

Households below average income – summary of a recent DWP release

June 2012

Background

The Department of Work & Pensions (DWP) releases survey data relating to income levels and distribution each year. This survey and subsequent analysis is important in showing what proportion of the population is relatively and absolutely income deprived, and the changes over time. The latest data relates to 2010/11.

The report uses the measurement Households Below Average Income (HBAI). The HBAI uses household disposable income, after adjusting for the household size and composition, as a proxy for material living standards. More precisely, it is a proxy for the level of consumption of goods and services that people could attain given the disposable income of the household in which they live. The survey covers 20,000 households, although this is 5,000 lower than previous surveys. As a consequence the confidence intervals associated with the data are slightly wider.

The HBAI looks at relative movements – which depend on how incomes at the lower end of the distribution compare with income growth of the rest of the population – as well as absolute movements which captures actual falls or rises in real terms. In absolute terms, as expected as the recession took hold, between 2009 & 2011 incomes fell in real terms across each quintile (20% of the given population) of the income distribution.

However, income inequality fell by two percentage points as the incomes of higher earners fell proportionally more than those at the bottom of the income distribution. As we comment on below, the income of those at the bottom of the distribution were somewhat protected by State benefits.

The HBAI considers income deprivation to be at 60% below the median average household income. It also considers the income distribution both before and after housing costs. Given that housing costs are a considerable part of households' financial costs, then this does change the dynamics of income distribution. Importantly, housing costs tend to differ more geographically than other household costs and it therefore impacts geographical income distribution. On a very simple basis, by considering housing costs the income 'advantage' seen in the South East tends to be partially deflated.

Households below average income

Median equivalised (the exercise of accounting for differences in the types of households so that they are considered on a standardized basis) net household income in 2010/11 was £419 per week Before Housing Costs (BHC) and £359 per week After Housing Costs (AHC). This means that the most commonly used threshold to determine if someone is in relative low income – 60% of median income - was £251 per week BHC and £215 per week AHC.

The income distribution is skewed towards the lower end, showing a relatively high concentration of individuals close to the 60% of median relative low income threshold (about 60% of the total population). There is a longer tail for higher incomes i.e. there are few households whose income is at the very top end of the distribution. As such, there is a big difference between the *median* and *mean* average within the income distribution.

Between 2009/10 and 2010/11, there were large reductions in mean and median incomes with those with higher incomes seeing larger reductions, resulting in incomes in 2010/11 being around the same levels as in 2004/05. The fact that incomes of many households now are no higher than they were 7 years ago has caught the attention of commentators. From a recession and recovery point of view, this downward adjustment has inevitably had an impact upon the strength of demand inherent in the economy.

Due to the recession, income from earnings rose by less than inflation. Lower-income households saw smaller decreases in income (see Chart 1); as such households are typically less dependent on earned income, with more of their income from benefits and tax credits. Benefit and tax credit income grew in cash terms and fell only slightly in real terms (see Chart 2).

Chart 1: Reduction in incomes – 2009/10-2010/11 – UK

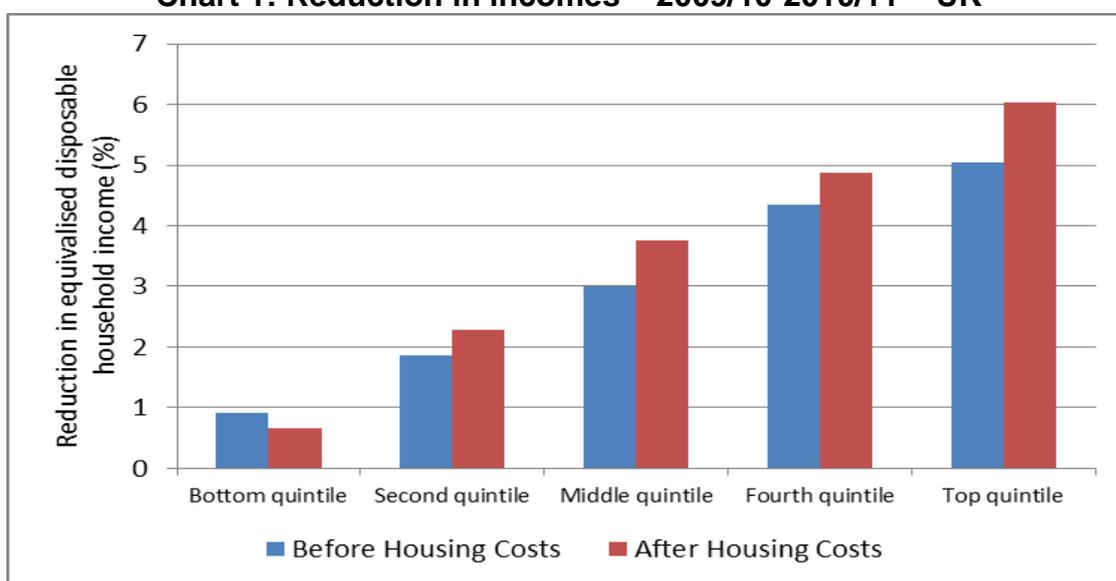
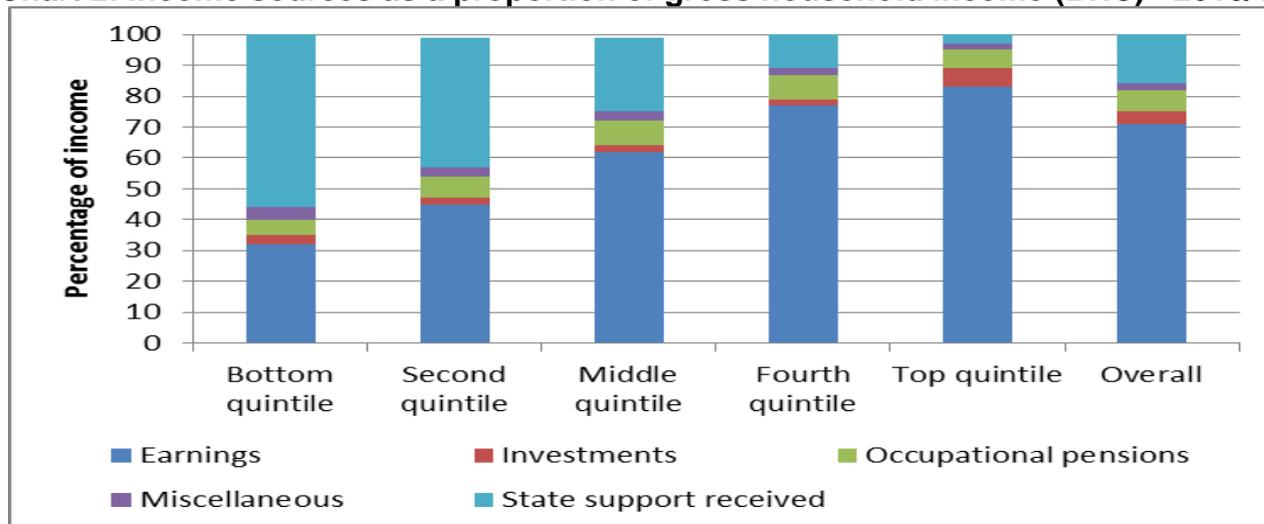


Chart 2 shows that the bottom of the income distribution derives a much smaller proportion of their income from earned income. Rather, for the bottom quintile, 56% of income is from State support – compared to just 3% for the top quintile. Because this income has been relatively protected (it tends to be inflation-indexed), then the bottom quintile’s income has been more robust. In comparison, earnings have been degraded by the twin effects of inflation and pressure on nominal wage increases.

Chart 2: Income sources as a proportion of gross household income (BHC) - 2010/11



There are two primary forms of measuring income levels and income inequality. *Relative* income refers to an individual's/household's income in relation to others in the population. Therefore, if that individual or household's income rises, but at a slower rate than the rest of the population, then their relative position will deteriorate.

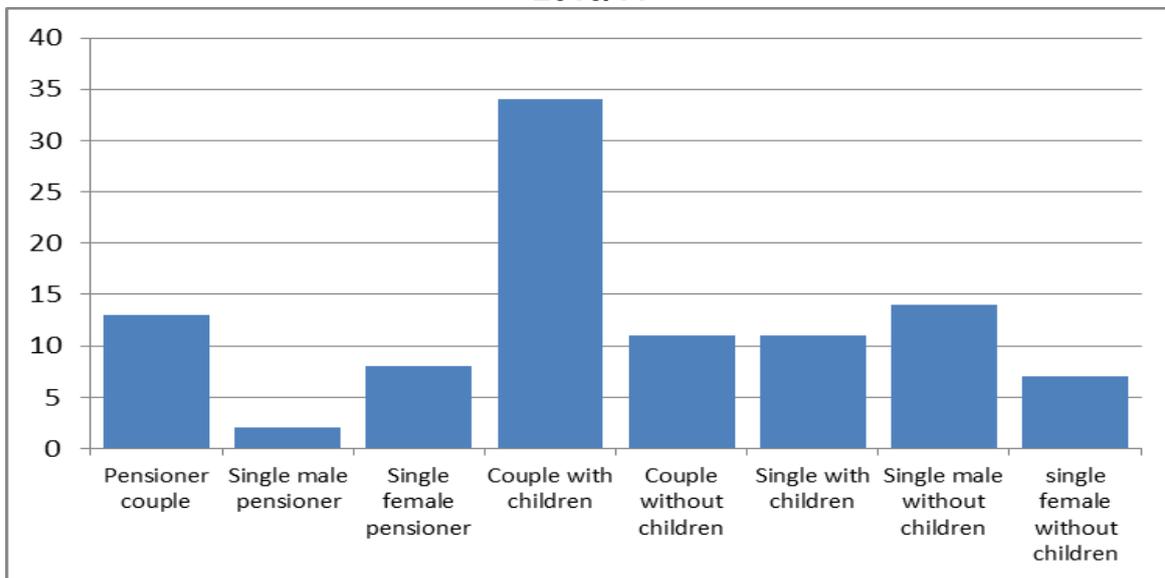
Alternatively, *absolute* income refers to their actual level of income and as long as it rises then their absolute income will rise. In the case of this work this is after accounting for inflation – therefore relating to absolute *real* incomes. Given that incomes have been under pressure due to the recession whilst inflation has been relatively high, then we shall see that it is not necessarily a given that absolute incomes have risen.

Firstly, if we consider relative income deprivation: In 2010/11, 16% of people (9.8mn) were in households in the UK with incomes below 60% of contemporary median net disposable household income BHC, and 21% (13mn) AHC. Compared to 2009/10, this represents a fall of 1 percentage point (0.5m) on a BHC basis and a fall of 1 percentage point (0.5m) AHC. The longer-term decline has been more considerable - compared to 1998/99, there has been a fall of 3 percentage points (1.3m) on a BHC basis and a fall of 3 percentage points (1.0m) AHC.

In absolute terms, in 2010/11, 11% of people (6.5mn) were in households in the UK with incomes below 60% of 1998/99 median net disposable household income held constant in real terms BHC, and 15% (9.1mn) AHC. Compared to 2009/10, this was flat in percentage point terms (a rise of 0.3m) on a BHC basis and was flat in percentage point terms (a rise of 0.3m) AHC. There had been considerable progress in the preceding decade. Compared to 1998/99, this represents a fall of 9 percentage points (4.7m) on a BHC basis and a fall of 9 percentage points (4.9m) AHC.

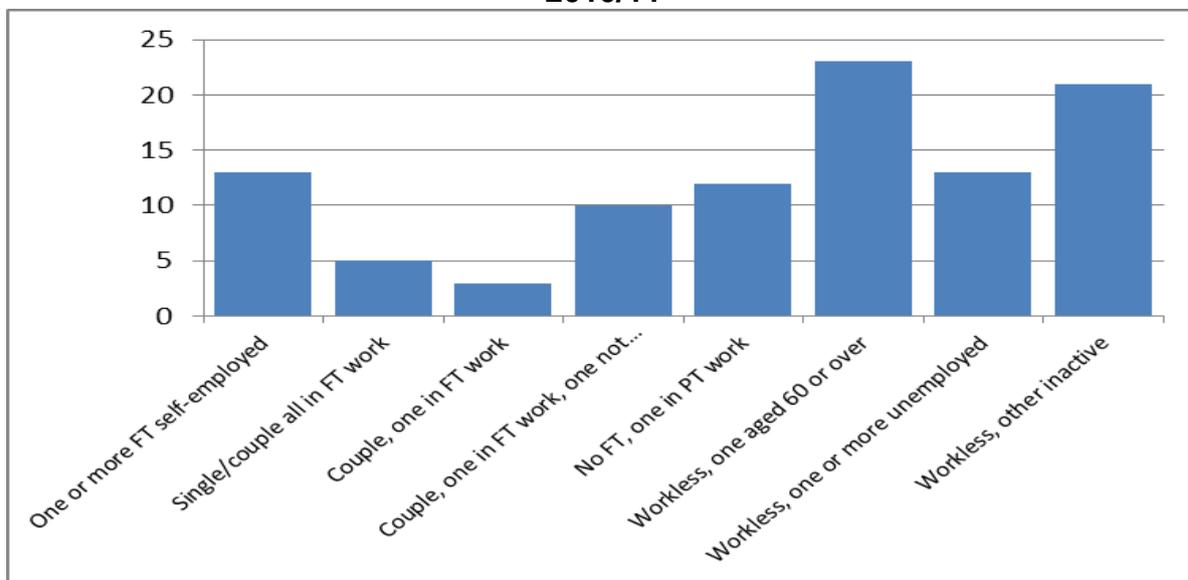
If we look at the data by household type (Chart 3), then the majority of households that are below the threshold are classified as 'couples with children'. This is largely to be expected, given the financial pressures associated with raising children.

Chart 3: Percentage of individuals in relative low income by household type (BHC) - 2010/11



In terms of the breakdown by economic status, unsurprisingly the largest proportion of individuals in relative low-income are associated with workless or inactive households. Chart 4 shows that over two-thirds of those in relative low-income live in households where there is some element of worklessness.

Chart 4: Percentage of individuals in relative low income by economic status (BHC) - 2010/11



Although much of the detailed data is not available at a geographical level lower than the UK, there is some aggregate data that can be broken down regionally. This data shows that, when compared to the UK, the South West has an income distribution that broadly matches the national average. Chart 3 shows that 15% of individuals are classified as being relatively low-

income (60% below the regional median average) BHC (UK average 16%). After housing costs, the figure rises to 20%. What is notable about this chart is the significant difference in London between the BHC and AHC adjustments. This shows the significant influence that the high cost of accommodation (both rental and mortgage costs) plays in the capital. The inference that we take – given that it is using the median average – is that housing is a much larger proportional cost to those at the middle-to-bottom part of the income distribution in London.

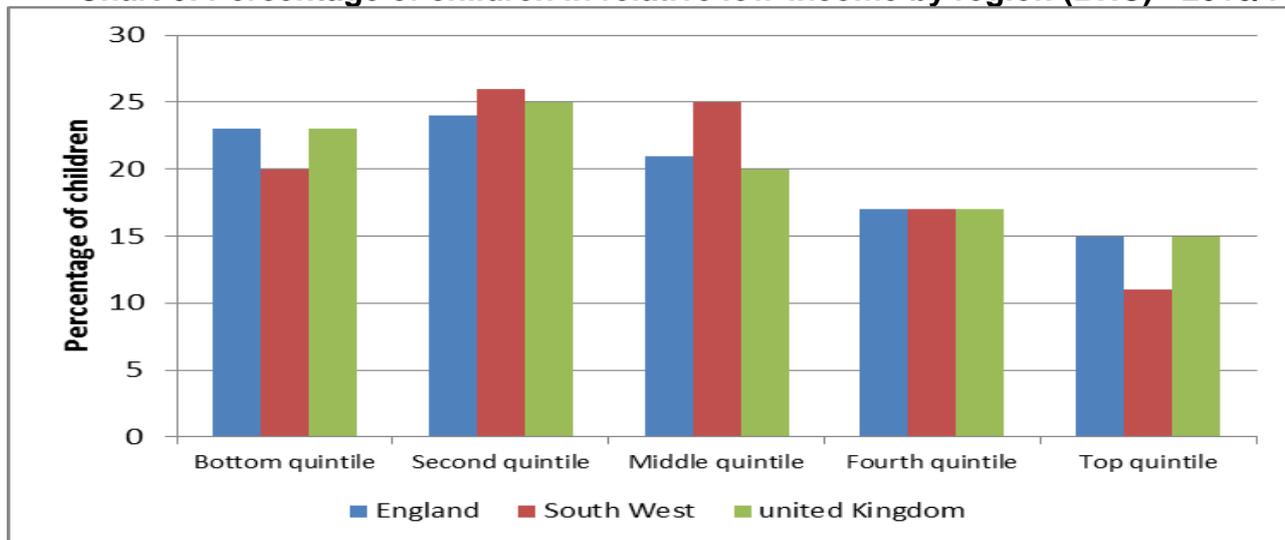
Chart 5: Percentage of individuals in relative low-income by region - 2010/11



The consequence of income inequality is, of course, most keenly felt in the impact that it has upon children. It has been proven that there is an increased chance of poverty in adulthood if that individual has grown up in a poor household. It is a vicious circle that is hard to break. It is for this reason why almost Governments have had child poverty targets.

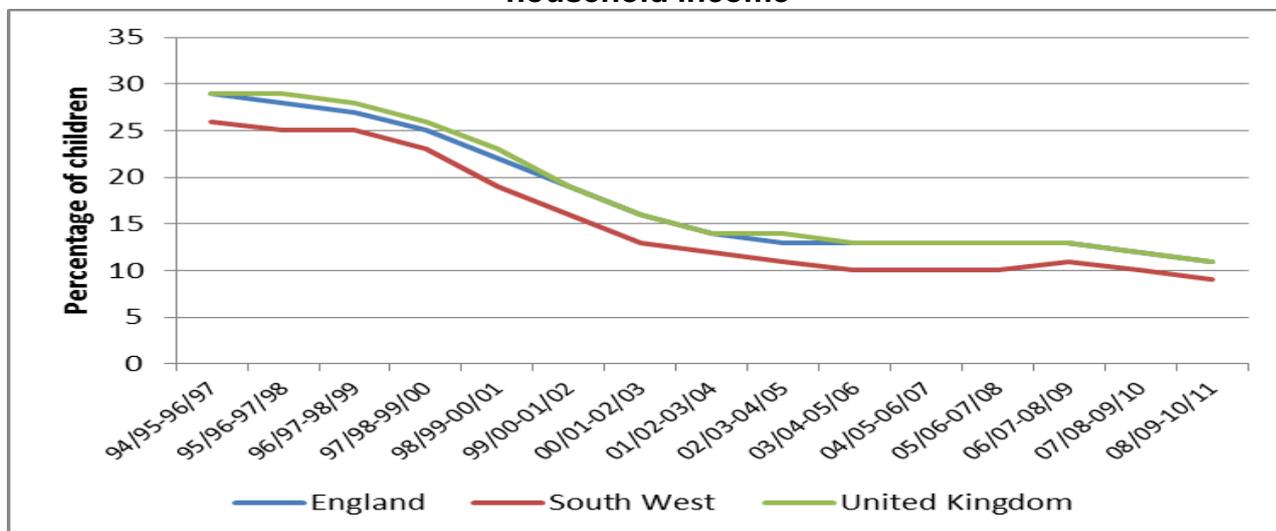
Chart 6 shows that just under half of all children in the UK live in households in the second and third quintiles of income distribution. That is, the majority live in households that are bunched around the average income level. However, 20% live in the bottom quintile (remembering the breakdown shown in Chart 3). There are proportionally fewer children living in households in the top quintile, probably showing that those households will tend to be older i.e. older people tend to earn more as their career develops. This is somewhat reinforced by looking at the South West breakdown. The region has proportionally even fewer children living in the top quintile – perhaps showing the slightly older demographic profile of the region.

Chart 6: Percentage of children in relative low-income by region (BHC) - 2010/11



The good news is that the proportion of children living in relative low-income households continues to fall – it is now the lowest level since the late 1980s. Chart 7 shows how the proportion of children in relative low-income households has fallen consistently over the last 15 years. The South West has experienced a similar profile over time, although at a slightly lower level.

Chart 7: Percentage of children living in households with less than 60% of median household income



Conclusion

This DWP analysis – which we have summarised here – is useful in understanding how the dynamics of income distribution changes over time. Importantly, it shows the impact of the recession on that profile, and from a policy perspective it highlights the importance of State support to protect those at the very bottom of the income scale. To that end, the implications of the proposed changes to the welfare system could have a profound income on future findings.

It is clear that the UK still has a skewed income distribution, but it is reassuring that income inequality continues to fall over time. Much of the media focus on the data has been two-fold. Firstly, it has been upon the ‘squeezed middle’ – those households that are bunched around the average income point which have obviously been affected by the downturn. Secondly, it has been on the absolute real declines for those at the middle-top end of the income distribution – returning their income levels back to 2005 levels.

The South West has broadly followed the national trends, albeit at marginally lower levels of income poverty than the average. Nevertheless, the broad principles highlighted above will have occurred in the region. The knock-on effects in terms of the strength of demand inherent in the economy will have been affected by changes in the level and distribution of income.

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