, provide us with a useful comparative snapshot. The UK score rose slightly between 1997 and 2007, before beginning to fall in 2009. The recent *Households Below Average Income* bulletin points out that in 2014-15, the UK Gini coefficient remained flat at 34 per cent: 'consistent with long term trends'.[55] We should note, however, that it rises to 39 per cent, when housing costs are taken

[54] William Watson, The Inequality Trap, University of Toronto Press, 2015
[55] ONS, Households below average income: 1994/95 to 2014/15, 2016

into consideration.[56]

Figure 11: UK Gini coefficient, 1994-95 – 2014-15 (ONS)

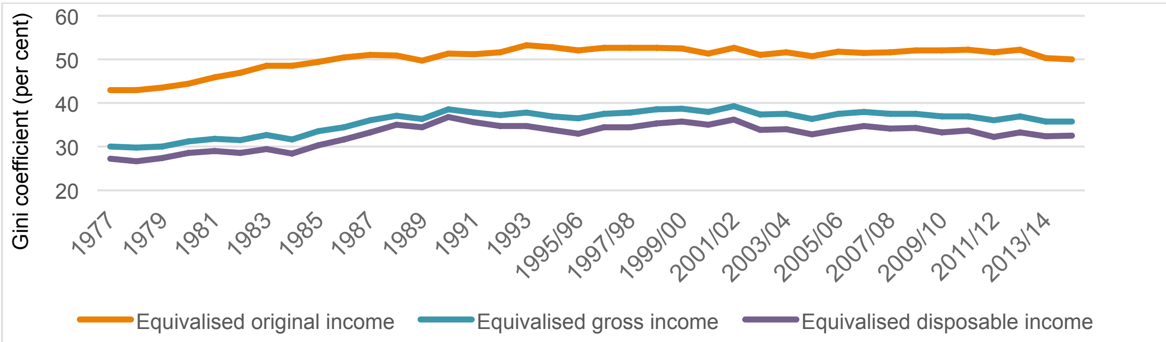
General recent stability relates again to historical trends regarding the redistributive impact of taxes and transfers: this impact decreased towards the end of the 1980s, but increased during the 1990s. It is also worth noting that in the 1960s and 1970s, priority was given to fairness over efficiency, a focus which was modified in the 1980s, following the economic crises of the previous decade.

A bigger-picture view of the UK's Gini situation is provided in Atkinson's *Inequality*:

> Readers concerned about the UK may draw some consolation from the fact that the last twenty years have seen no increase in overall income inequality as measured by the Gini coefficient. It is the case, however, that the level of inequality remains stubbornly above its level in the 1960s and 1970s […] Overall inequality is not back to the levels reached in the Jazz Age, but it is more than halfway there.[57]

[56] ibid
[57] Anthony B. Atkinson, Inequality: What can be done?, Harvard University Press, 2015

Figure 12: Gini coefficients for original, gross, and disposable income, 1977-2014 (ONS)



While, again, nuance and accuracy is lost in large-scale comparisons, it is generally accepted that the UK's Gini coefficient is higher than many similarly developed countries. The House of Commons Library's recent paper, *Income inequality in the UK, 2016*, clarifies that:

> OECD figures suggest income inequality in the UK is higher than in most European countries but is lower than in the United States, based on the Gini Coefficient for equalised disposable income. […] Data published by Eurostat gives a slightly different picture, indicating income inequality in the UK is lower than in some other EU countries but is still higher than the EU average.[58]

Box B: Problems with measurements

There is no time in this short report to interrogate fully the accuracy of the comparative measures we are discussing. However, we should be aware of the current debate regarding a perceived lack of nuance in many measures currently relied upon to calculate inequality. This is exemplified by the Resolution Foundation's recent work on claims about economic stagnation that were informed by the 'elephant curve': the Foundation convincingly argues that these claims are not accurate, since issues such as population change were not sufficiently taken into account.[59] Engagement with this debate is also seen in the work undertaken by market-orientated economists such as Ryan Bourne to discredit sensationalist headlines based on misleading net-wealth comparisons.[60] Similarly, while the Gini coefficient provides us with a quick way to compare certain overall pictures, many question its value in helping us to draw more nuanced conclusions. As well as technical considerations, this relates largely to the argument advanced in this report regarding the inherent inability of such an approach to describe living standards.

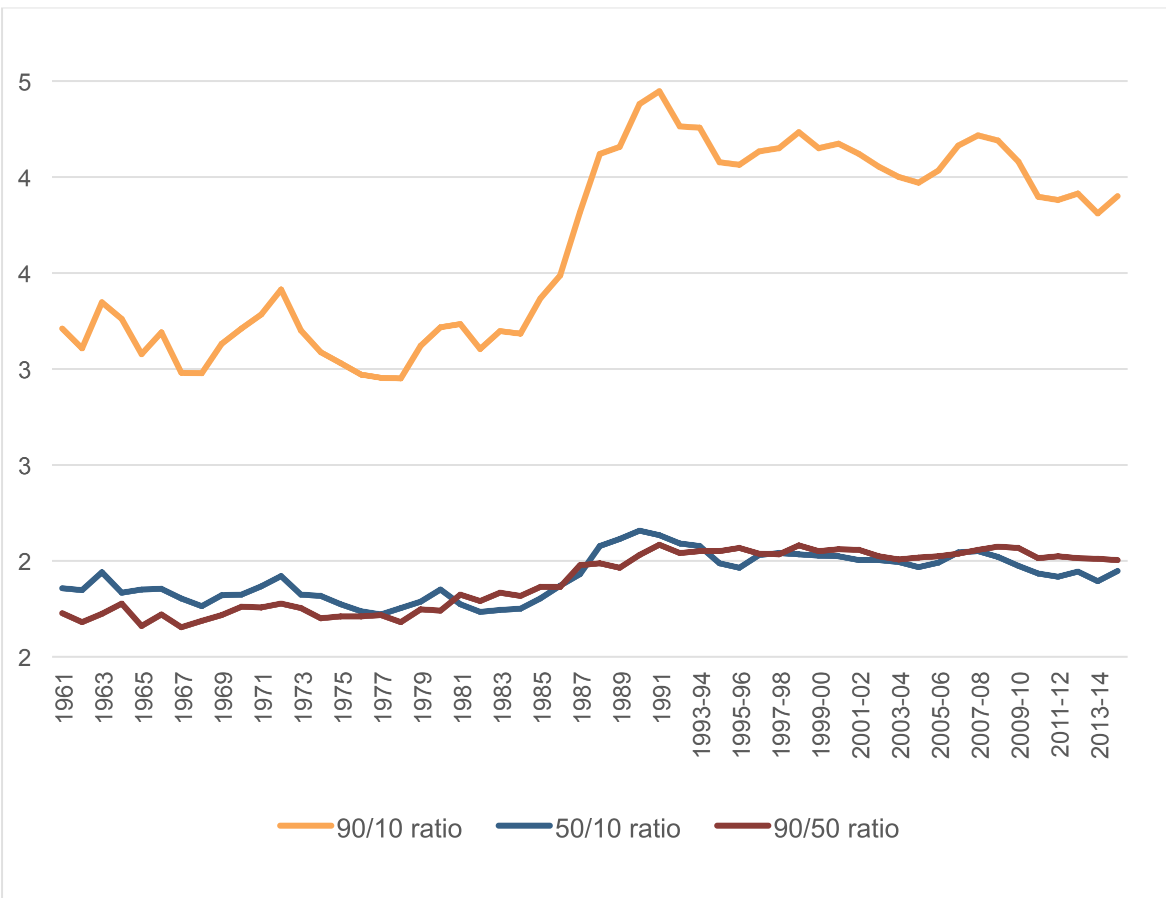
[58] House of Commons Library, Income inequality in the UK, 2016
[59] Adam Corlett, Examining an elephant: globalisation and the lower middle class of the rich world, Resolution Foundation, 2016
[60] Ryan Bourne, Beware Oxfam's dodgy statistics on wealth inequality, IEA, 2015

Comparisons within the distribution: income ratios and shares

Methods for assessing inequality within — rather than between — nations often involve calculating the percentage shares of income going to specific points on the national income distribution, and making comparisons between those points. The points that are most commonly compared are the 99th percentile (P99), the 90th (P90), the 50th (P50), and the 10th (P10). This is the approach that informs the headlines claiming that 'the *x* per cent is better off than the *y* per cent', or 'the *z* percent takes *a* per cent of the nation's income'. Again, it is important to be aware which figures are being compared: for instance, whether or not housing costs have been included.

While recognising the rise of the 1 per cent, calculations based on this approach build on the suggestion that there has been general stagnation of income inequality in the UK over the past three decades.

Figure 13: UK income inequality as measured by the 90/10, 50/10, 90/50 ratios, 1961 – 2013-14 (ONS)



3.4 Distribution of wealth

There is notably less data available on wealth than income, but the ONS biennial *Wealth and Assets Survey* series (WAS) aims to counter this. The most recent WAS report, from December 2015, identities that, between July 2012 and June 2014, the total combined wealth of all UK households was £11.1 trillion — an increase on the previous two years of 18 per cent.[61]

To calculate a household's total wealth — a 'stock' concept, which the ONS refers to as 'the balance at a point in time' — the survey uses respondents' data, and IFS modeling, to collate figures relating to net property wealth (gross, minus mortgage debt), net financial wealth, physical wealth (the contents of the household's main residence and other properties, collectibles and valuables, and vehicles) and private-pension wealth.[62] (It is important to be aware of this dependence on net figures: when we casually consider the size of someone's wealth, we do not typically account for their mortgage debt.) According to WAS, the median household's total wealth now stands at £225,110.[63]

In that assessments of wealth represent households' ongoing financial situations in terms of the assets they have accrued over time, average wealth tends to be less equally dispersed than income. Britain's relatively low household-savings rates — explained not least by many of the issues we have covered, from the ageing population, to the rise in housing costs — make this disparity even greater. In Policy Exchange's *No Worker Left Behind* report, Jonathan Dupont emphasises how British savings rates lag behind France and Germany, 'let alone the levels saved by much poorer Chinese households'.[64]

The uneven distribution of wealth is neatly exemplified by the 2015 WAS report's calculation that the ratio between the top and bottom deciles is currently ten times larger than it is for income.[65] The top decile (which includes extreme outliers) owns 45 per cent of the total wealth, whereas the bottom owns less than 0.5 per cent.

[61] ONS, Article: Main results from the Wealth and Assets Survey: July 2012 to June 2014, 2015
[62] ibid
[63] ibid
[64] Jonathan Dupont, No Worker Left Behind: How to improve pay and work for the low paid, Policy Exchange, 2015
[65] ONS, Article: Main results from the Wealth and Assets Survey: July 2012 to June 2014, 2015

Figure 14: Distribution of UK total household wealth by percentile, 2012-14 (ONS)

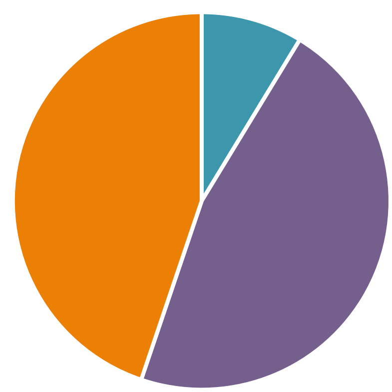


Figure 15: Total UK household wealth distribution, top and bottom percentiles, 2012-14 (ONS)

Percentile point	Total household wealth (£)
1st	-4,434
2nd	1,833
3rd	2,510
4th	3,100
5th	4,600
6th	6,680
7th	7,520
8th	8,366
9th	10,200
10th	12,550

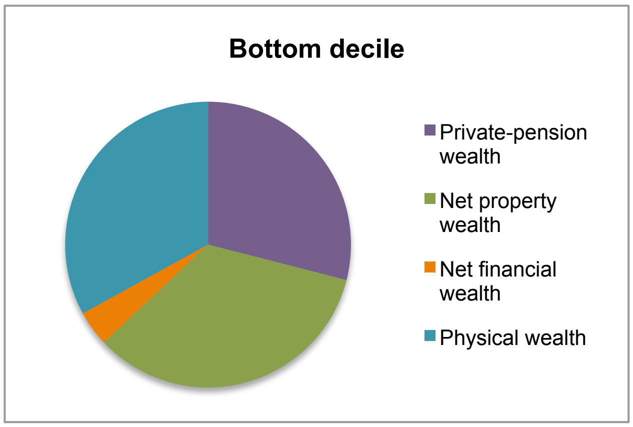
Percentile point	Total household wealth (£)
90th	1,048,537
91st	1,116,103
92nd	1,181,879
93rd	1,265,510
94th	1,369,910
95th	1,496,960
96th	1,646,370
97th	1,862,687
98th	2,163,215
99th	2,872,575

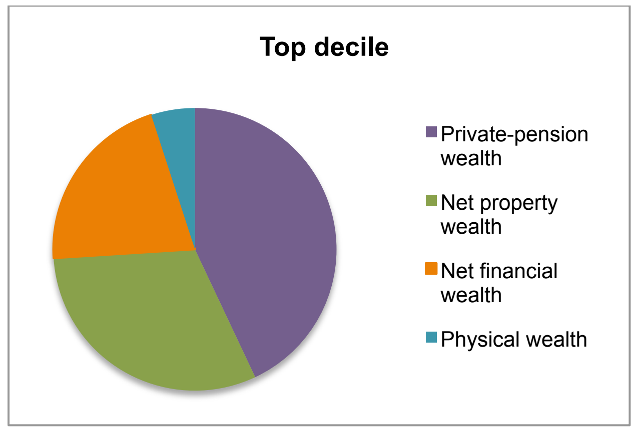
In *Inequality,* Tony Atkinson uses research by Jesper Roine and Daniel Waldenstrom to provide a bigger-picture view, showing that the wealth owned by the UK's top 1 per cent fell by 17 percentage points between 1950 and 1975, before increasing by 2 percentage points between the early 1980s and 2000s. Atkinson comments that, while 'we need to be cautious in drawing conclusions about any upturn in wealth concentration', we can 'conclude that the trend to less wealth concentration came to an end'.[66]

[66] Anthony B. Atkinson, Inequality: What can be done?, Harvard University Press, 2015

The latest WAS survey shows that the disparity between the top and bottom deciles is growing: the bulletin emphasises that 'the increase seen in the top 10 per cent of households accounted for over half of the [aggregate total] 18 per cent increase'.[67] This is unsurprising when we consider those aforementioned factors — including the rising cost of housing — and also the breakdown of households' wealth, with particular reference to the private-pension situation:

Figure 16: Household total wealth by component, Great Britain, 2012 –2014 (ONS)



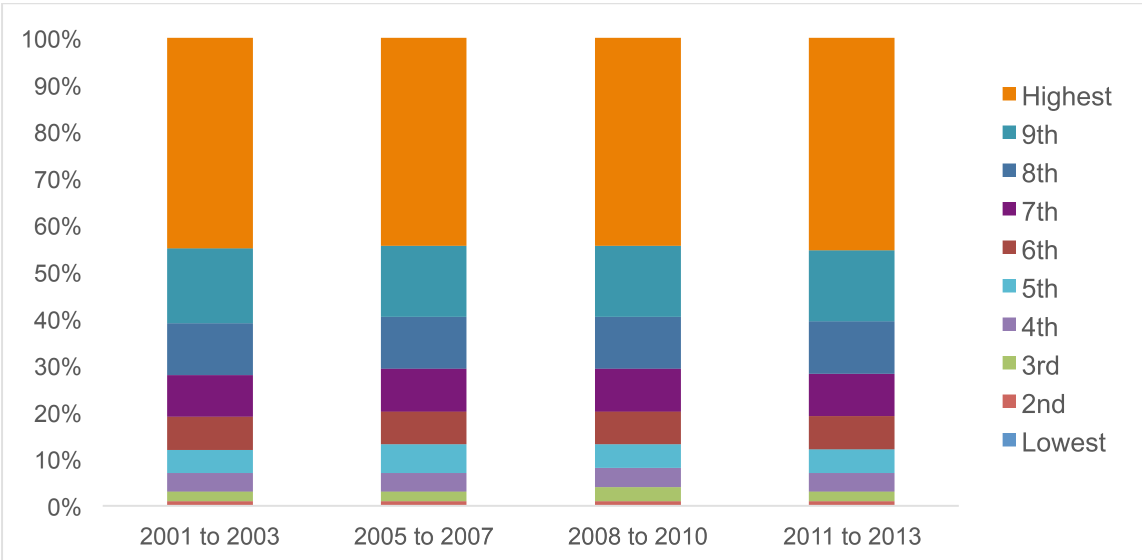


Again, we must recognise regional disparities. The report points out that 22 per cent of South-Eastern households are within the top decile of the distribution, in comparison with only 2 per cent of those in the North East.

HM Revenue and Customs also produces a statistical series on identified personal wealth — the *Distribution of Personal Wealth Statistics* — based on inheritance-tax returns, although its data represents only those estates requiring a grant of representation, meaning it is 'not intended to be an estimate of the total value of personal wealth held by the whole UK population'.[68] The series was last updated in September 2016 to report that 'the distribution of wealth held by each decile has been broadly unchanged since 2001-03' and that — as with WAS — the top decile of its distribution holds around 45 per cent of the total wealth.[69]

[67] ONS, Article: Main results from the Wealth and Assets Survey: July 2012 to June 2014, 2015
[68] HMRC, UK Personal Wealth Statistics: 2011 to 2013, 2015
[69] ibid

Figure 17: Proportion of UK identified wealth by decile (HMRC)



3.5 Distribution of consumption

We should recognise that, owing to its focus on people's actual behaviour — driven by their desires, needs, and capabilities — rather than their proposed capacity to behave, the metric of consumption is often argued to provide a better insight into levels of equality than comparisons of income or wealth. As Stanford's Luigi Pistaferri, and UCL's Orazio Attanasio point out in their 2016 article, *Consumption Inequality*, 'if one is interested in the effects of inequality on those in the poorest segments of society, consumption might reveal different insights than income — for example, because of different dynamics in the relative prices of goods consumed by rich and poor households'.[70] It is generally accepted that trends in spending, income, and wealth tend to be closely correlated, but that, when compared with income and wealth, the distribution of a country's consumption is usually more equal.

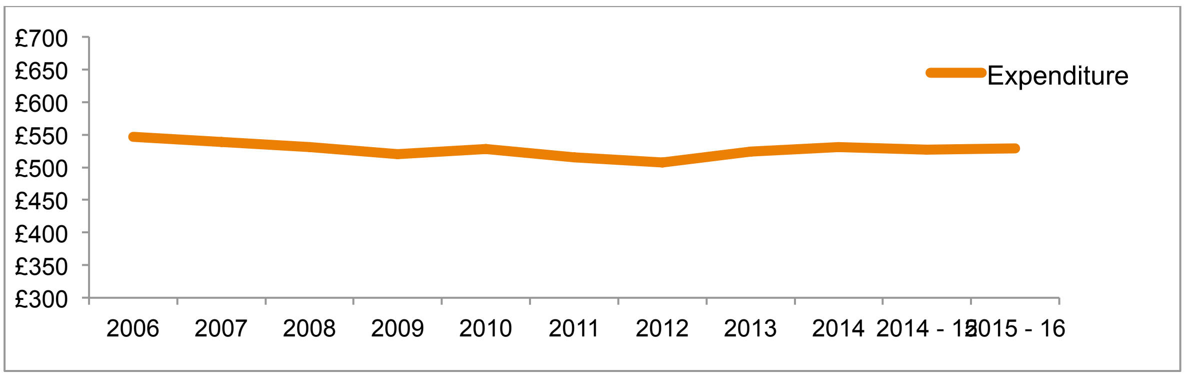
Between 1957 and 2001, the *Family Expenditure Survey* and the *National Food Survey* were the key indicators of UK household expenditure and food consumption.[71] In 2001, they were replaced by the *Expenditure and Food Survey*, which was itself succeeded by the *Living Costs and Food Survey* (LCF) in 2008. Data from the LCF is reported by the annual *Family Spending* (FS) publication. FS used to follow the calendar

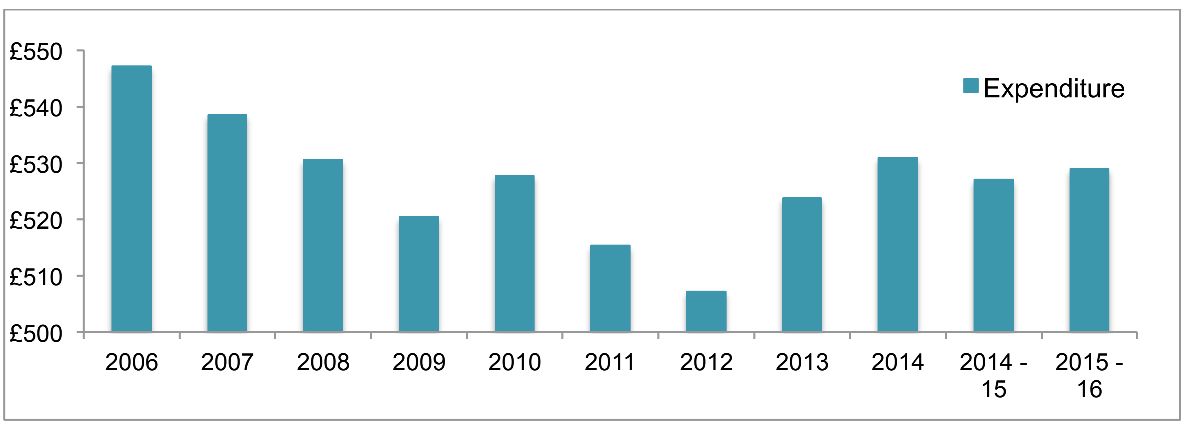
[70] Orazio Attanasio and Luigi Pistaferri, Consumption Inequality, Journal of Economic Perpectives, 2016
[71] Living Costs and Food Survey (Expenditure and Food Survey), ukdataservice.ac.uk

year, but in June 2016, it was announced that its bulletins would, in future, follow the financial year. The latest report, *Family spending in the UK: financial year ending March 2016* (FSUK), came out in February 2017. Its main measure is equivalised household disposable income, and the form of average mostly used is the mean.[72]

FSUK's headline finding is that, in the financial year ending 2016, average weekly household spending 'remained level' at £528.90, when compared with the previous year, allowing for inflation. (The 2015 FS bulletin had reported the 2014 average to be £531.30.[73]) While spending, therefore, has risen from the downturn low of 2012 (£507.20), it has not yet returned to pre-2007 levels. February's bulletin also reveals that consumer confidence — which had been growing — seems to be beginning to 'level off', despite increased disposable income.[74]

Figures 18.1 and 18.2: Average weekly household spending, UK, 2006 – 2016 (ONS)

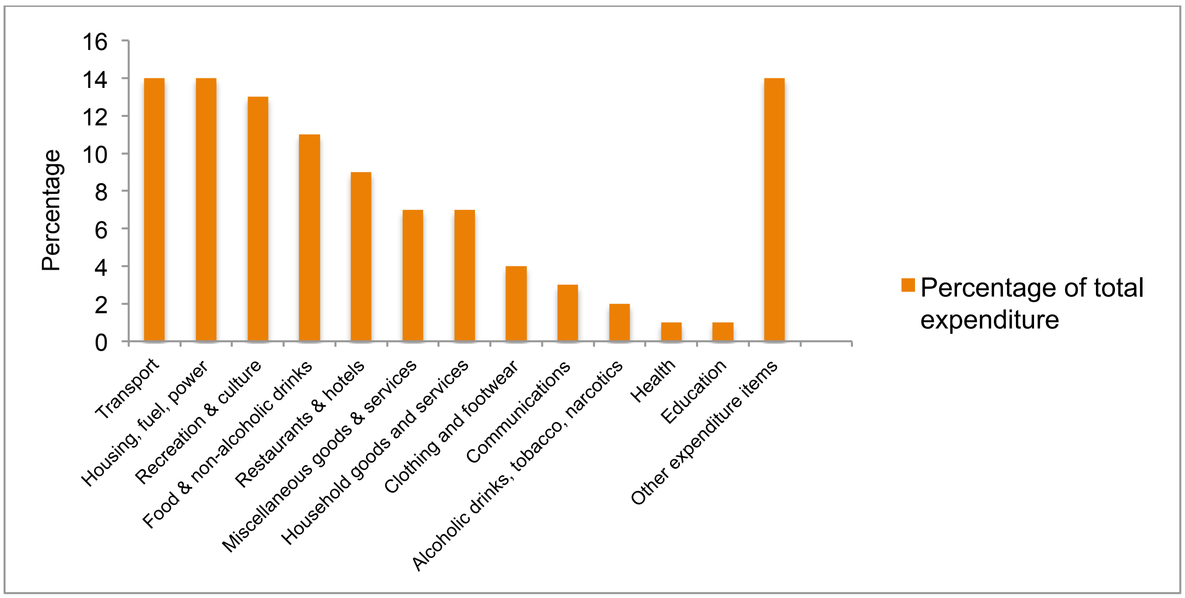




[72] ONS, Family spending in the UK: financial year ending March 2016, 2017
[73] ONS, Family Spending 2015: a report on the Living Costs and Food Survey 2014, 2015
[74] ONS, Family spending in the UK: financial year ending March 2016, 2017

Aside from 'other expenditure items' (which includes mortgage payments and council tax), transport is shown — as in previous bulletins — to be the highest category of average spending, accounting for 14 per cent of the net total. This is followed by 'housing, fuel, and power' (which excludes mortgage payments and council tax), and then 'recreation and culture'. While lower-income households spend more, proportionally, on food and non-alcoholic drinks (this accounts for 17.3 per cent of the total spent by the bottom decile of the distribution, as opposed to 7.5 per cent by those in the top), unsurprisingly, the poorest have less money to spend on 'non-essential items'.[75]

Figure 19: Breakdown of UK total expenditure, financial year ending 2016 (ONS)



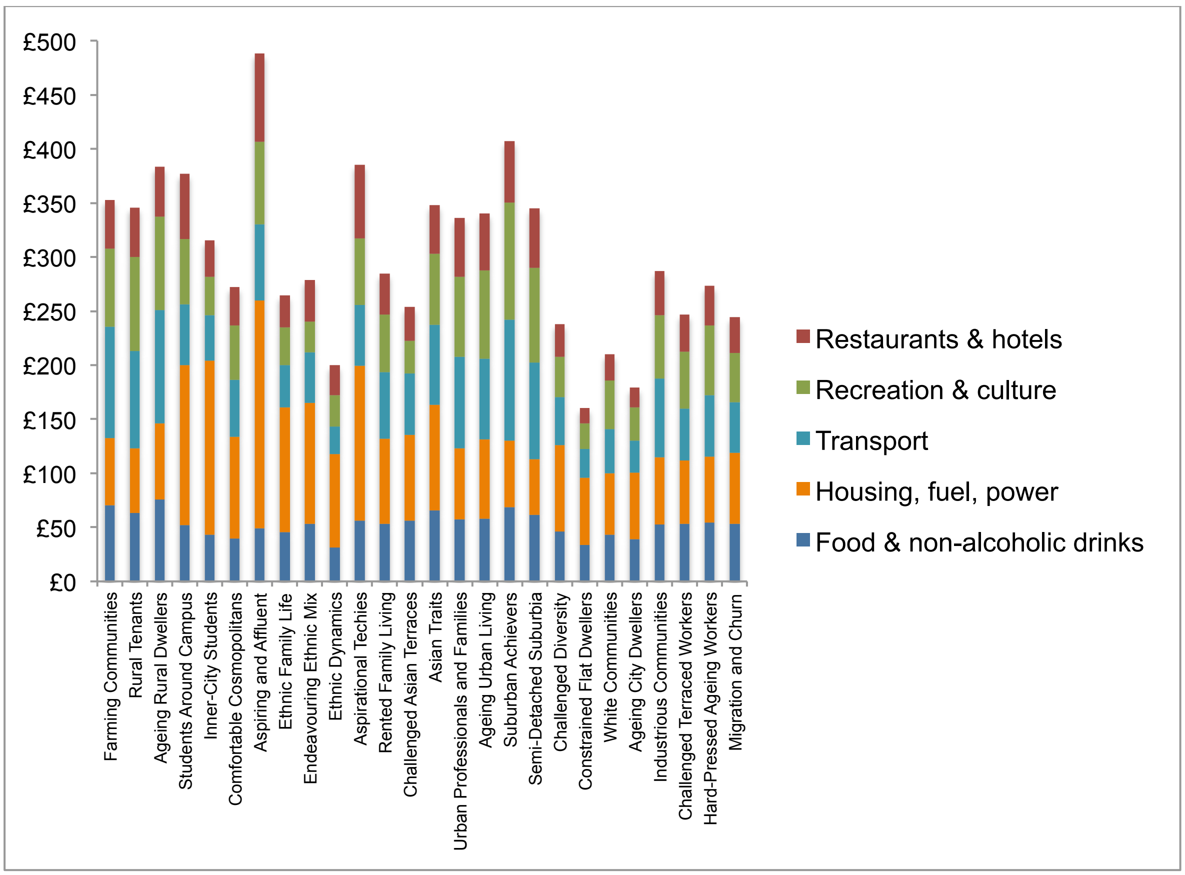
Once more, regional discrepancies are significant, and are again skewed by housing costs: the bulletin shows that average weekly spending in London is currently £652.40, in comparison with £423.50 in the North East; the expenditure of South-Western households (£528.90) is almost exactly at the average rate.[76] Again, the disproportionate amount spent in London on housing costs is emphasised — with rent typically seeming correlated with regional house prices.[77]

Age is of consequence, too: households in which the 'legally responsible person' is of peak retirement age (65 – 74) spend more on categories such as 'recreation and culture', presumably not least owing to their

[75] ibid
[76] ibid
[77] ibid

reduced housing costs, as well as their increased leisure time. The bulletin's dataset also provides consumption breakdown figures for 'Output Area Classification' groupings, ranging from Ethnic Family Life, to Suburban Achievers, to Constrained Flat Dwellers. As expected, a general trade-off between housing and transport is apparent, with those living within cities usually paying a relatively higher proportion on housing than on transport, in comparison with those in more rural settings.[78]

Figure 20: Breakdown of UK consumption for Output Area Classifications, financial year ending 2016 (ONS)



Although this kind of data is invaluable for keeping track of short- and longer-term trends in total UK spending — and the spending of households variously differentiated within that — there is debate, as with similar assessments of income and wealth, about the extent to which it can inform us about the fulfilment of need or demand. As Attanasio and Pistaferri conclude in *Consumption Inequality*, 'researchers interested in

[78] ibid

measuring inequality in well-being need to go beyond the fact that consumption is unequally distributed and realize that a full picture of the evolution in welfare requires taking a stand on quality concerns and on the value that people attach to leisure, among other things'.[79]

Key findings

- On varying forms of measurement, large-scale income inequality has remained flat over the past 30 years.
- The poorest fifth of households comprise the only group whose disposable household income has not dropped beneath its pre-downturn levels.
- In 2016, the poorest fifth's disposable household income increased the most, proportionally. After several years of increases, the richest fifth's fell, and still remains below pre-downturn levels.
- Government intervention continues to have the greatest influence on income inequality: benefits reduced the UK's Gini coefficient score by 14.2 percentage points in 2014-15, and direct taxes reduced it by a further 3.2.
- In 2014-15, the ratio between the top and bottom quintile's original income was 12 times; once tax and benefits were taken into consideration, that ratio fell to 5.
- Social security spending has increased gradually since the Second World War.
- The UK Gini coefficient score remained flat — at 34 per cent — in 2014-15, which is consistent with long-term trends.
- Median household total wealth (net property wealth, net financial wealth, physical wealth, and private-pension wealth) stands at £225,110.
- The ratio between the top and bottom deciles of the distribution is currently 10 times larger for wealth than it is for income. The top decile owns 45 per cent of the total wealth, whereas the bottom owns less than 0.5 per cent. Again, there are regional disparities: 22 per cent of South-Eastern households are in the top decile, as opposed to 2 per cent of those in the North East.
- While spending has increased from the downturn low of 2012, it has not yet returned to pre-2007 levels. Regional disparities are significant: weekly household spending in London is currently £652.40, in comparison with £423.50 in the North East.
- Lower-income households spend more, proportionally, on food and non-alcoholic drinks, and, unsurprisingly, have less to spend on 'non-essential' items.

[79] Orazio Attanasio and Luigi Pistaferri, Consumption Inequality, Journal of Economic Perpectives, 2016

4

A ‘social minimum’: equality or need?

‘The size of the cake and its division among the participants at the feast constitute what one most naturally regards as the basically economic aspects of the good society. […] In the choice of policies for the redistribution of income and wealth it is, of course, desirable to select that form of policy which has the smallest adverse effects not only on the size of the cake but also on the other basic social goods.’[80] (Meade, The Just Economy)

Even the staunchest redistributionists accept that uniformity is neither attainable nor truly desirable. In terms of income, therefore, egalitarian aims tend to be represented by methods — such as standards or caps — of ensuring certain levels, rather than full-on redistribution. Examples of those methods include minimum and maximum wages, and even Universal Basic Incomes. None of these limit individuals’ overall wealth, however, and most are targeted at providing for the less well off, instead of completely restraining the rich. With regards to using such methods in the hope of attaining a more even distribution, justifications are generally predicated on two concepts — equality itself, and need.

4.1 Equality

Various conceptions of equality have been conceived as societal goals since long before its inclusion in the French Revolutionists’ tripartite slogan. Nonetheless, how a society should help to ‘effect’ equality — whatever it is understood to be — and what that might mean in reality, are different questions, altogether. To look at this the other way round, our outlook tends to centre on how we feel our society should deal with inequality.

Conventional views about inequality remain strongly influenced by the thought of the late twentieth-century American political philosopher John Rawls, and particularly his *A Theory of Justice* (1971). Political attitudes were revolutionised by Rawls’ ‘maximin’ focus on improving the chances of the least well off. As Oxford academic Jonathan Wolff explains:

[80] J.E.Meade, The Just Economy, George Allen and Unwin, 1976

> It was common in the '40s and '50s for politicians on the Left to say that if inequalities exist then they have to benefit everyone. We can allow inequalities but only if everyone is made better off. Rawls modified that [in the '70s] and said it's not good enough that they make everyone better off, they've got to make the worst off as well off as possible. It's amazing to think that after two and a half thousand years of political philosophy, Rawls was probably the first person ever to write that down or say it.[81]

This acceptance of inequality if, and only if, it provides the 'greatest possible benefit' for the poorest — while still ensuring basic liberties for all, and fair equality of opportunity — is at the heart of many politicians' understanding of the extended modern welfare state. On Rawls' grounds, income should be distributed more equally because that is how a just society should behave.

Box C: Maximin and the Principles of Justice

Rawls: 'The maximin rule tells us to rank alternatives by their worst possible outcomes: we are to adopt the alternative the worst outcome of which is superior to the worst outcomes of the others.'[82]

Rawls' first 'principle of justice' is that of 'equal liberty': 'each person is to have an equal right to the most extensive total system of equal basic liberties compatible with similar liberties for all'. His second principle — that of 'difference' — advances that we should regulate inequality through redistribution, by arguing that 'social and economic inequalities are to be arranged so that they are both (a) to the greatest benefit of the least advantaged persons' and '(b) attached to offices and positions open to all under conditions of fair equality of opportunity'. The three principles' strict ranking, in order of priority, is: 1, 2b, 2a.[83]

Of course, a great deal has been written in response to Rawls. There is no time here to recount this in depth, but it includes the classic communitarian criticisms — which suggest his argument to be flawed on the grounds of its attempt to divorce the individual from his social context — and ensuing proposals that peoples' resources or capabilities to access opportunities or outcomes should also be factored in.

However, for our purposes, it seems sufficient to point out that the Rawlsian maximin approach does not take into consideration the least well off's current standard of living. As Jeremy Waldron points out in *Liberal Rights*: 'the difference principle requires us to attend to the position of the least favoured group whenever

[81] Nigel Warburton, Jonathan Wolff recommends the best books on Political Philosophy, fivebooks.com, 2015
[82] John Rawls, A Theory of Justice, Harvard University Press, 1971
[83] ibid

social inequalities are in question, no matter what their level of wellbeing may be'.[84] The clear alternative approach, therefore, is to focus on the actual needs of that least well off group.

4.2 Need

It is hard to reach consensus regarding a needs-based minimum level of financial protection. It is important to note, however, that such an approach might well end up providing the least well off with just as much support as they would receive under the Rawlsian approach. The difference would be, however, that its intention would be to provide an appropriate safety net, rather than to force a 'just' redistribution of other people's resources.

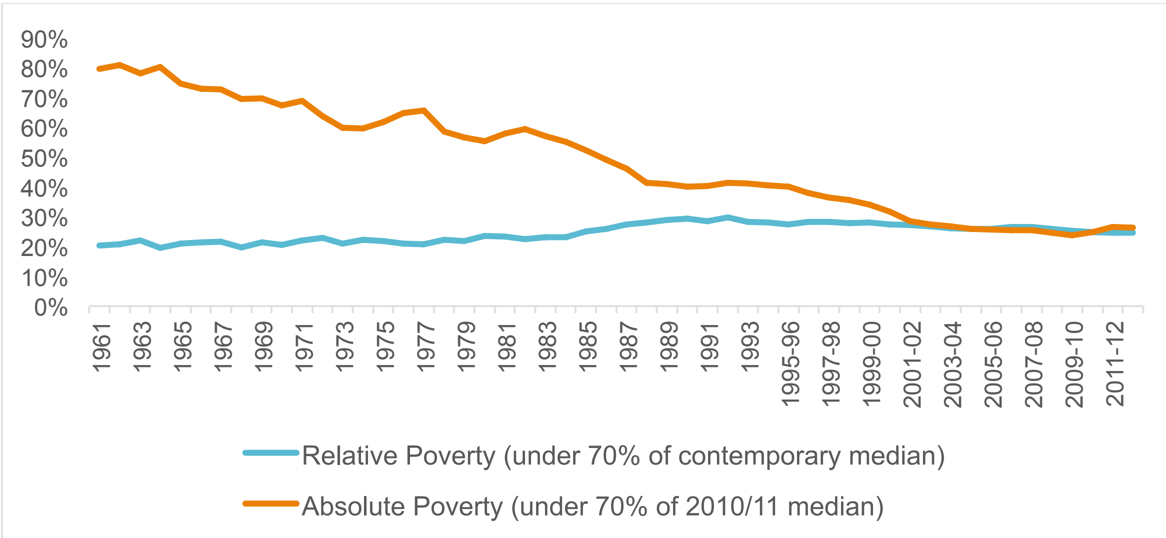
That seems important when considering the disadvantage that such processes can cause those tasked with provision. The resultant restriction on the rest of the distribution's economic freedom — through increased taxation, or even a pay cap — can, understandably, be substantial. As Tony Atkinson has calculated, 'the tax rate increase required to reduce the Gini coeffient for disposable income from 35 to 25 per cent would be 16 percentage points of income'.[85]

'Acceptable' standards of living: relative and absolute

This focus on need returns us to questions of relative and absolute. That many people seem to remain unclear about the facts underlying popular social anxieties — such as the educational prospects of disadvantaged children (improving), and the aforementioned higher-than-ever number of Britons in employment — shows a lack of government clarity. These misunderstandings stoke divisive uncertainty and social unrest. Similarly, for political and societal accord, it is essential to stress that the number of Britons in absolute poverty has decreased vastly over the past century. (That the number in relative poverty is more stable is, inherently, to be expected.)

[84] Jeremy Waldron, Liberal Rights, Cambridge University Press, 1993
[85] Anthony B. Atkinson, Inequality: What can be done?, Harvard University Press, 2015

Figure 21: Relative and absolute poverty in the UK, 1961 - 2012 (ONS)



We must also remember that disadvantage in the UK is relative, not only to here, but to elsewhere, too. And that, again, contrary to what often seems to be the general consensus, an outstanding amount of progress continues to be made, across the world, in terms of improved living standards. As chronicled by the Our World in Data project run by Oxford economist, Max Roser, the problem of truly absolute poverty has reduced rapidly over the past forty years, globally. The data presented on Roser's website is available freely, presented as a 'public good' to counter this potent uncertainty. He explains:

> On every day in the last 25 years there could have been a newspaper headline saying "The number of people in extreme poverty fell by 137,000 since yesterday". Unfortunately the slow developments that transform our world entirely never make the news, and this is very reason why we are working on this online publication.[86]

Globally, Roser clarifies that 'after around 1970, the decrease in poverty rates became so steep that the absolute number of people living in extreme poverty started falling as well. This trend of falling poverty — both in absolute numbers and as a share of the world population — has been a constant during the last three decades'.[87]

[86] Max Roser and Esteban Ortiz-Ospina, Global Extreme Poverty, Published online at OurWorldInData.org, 2017
[87] ibid

Yet none of this is to suggest there is not further progress to be made in the UK, and elsewhere. Since Adam Smith, it has been recognised that a focus on absolute poverty that ignores the relative position of individuals is an incomplete account of the economic welfare of a society. Few politicians disagree that the state has a responsibility to address societal problems, and addressing the living standards of those people in the most difficult circumstances poses a serious challenge even to wealthy modern advanced economies. We must allow neither an all-consuming emphasis on equality, nor improvements in average standards to distract us from ensuring the welfare of the least well off. While there are, of course, differing expectations regarding the obligation the state has to provide for people who cannot provide for themselves, some form of basic safety net — along the lines of a 'social minimum' — does seem essential.

Methods for calculating an acceptable social minimum are often based on assessing who the most needy in a society are, and then considering their situation in comparison with the society's average. For instance, as aforementioned, UK households that are defined, officially, as being in 'income poverty' are those receiving below 60 per cent of median income. Other comparative measures include governmental indicators of disadvantage: birth-weight, Early Years development, school readiness, learning assessments at all education stages, Free School Meals, progression to Higher Education, access to certain professions, and the ten-years-on wage progression of low-earning 25-30-year-olds. Typical measures used within policymaking and research take various sets of those indicators.

Yet those approaches are, once more, based on relative standards. Again, the alternative is a genuinely needs-based approach, starting with an objective computation of what is needed to live — and partake — in (a certain) society. That involves calculating what is necessary, monetarily, to ensure an acceptable base standard of living, including provision for everyday necessities from shelter to sustenance. While indices such as CPI and RPI are not intended to impart a baseline living cost, their calculations — which show the relative current costs of the 'average shopping basket' — are nonetheless helpful for quantifying the expense of such a baseline.

Here are two of the more standard approaches to this kind of 'social minimum':

1) The National Living Wage, and the Living Wage Foundation's Living Wage

Following an amendment to the Minimum Wage Act, employers have been obligated, since April 2016, to pay the UK National Living Wage (NLW) to full- and part-time workers over the age of 25. This was originally set at an hourly rate of £7.20, with the aim of rising above £9 by 2020. NLW rates are advised by the independent non-departmental advisory body, the Low Pay Commission; the £9 goal is informed by a target of 60 per cent of median earnings. It is, therefore, also set relative to average earnings, rather than on a specific assessment of need.

The Living Wage Foundation's 'real living wage', however, is 'independently-calculated each year based on what employees [over the age of 18] and their families need to live'.[88] Its 2016 rates — £9.75 in London, and £8.45 elsewhere in the UK — were calculated by the Resolution Foundation, and are 'built on a basket of goods that represents a decent standard of living, determined through research with the public'. They include costs of housing, council tax, travel, and childcare, and take regional differences into account.

2) The Joseph Rowntree Foundation's 'Minimum Income Standard'

The Joseph Rowntree Foundation (JRF) has published an annual update to their 'Minimum Income Standard' (MIS) since 2008. For 2016, it stands, before tax, at £17,100 for single people, and, for couples with two children, at 'at least' £18,900 per adult.[89] The JRF's February 2017 overview report, *Households below a Minimum Income Standard,* revealed that 'between 2008-9 and 2014-15, the number of individuals below MIS rose by four million, from 15 million to 19 million (from 25 to 30 per cent of the population)'.[90]

The foundation's definition of this minimum standard is that it is a level that 'includes but is more than just, food, clothes and shelter. It is about having what you need in order to have the opportunities and choices necessary to participate in society' — this, therefore, 'does not claim to be a poverty threshold'.[91] The assessment leading to what this standard entails involves focus groups consisting of 'members of the public from a range of social backgrounds', informed by experts, including a nutritionist, a heating engineer, and a motoring costs specialist.

Recent changes have included increased travel requirements, the introduction of nursery choice, and, owing to the removal of the Spare Room Subsidy, a new acceptance of 'more restricted housing standards for larger families'.[92] We should note that the foundation publishes minimum household budgets both before and after rent and childcare. As aforementioned, the cost of housing is one of the highest contributors to the cost of living, particularly for those near the bottom of the income distribution. The report also reiterates the impact of the recently introduced NLW.

[88] livingwage.org.uk
[89] Abigail Davis, Katherine Hill, Donald Hirsch and Matt Padley, A Minimum Income Standard for the UK in 2016, Joseph Rowntree Foundation, 2016
[90] Matt Padley, Donald Hirsch, Laura Valadez, Households below a Minimum Income Standard: 2008/9 to 2014/15, Joseph Rowntree Foundation, 2017
[91] Abigail Davis, Katherine Hill, Donald Hirsch and Matt Padley, A Minimum Income Standard for the UK in 2016, Joseph Rowntree Foundation, 2016
[92] ibid

Problems in calculating a minimum cost of living

An obvious problem arising in calculating a minimum cost of living is that of subjectivity. The calculations behind the approaches above rely upon opinion-based evidence, provided by focus groups. This report is not the place to argue to what extent overseas holidays or satellite television are human necessities, but it can certainly be contended that genuine basic 'need' is not always the primary concern of social-minimum calculations. Few would suggest that the cost of living should be predicated solely on the bottom two rungs of Maslow's 'hierarchy of needs' (those rungs being 'physiological needs' and 'safety needs'). But when we remember that the poorest people's cost of living is subsidised by those sometimes only a little better off, harsher conclusions can feel more appropriate, at least in consequentialist terms.

Nonetheless, strong arguments for a more equal distribution of income must surely be based primarily on fundamental need. When a reasonable calculation of need has been achieved, the question still remains as to how best to ensure the resultant provision required. For those unconvinced by solutions such as state-imposed minimum incomes, then tax reforms offer another option. In the context of the UK's complex tax and benefit system — in which the rates and thresholds of income tax and national insurance contributions are unaligned — there may be long-term scope to make greater progress than through the regulation of wages.

Conclusion

This discussion about need returns us to our opening assertion that focusing on living standards is more important than aiming for evenly-spread pay. Through consideration of the present situation, and of standard solutions advanced for ensuring the wellbeing of the least well off, this seems to be the case not only pragmatically, but also more fundamentally.

A free economy is an efficient hub of supply and demand, and should, therefore, be tempered only with the regulation necessary to tackle market failures. However, if we believe that state power is predicated on the consent of the governed, who partake in ordered society to gain the protection they cannot provide for themselves, then our liberal economy must include the provision of a safety net. An economy run along these lines should be capable of generating progressive increases in economic welfare for society as a whole.

While this report's purpose is to clarify, rather than to propose specific policy suggestions, it is evident that greater governmental clarity on these issues — both in terms of the actual facts of the matter, and the strong, positive, justification for concentrating on living standards over income distribution — could help to relieve public uncertainty and societal division.

Overall findings

- In 2014-15, income from employment made up 72 per cent of gross weekly household income, although this varies from 81 per cent for those in the top quintile of the distribution, to 37 per cent for those in the bottom.
- There is also regional disparity: for those in London, earnings accounted for 80 per cent of their total income; for those in the North East, this was 63 per cent.
- In 2016, median gross weekly earnings for full-time employees rose 2.2 per cent, nominally (or 1.9 per cent, in real terms) on 2015 — the joint fastest rate of growth since the 2008 Great Recession. However, the past few months have seen a slightly lower increase in the growth of regular pay.
- Employment is at an all-time high, and increasing steadily. While unemployment rates are more static, they are at their lowest since 2005.
- In the financial year ending 2016, the median equivalised UK household disposable income was £26,300 — higher than the pre-downturn figure for the first time.
- The current growth rate correlates with the 40-year average, although that average is skewed by the more successful decades.
- Low-income households continue to spend proportionately more on the cost of living, especially housing.
- On varying forms of measurement, large-scale income inequality has remained flat over the past 30 years.
- The poorest fifth of households comprise the only group whose disposable household income has not dropped beneath its pre-downturn levels.
- In 2016, the poorest fifth's disposable household income increased the most, proportionally. After several years of increases, the richest fifth's fell, and still remains below pre-downturn levels.
- Government intervention continues to have the greatest influence on income inequality: benefits reduced the UK's Gini coefficient score by 14.2 percentage points in 2014-15, and direct taxes reduced it by a further 3.2.
- In 2014-15, the ratio between the top and bottom quintile's original income was 12 times; once tax and benefits were taken into consideration, that ratio fell to 5.

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- Median household total wealth (net property wealth, net financial wealth, physical wealth, and private-pension wealth) stands at £225,110.
- The ratio between the top and bottom deciles of the distribution is currently 10 times larger for wealth than it is for income. The top decile owns 45 per cent of the total wealth, whereas the bottom owns less than 0.5 per cent. Again, there are regional disparities: 22 per cent of South-Eastern households are in the top decile, as opposed to 2 per cent of those in the North East.
- While spending has increased from the downturn low of 2012, it has not yet returned to pre-2007 levels. Regional disparities are significant: weekly household spending in London is currently £652.40, in comparison with £423.50 in the North East.
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