

Chapter 2

The income distribution

- Overall, the income distribution in 2004/05 was skewed towards the lower end, showing a relatively high concentration of individuals close to the 60 per cent of median low-income threshold and – particularly BHC – a long ‘tail’ for higher incomes.
- Benefits together with tax credits were the main source of income for the bottom quintile whereas earnings were the main source for the other four quintiles.
- There was income growth across the distribution as a whole from 1994/5 to 2004/05, with income growth in the second quintile substantially higher than in other quintiles on both Before Housing Costs and After Housing Costs measures.
- Throughout the income distribution, income growth from 1994/5 to 2004/05 was higher for income After Housing Costs than Before Housing Costs.
- On one measure, the ratio of the incomes of the top quintile (fifth) of the population to the incomes of the bottom quintile showed no consistent change between 1994/5 and 2004/05. On another measure, which is more sensitive to data that may be less reliable, the income share of the top quintile increased modestly relative to those in the bottom quintile up to 2000/01, and then fell slightly.
- The Gini coefficient, a measure of inequality, increased slightly between 1994/5 and 2000/01 on both BHC and AHC measures, but has since shown evidence of a slight fall.
- Single pensioners had relatively high growth in median income from 1994/5 to 2004/05. Workless working-age families had relatively low growth in median income, as did families where one or more adults were in full-time work.

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Introduction

This chapter looks at the overall income distribution and, in order to place the findings presented in this report in a wider context, considers the prevailing social and economic conditions between 1994/5 and 2004/05.

The economic climate

Table 2.1 presents a time-series of key economic indicators, which show over the period 1995 to 2004:

- Sustained growth in GDP.
- Rising employment rates (as a result of falling unemployment over the period), though there has been little change since 2000.
- Low inflation and a decline in nominal interest rates.
- Growth in average earnings above the rate of inflation since 1996.
- Sustained growth in real disposable income.

All of the above are indicators of a growing economy, although this growth appeared to have slowed somewhat around 2001. The implication for statistics on incomes and living standards as presented in HBAI is that average incomes in real terms (both mean and median) are likely to exhibit strong growth over the period as a whole, with a slight reduction for more recent years. This is supported by the HBAI figures appended to the table.

The overall income distribution

Figure 2.1 shows the income distribution for Great Britain in 2004/05 both Before Housing Costs (BHC) and After Housing Costs (AHC). The shaded areas numbered 1 to 10 show each successive tenth, or decile, of the population.

HBAI presents analyses of disposable income on two bases: Before Housing Costs (BHC) and After Housing Costs (AHC). This is principally to take into account variations in housing costs that do not correspond to comparable variations in the quality of housing.

Figure 2.1 (BHC): Income distribution for the total population, 2004/05

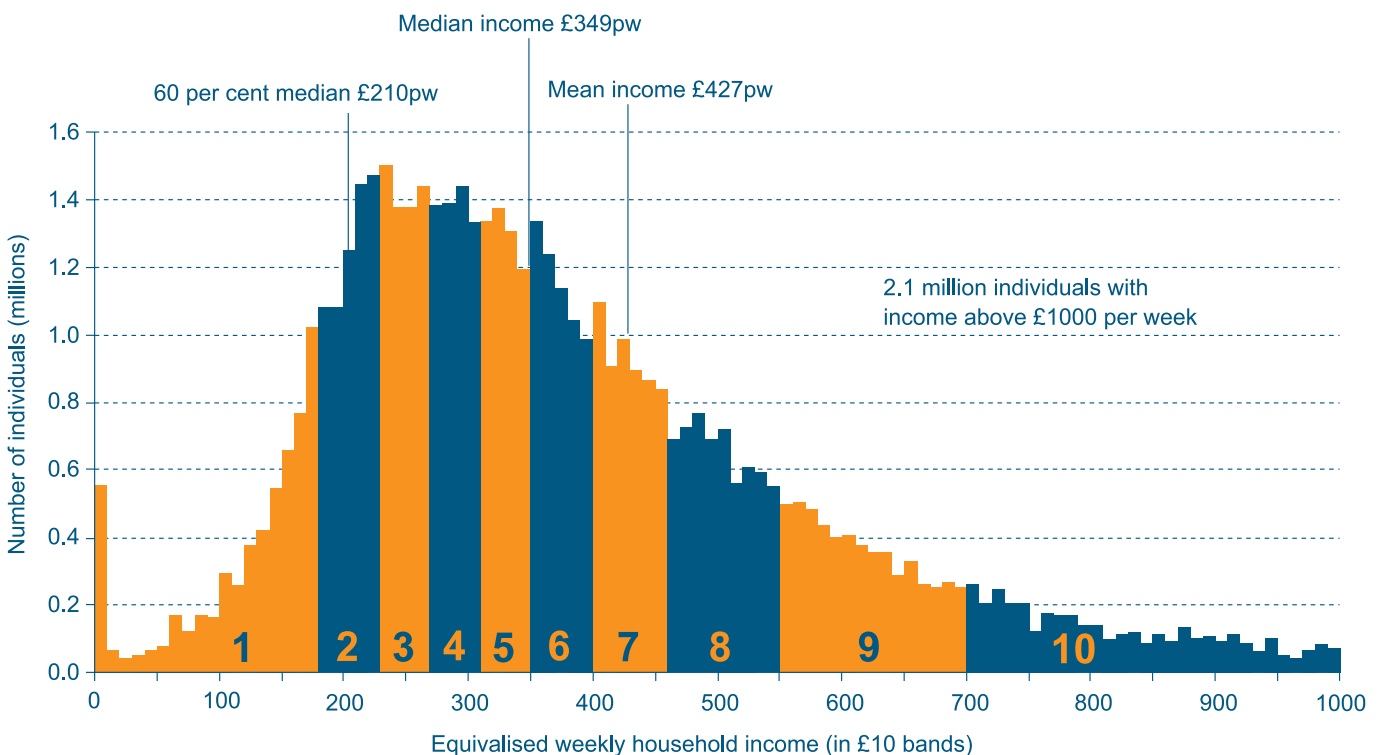
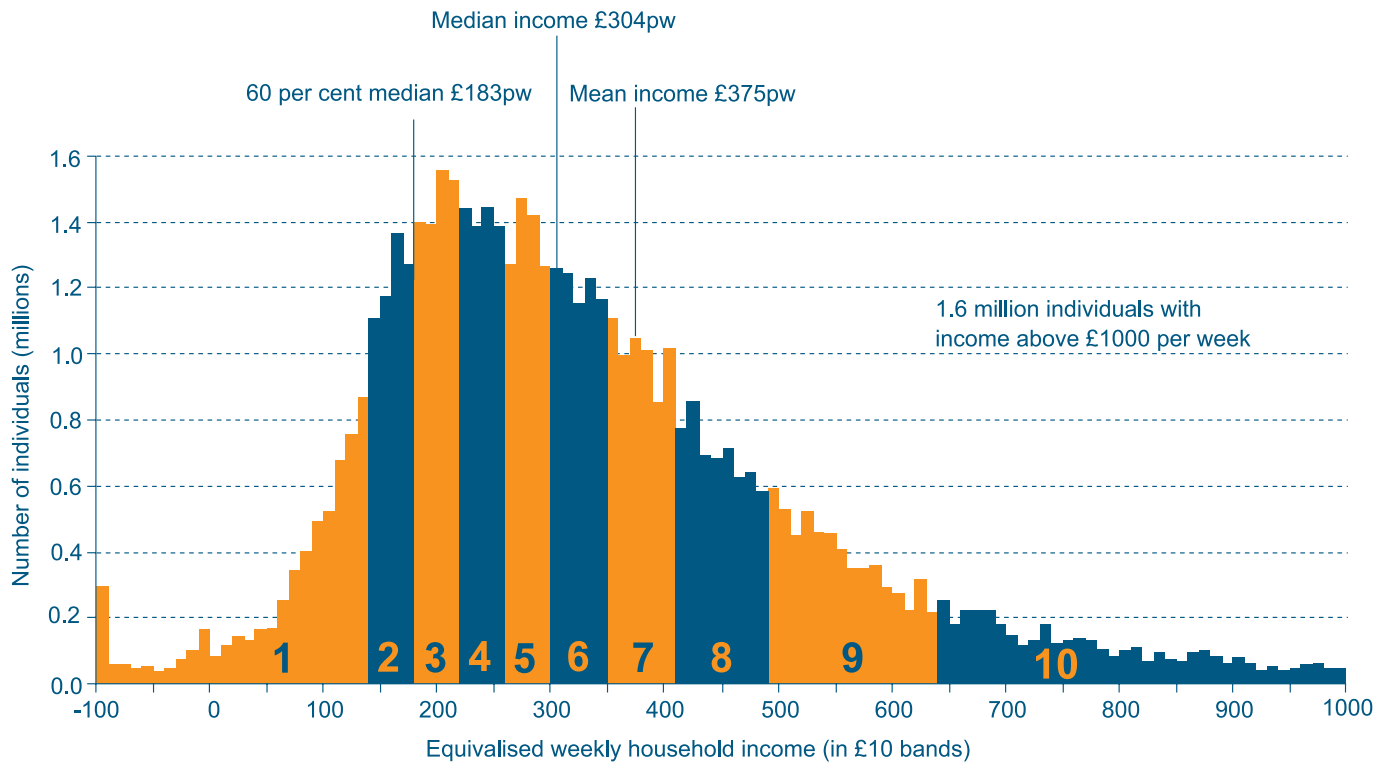


Figure 2.1 (AHC): Income distribution for the total population, 2004/05



The income distribution was clearly skewed towards the lower end and had a long tail at the upper end. On a Before Housing Costs basis, almost two thirds of individuals had an equivalentised household income that was less than the national mean average. There was a large concentration of individuals around the 60 per cent of median income mark. The distribution showed similar characteristics on an After Housing Costs basis.

The presence of substantial numbers of individuals with relatively high incomes results in a skewed distribution and a large differential between the overall mean and the median.

Income measures used in HBAI take into account variations in the size and composition of the households in which people live. This process is called equalisation.

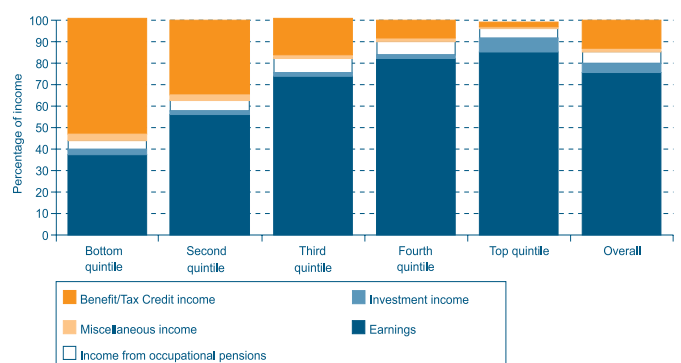
Equalisation reflects the idea that a family of several people needs a higher income than a single individual in order for them to enjoy a comparable standard of living.

Equivalence scales conventionally take a couple with no children as the reference point. Consider a single person, a couple with no children, and a couple with two children aged four and seven, all with household incomes of £100 BHC. The process of equalisation gives an equivalentised BHC income of £164 to the single person, £100 to the couple but only £72 to the couple with children. **Appendix 2** gives more detail.

Sources of income

Households receive income from a variety of sources. The main ones are earnings, self-employment, Social Security Benefits/Tax Credits, interest on investments and occupational pensions. **Table 2.2 and Figure 2.2** show the distribution of gross income sources for each fifth, or quintile, of the population, ranked by net disposable household income. The various sources of income are shown as a percentage of the total gross income of the quintile.

Figure 2.2 (BHC): Income sources as a proportion of gross income by quintiles, 2004/05



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Successive quintiles, from the bottom to the top, showed a steadily diminishing share of benefit/Tax Credit income and an increasing share of income from employment. These were the main sources of income overall, accounting for around nine-tenths of income combined.

On a Before Housing Costs (BHC) basis, earnings made up around four tenths of the gross income of the bottom quintile while benefits together with Tax Credits made over half. In the top quintile, nearly 90 per cent of income was derived from earnings. The largest proportion of income from investment was also seen in the highest income group (although it should be noted that comparisons with National Accounts data would suggest that surveys such as the FRS understate investment income). These findings were mirrored on an After Housing Costs (AHC) basis.

Statistics relating to the overall equivalised income distribution and their equivalent money values for a selection of family types.

As explained above, household incomes in HBAI are adjusted, or equivalised, in order to facilitate comparisons between different family types.

Table 2.3 shows how the equivalised values of different statistics relating to the overall income distribution can be translated into actual household incomes for a selection of family types. Similar information is presented for historic years in **Supplementary Table C**.

For example, **Table 2.3** shows that equivalised median income BHC in 2004/05 was £349 per week. This translates into an actual net income of £349 for a couple with no children, £213 for a single person with no children, £510 for a couple with two children aged five and eleven and £374 for a lone parent with two children aged five and eleven.

Income growth in real terms

Supplementary Table A1 shows real-terms changes in incomes by decile and quintile group from 1994/5. Between 1994/5 and 2004/05 median income grew by 24 per cent in real terms BHC and 32 per cent AHC, while mean income growth was 25 and 35 per cent respectively.

Over this period, there was growth across the distribution as a whole, with incomes AHC growing at a faster rate than those on a BHC basis. On a BHC basis, the bottom decile showed less growth than all other deciles, whilst the second, third and fourth deciles' medians showed more growth. On an AHC basis, the second, third and fourth decile medians also showed more growth. Over the same period, growth for the second quintile medians both BHC and AHC were greater than it was for other quintile medians.

Supplementary Table A1 also shows real-terms changes in income from 1996/7 to 2004/05. On both

BHC and AHC measures there was greater growth at the lower end of the distribution. The bottom and second quintile medians exhibited growth that was statistically significantly higher than the majority of other quintiles.

One way of measuring inequality is to look at the ratio of the top quintile median (90th percentile) to the bottom quintile median (10th percentile). **Supplementary Table A2** shows that there is some evidence to suggest there was a slight fall in this measure since 1996/7. **Supplementary Table A2** also shows the ratio of the top to middle quintile medians, and middle to bottom quintile medians. Both BHC and AHC measures have shown little change since 1994/5.

As shown in **Table 2.1**, comparisons between growth in Real Household Disposable Income and real growth in mean BHC unequivalised income show that there is a reasonable match between the two over the period. For some more recent years, income growth in the HBAI-based series appears slightly lower than the National Accounts estimates. The implication of this is that absolute real income growth could be understated in the HBAI series. Comparisons over a longer time period are believed to be more robust.

Income shares

Supplementary Table A3 shows the share of total income received by individuals in different quantiles of the income distribution. It can be seen that individuals in the top quintile accounted for a little over 40 per cent of total income whilst those in the bottom quintile accounted for less than eight per cent.

The income shares of the top 10 and 20 per cent of the income distribution generally increased between 1994/5 and 2000/01, with indications of a following slight decline. The shares of the top 30, 40 and 50 per cent showed a slight rise followed by a slight fall over the period 1994/5 to 2004/05.

Looking at the ratio of the total income received by equivalent quantile groups at the top and bottom of the income distribution over time is another way of measuring and tracking inequality in the income distribution. These data would suggest that there was a modest rise in inequality between the mid-1990s and 2000/01, with a small fall thereafter. These results, however, are sensitive to data at the extremes of the income distribution that may be less reliable than other data.

Gini coefficient

Supplementary Table A3 also shows the value of the Gini coefficient since 1994/5. The Gini coefficient is a widely-used measure of inequality, which can take values from zero to 100. A value of zero would indicate total equality, while a value of 100 would indicate total inequality. In 2004/05, the coefficient was 34 for income

Before Housing Costs, and 38 for income After Housing Costs. Changes between 1994/5 and 2004/05 have not been large. For both BHC and AHC income, the coefficient increased between 1994/5 and 2000/01, with indications of a slight fall between 2000/01 and 2004/05.

When considering changes in the top and bottom deciles, users should consider that results for the bottom decile are particularly vulnerable to income measurement problems, and have limited validity as a guide to the consumption capabilities of the poorest ten per cent of individuals. Results for the top ten per cent are also particularly vulnerable to sampling errors and income measurement problems.

Income growth by family type and economic status

Supplementary Table A4 shows real-terms percentage changes in income between 1994/5 and 2004/05 for different family groups. Due to sampling variation we cannot make many conclusive comparisons, as the majority of differences between or within family groups are not statistically significant. Significant observations from this table are as follows:

- Single male and female pensioners had relatively high growth in median income compared to other family types between 1994/5 and 2004/05. This was also true for the growth of the second and fourth quintiles on an After Housing Costs basis only.
- Single female pensioners had significantly higher growth across all quintiles apart from the bottom on an After Housing Costs basis when compared against other quintiles.
- Singles/couples with no full-time worker, but one or more part-time workers, and the workless with a head or spouse aged 60 or over, both showed higher growth for median income and second quintile median income on both a BHC and an AHC basis compared to other economic status types.
- The unemployed showed significantly lower growth in the bottom two quintiles than other economic groups, and the bottom quintile median income for this group fell in real terms on the Before Housing Costs measure. The 'workless – other inactive' group, had lower growth for the second quintile than for most other economic status types.
- The group comprising single people in full-time work and couples both in full-time work showed low growth, significant in most cases, in all but the top quintile when compared with other economic groups on both income measures.
- Couples where one partner worked full-time and the other did not work, had lower growth in median income than the population as a whole – though higher growth in mean income.
- The bottom two quintiles for individuals in lone-parent families grew by less than most other family types, while the top two quintiles – particularly AHC – grew by more than most.

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Table 2.1: Recent economic indicators

Percentages							Source: ONS
	GDP Growth	Base Interest Rate	Inflation Rate (Headline)	Male Employment rate	Female Employment Rate	Average Earnings Growth	Real Household Disposable Income growth
1995	2.9	6.6	3.5	76.3	65.8	3.1	2.3
1996	2.7	5.9	2.4	76.6	66.7	3.6	2.5
1997	3.2	6.6	3.1	77.7	67.4	4.2	3.6
1998	3.2	7.2	3.4	78.3	67.9	5.2	0.9
1999	3.0	5.3	1.5	78.6	68.6	4.8	3.2
2000	4.0	6.0	3.0	79.3	69.1	4.5	4.8
2001	2.2	5.1	1.8	79.5	69.4	4.5	4.2
2002	2.0	4.0	1.7	79.0	69.6	3.5	1.7
2003	2.5	3.7	2.9	79.3	69.8	3.4	2.8
2004	3.2	4.4	3.0	79.3	69.9	4.3	1.9

Notes:

1. All growth figures are for the year in question compared to the previous year.
2. GDP at market prices, chained volume measure (UK National Accounts 2005 Edition)
3. The base interest rate is the annual average for the relevant calendar year
4. Inflation rate is the annual average change for each calendar year as measured by All Items Retail Price Index
5. Employment Rates are seasonally adjusted figures for the Spring quarter of each year (March to May)
6. Average earnings growth is the actual (as opposed to real terms) annual average for each calendar year
7. Real disposable income growth is based on the Real Disposable Income series, calendar years
8. All figures are for the United Kingdom, except Average Earnings Growth which covers Great Britain.

Percentages			Source: FRS
	HBAI mean net disposable unequivalised income growth (BHC)		
	Real Terms	Cash terms	
1995/6	-0.5	2.8	
1996/7	2.4	5.5	
1997/8	3.7	5.2	
1998/9	4.5	6.0	
1999/00	0.6	3.3	
2000/01	7.6	7.0	
2001/02	5.1	6.5	
2002/03	0.7	2.7	
2003/04	-0.3	2.2	
2004/05	1.9	4.9	

Notes:

1. Growth in unequivalised mean net disposable income is also presented here, in order to allow better comparisons with Real Household Disposable Income growth.
2. Some minor revisions exist since last year to the real and cash terms growth rates due to a mistake. Other revisions due to revisions to underlying ONS data.

Table 2.2: Income sources as a proportion of total¹ income by quintile

Percentage of Total ¹ Income						Source: FRS 2004/05
Source of Income	Bottom Quintile	Second Quintile	Middle Quintile	Fourth Quintile	Top Quintile	Overall
Before Housing Costs						
Earnings	37	56	74	82	85	76
Investments	3	2	2	2	7	4
Occupational pensions	4	5	6	6	4	5
Miscellaneous	3	2	2	2	1	2
Benefits/Tax Credits	54	35	17	8	2	13
After Housing Costs						
Earnings	41	58	76	82	84	76
Investments	2	2	2	2	7	4
Occupational pensions	2	4	5	6	5	5
Miscellaneous	4	3	2	2	1	2
Benefits/Tax Credits	51	33	16	9	3	13

Note:

1. Tax Credits are added into the definition of total income used here.

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Table 2.3: Statistics relating to the overall equivalised net disposable income distribution and their equivalent money values for a selection of family types

£per week equivalent 04/05 prices		Source: FRS 2004/05							
	Mean	Median	50% mean	60% median	Bottom	Second	Quintile		
							Middle	Fourth	Top
Including the self-employed									
Before Housing Costs									
Couple with no children (equivalised income benchmark)	427	349	213	210	< 225	225 - 306	307 - 399	400 - 547	548 +
Single with no children	260	213	130	128	< 138	138 - 187	188 - 243	244 - 333	334 +
Couple with two children aged 5 and 11	623	510	311	306	< 329	329 - 447	448 - 582	583 - 798	799 +
Single with two children aged 5 and 11	456	374	228	224	< 241	241 - 327	328 - 427	428 - 585	586 +
After Housing Costs									
Couple with no children (equivalised income benchmark)	375	304	188	183	< 183	183 - 262	263 - 352	353 - 491	492 +
Single with no children	206	167	103	100	< 101	101 - 144	145 - 193	194 - 270	271 +
Couple with two children aged 5 and 11	552	447	276	268	< 269	269 - 385	386 - 517	518 - 721	722 +
Single with two children aged 5 and 11	383	311	191	186	< 187	187 - 267	268 - 359	360 - 500	501 +
Excluding the self-employed									
Before Housing Costs									
Couple with no children (equivalised income benchmark)	415	346	208	208	< 226	226 - 304	305 - 394	395 - 537	538 +
Single with no children	253	211	127	127	< 138	138 - 185	186 - 240	241 - 328	329 +
Couple with two children aged 5 and 11	607	506	303	304	< 329	329 - 444	445 - 575	576 - 784	785 +
Single with two children aged 5 and 11	444	371	222	222	< 241	241 - 325	326 - 422	423 - 575	576 +
After Housing Costs									
Couple with no children (equivalised income benchmark)	365	302	183	181	< 183	183 - 261	262 - 349	350 - 481	482 +
Single with no children	201	166	100	100	< 101	101 - 143	144 - 192	193 - 265	266 +
Couple with two children aged 5 and 11	537	444	269	266	< 270	270 - 383	384 - 513	514 - 708	709 +
Single with two children aged 5 and 11	373	308	186	185	< 187	187 - 266	267 - 356	357 - 491	492 +

Note:

This table takes levels of equivalised income for the population as a whole and translates them into cash equivalents for a selection of family types. For example, for results Before Housing Costs including the self-employed, it shows that 60 per cent of median (equivalised) income in 2004/05 was £210 per week. This implies that a single person without children needs a cash income of £128 or less to be below 60 per cent of median (equivalised) income for the population as a whole.