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## The income distribution in the UK: a picture of advantage and disadvantage

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## **Chapter 7: The income distribution in the UK: a picture of advantage and disadvantage**

Stephen P. Jenkins

### *Abstract*

Income is the most commonly used measure of material well-being. In a modern-day mixed economy, such as the UK, an individual's money income is the preeminent measure of their command over resources. This chapter describes the UK income distribution and how it has evolved over the last 50 years. It also includes some comparisons with the income distributions of other rich countries. The chapter provides multiple perspectives on the distribution of income over time focus on both the top and the bottom of the distribution as well as the spread of incomes: there is evidence about real income levels and inequality, and the prevalence of affluence and of poverty.

### *Keywords*

Inequality, poverty, affluence, income distribution, United Kingdom

## **Introduction**

This chapter provides a picture of advantage and disadvantage in Britain using the lens provided by the most commonly-used measure of individuals' material well-being, the income of the household to which they belong. Income is not the only indicator that may be used to characterise whether an individual is badly-off or well-off or to summarise the extent of poverty and affluence in a country overall. Complementary perspectives are provided by information about social inclusion and exclusion measured by a set of material deprivation indicators (Chapter 1), individuals' capabilities and functionings (Chapter 2), whether their human rights are realised (Chapter 3), or their social class (Chapter 4). Nonetheless, income-based measures are particularly important. In a modern-day mixed economy such as the UK's, individuals' money income (and their wealth, treated in Chapter 8) is the preeminent measure of their command over resources. For this reason, income is the principal focus of the statistics used to assess social progress in the UK and other rich countries. The strengths and weaknesses of using income to measure material living standards are not reviewed here. Instead, the aim of this chapter is to describe the distribution of income in the UK today, documenting how it has changed over the last 50 years and how it compares with those of international comparators such as other European and OECD countries.

The chapter provides multiple perspectives on the income distribution. I discuss evidence about the real income levels and inequality, as well as the prevalence of poverty and of affluence. In the concluding section, I reflect on some of the issues raised by the evidence. First, however, I explain the definitions and sources used in the chapter.

## **Definitions and sources**

Throughout the chapter (with an exception discussed below), an individual's 'income' is the *equivalised net income of the household* to which he or she belongs. This is equal to the total money income received by all household members from all sources minus income taxes and national insurance contributions paid and some other deductions, deflated by an equivalence scale factor that adjusts for differences in household size and composition, and adjusted using a price index to take account of inflation. A household is a 'single person or group of people living at the same address as their only or main residence, who either share one meal a day together or share the living accommodation (i.e. living room)' (Department for Work and Pensions 2014a: 227).

The specific money income sources included in the net income definition are those used by the Department for Work and Pensions' (DWP's) *Households Below Average Income (HBAI)* statistics are shown in Table 7.1. (These statistics are the UK's official statistics about the income distribution among persons.) Incomes are reported on a weekly basis. If someone reports earnings or other receipts over a longer period (e.g. an annual or monthly salary), the amount is converted to a weekly-equivalent amount pro rata.

**Table 7.1 The definition and sources of net household income: receipts and deductions**

| Income sources: receipts and deductions: |  |
|--|--|
|  | (a) usual gross earnings from employment   |
| +  | (b) earnings from subsidiary employment  |
| +  | (c) profit or loss from self-employment  |
| +  | (d) income from social security benefits and tax credits   |
| +  | (e) private and occupational pensions  |
| +  | (f) income from investments and saving   |
| +  | (g) private transfers and other income   |
| -  | (h) income tax paid (employees and self-employed)  |
| -  | (i) local tax paid (Council tax)   |
| -  | (j) National Insurance contributions (employee and self-employed)  |
| -  | (k) contributions to occupational pension schemes  |
| =  | <i>Net household income before the deduction of housing costs ('BHC')</i>  |
| -  | (l) Housing costs: rent (gross of housing benefits), mortgage interest payments, water rates and other water charges, structural insurance payments (owner-occupiers), and ground rent and service charges |
| =  | <i>Net household income after the deduction of housing costs ('AHC')</i>   |

*Notes.* Equivalised net household income is equal to net household income divided by an equivalence scale (to adjust for differences in household size and composition). Incomes in different years are adjusted by a year-specific price index to express them in constant purchasing power terms. See main text for further details.

There is an important distinction between net income before the deduction of housing costs (net income BHC) and net income after the deduction of housing costs (net income AHC). The *HBAI* statistics report income distribution estimates based on both definitions; the BHC definition is the one that is used by international organisations such as Eurostat and the OECD, and international data providers such as the Luxembourg Income Study, and is consistent with the recommendations of bodies such as the Expert Group on Household Income Statistics (2001). For this reason, my discussion focuses on distributions based on the net income BHC definition, but I also refer to AHC distributions measures where they lead to different conclusions about distributional trends. Observe that an increase in someone's Housing Benefit to cover an increase in their rent would be counted as an increase in their income according to the BHC measure even though the household's net spending power would be unchanged. Also, BHC measures do not take account of variations in housing costs, and a given amount of income will go less far in areas with high housing costs. On the other hand, AHC measures do not reflect the fact that housing costs represent choices made by

households about how they live. Among households with the same AHC income, those choosing to spend a higher share of their income on higher quality housing will be counted as having a better standard of living than those living in cheap, poor quality housing. For further discussion of BHC and AHC measures, see Johnson and Webb (1992).

In order to compare real living standards over time in constant purchasing power terms, taking account of the fact that £1 in 1990 is worth more than a £1 in 2000 because of inflation, all incomes are adjusted using a price index and expressed in the prices of a particular year (financial year 2012–13 below). This assumes that all groups in society experience same rate of price inflation. Evidence about differences in experience of inflation is provided by Flower and Wales (2014).

Equivalisation produces a measure of real living standards that is comparable across households in a given year. A money income of £500 per week (say) leads to higher living standards for a single householder than a childless married couple or a family of four. Looking at per capita income (total income divided by household size) would be one way of taking account of this issue, but this adjustment would not take account of potential economies of scale in the provision of household goods and services such as space, heat and light, food preparation and purchase, and so on. According to *HBAI* definitions, a net household income (BHC) of £500 per week for a married couple is equivalent in living standards terms to £750 pounds per week for a single householder (£500 is two-thirds not one-half of £750). Children add to household needs, of course, but not as much as an additional adult. According to *HBAI* definitions, a net household income of £500 per week corresponds to £417 per week in living standards' terms for a married couple with one child (aged less than 14 years), or £357 per week if there are two children. These adjustments are characterised as the so-called modified-OECD equivalence scale: see DWP (2014*b*) for further details and note the slightly different adjustment applied to AHC incomes.

The final step in defining the income distribution is the assumption that the household income total is shared equally within each household, so that each individual is attributed the equivalised income of the household to which he or she belongs. Individuals without income of their own, such as children, are assumed to benefit from income transfers by other individuals within the household. Supposing that complete income sharing is the universal rule is undoubtedly inaccurate, but it is also difficult to imagine what other assumptions would be more appropriate as a general rule. The equal-sharing assumption is widely adopted by analysts and statistical agencies around the world, not only in the UK. The assumption and alternatives are analysed by Jenkins (1991). There is also the issue of whether the aggregate

‘income unit’ should be taken to be the household, or the more narrowly defined nuclear family. The National Equality Panel (2010) additionally provides information about the distribution of ‘individual incomes’ – the distribution arising were each adult to benefit only from the income that he or she received and be unaffected by that of other household members.

Estimates of income distributions using these definitions are derived in the UK using data from the Family Resources Survey, a large household survey that has been running since the early 1990s. Data for earlier years (back to 1961) come from the Family Expenditure Survey. At several points below, I supplement the survey-based estimates with information derived from income tax data from Her Majesty’s Revenue and Customs (HMRC). For assessing economic advantage (rather than poverty), tax data have benefits compared with household surveys because there is better coverage of the top of the income distribution and, arguably, measurement error may be less. In addition, sample sizes are much larger and some data series go back to the beginning of last century. On the other hand, the distributional definitions are less satisfactory because ‘income’ for tax purposes differs from the more comprehensive measures discussed earlier. The tax data definitions refer to gross taxable (or after-tax) income of tax units (which in the UK refer to individuals since 1990). Moreover, the most detailed data (from the Survey of Personal Incomes) refer to taxpayers rather than to the full population, thereby excluding all those in receipt of low (below tax) or zero incomes.

The final point to note about definitions is that this chapter is about income. Income is not the same as ‘consumption’, which refers to the resources actually enjoyed by households (measured in terms of their spending) rather than their potential command over resources. Income is arguably a better indicator of someone’s economic power, and not dependent on choices about how they spend their money. (For comparisons of distributions of consumption expenditure and income in the UK, see Brewer and O’Dea (2012).) Also, income and consumption each refer to flows per period, and should be distinguished from the stock of financial assets at a particular point in time, i.e. wealth. The distribution of wealth is the subject of Chapter 8.

### **The UK income distribution, 2012–13**

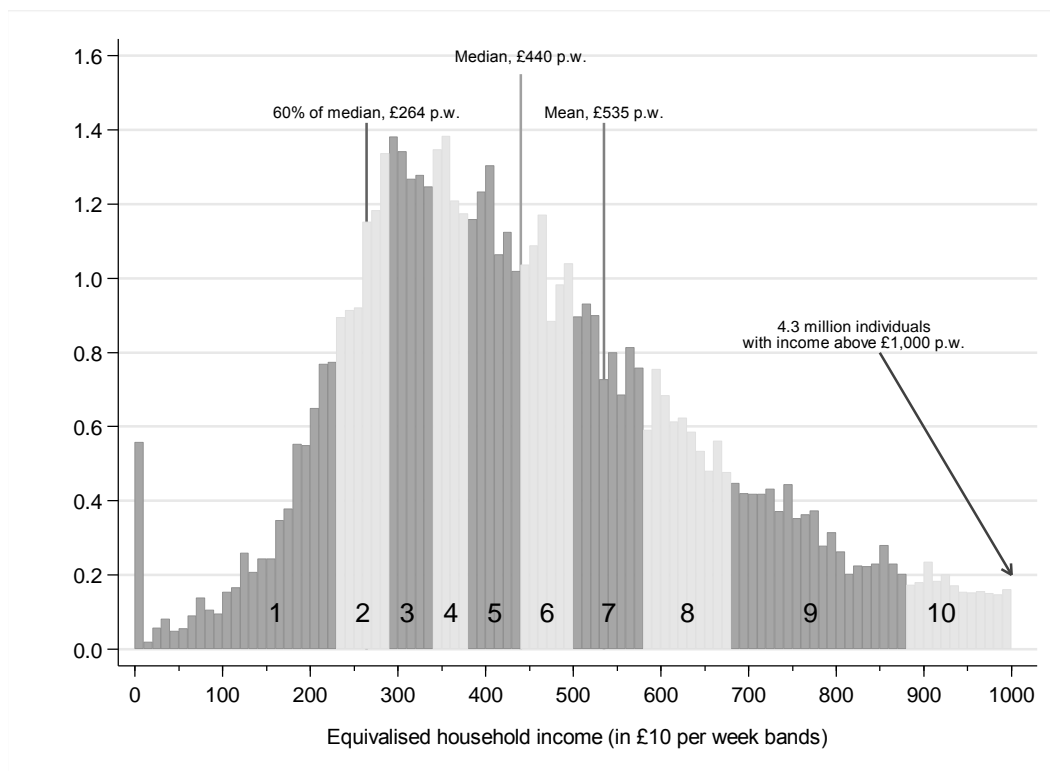
The UK’s income distribution in 2012–13 (BHC definition) is pictured in Figure 7.1 The chart shows the numbers of individuals with (equivalised) incomes in each £10 band between zero and £1000 per week. The stripes classify individuals according to where they stand in

the income parade that orders them from poorest to richest. The poorest tenth (decile group 1) are on the left and the richest tenth (decile group 10) on the right, with the other eight decile groups in between. The frequency distribution is not bell-shaped as with a Normal distribution; rather, it is skewed with a long right-hand tail. Not all of the very richest individuals can be shown on the chart: the income of the person in the middle of richest tenth (the 95<sup>th</sup> percentile) is £1,117 per week, and there are around 2.93 million people with incomes above this amount.

The greatest concentration of individuals along the income range is between about £250 and £400 per week (the frequencies are greatest, and the stripes narrowest). The middle income (the median or 50<sup>th</sup> percentile) is £440 per week, which is only 82% of the average (mean) income of £535 per week. The person with average income is found some two-thirds of the way along the income parade (i.e. between the 60<sup>th</sup> and the 70<sup>th</sup> percentile) and hence not particularly representative of ‘middle incomes’. Also shown in Figure 7.1 is the value of the most-commonly used poverty line in the UK and Europe (60 per cent of median income). The threshold was £264 per week in 2012–13, and it can be seen around 15 percent of individuals were income-poor in 2012–13. I provide more detail about the prevalence of disadvantage provided later in the chapter.

Finally, observe the perhaps surprisingly large number of individuals with an income between £0 and £10 per week. Although this refers to fewer than 1 per cent of the UK population, the number raises questions about the accuracy of measurement of very low incomes. On this, see Brewer et al. (2009).

**Figure 7.1. The UK income distribution, 2012–13**



*Notes.* Graph drawn by the author using data from the spreadsheet accompanying Chart 2.4 (BHC) in DWP (2014a).

The HBAI data also tell us *who* the poorest and richest individuals were in 2012–13. Table 7.2 shows the composition of the poorest tenth and the richest tenth, using a range of subgroup definitions that classify individuals according to their or their family’s characteristics.

Table 7.2 shows, for example, that adult men and women and children are represented in the poorest tenth in proportion to their numbers in the population as a whole, but men are over-represented in the richest tenth (45 per cent compared to 38 per cent) and children are under-represented (16 per cent compared with 21 per cent).



**Table 7.2. Composition of the poorest and richest tenths of the 2012–13 income distribution, by subgroup**

| Subgroup                                   | Subgroup share (%) of: |               |            |
|--|------------------------|---------------|------------|
|  | Poorest tenth          | Richest tenth | Population |
| <i>Sex and adulthood</i>                   |                        |               |            |
| Adult man                                  | 38.6                   | 45.0          | 38.3       |
| Adult woman                                | 39.5                   | 39.6          | 40.5       |
| Child                                      | 21.9                   | 15.5          | 21.2       |
| <i>Family type</i>                         |                        |               |            |
| Pensioner couple                           | 10.3                   | 12.3          | 13.6       |
| Single male pensioner                      | 1.9                    | 1.3           | 1.9        |
| Single female pensioner                    | 7.5                    | 1.7           | 5.2        |
| Couple with children                       | 32.4                   | 32.6          | 34.9       |
| Single with children                       | 10.1                   | 1.0           | 8.0        |
| Couple without children                    | 13.1                   | 35.3          | 18.4       |
| Single male without children               | 16.0                   | 10.9          | 10.8       |
| Single female without children             | 8.6                    | 5.1           | 7.2        |
| <i>Economic status</i>                     |                        |               |            |
| One or more self employed                  | 14.8                   | 18.1          | 9.8        |
| Single/couple all in full time work        | 4.9                    | 45.7          | 26.2       |
| Couple/one in full time, one part time     | 2.6                    | 13.2          | 13.1       |
| Couple, one full time one not working      | 8.3                    | 8.2           | 10.5       |
| No full time, one or more part time worker | 15.0                   | 5.2           | 10.1       |
| Workless, head or spouse aged 60 or over   | 20.7                   | 6.7           | 17.3       |
| Workless head or spouse unemployed         | 14.6                   | 0.7           | 3.8        |
| Workless, other inactive                   | 19.2                   | 2.3           | 9.3        |
| <i>Region</i>                              |                        |               |            |
| Rest of the UK                             | 75.3                   | 55.4          | 73.2       |
| London and South East                      | 24.7                   | 44.6          | 26.8       |

*Notes.* Author's estimates using data from the public-use file of unit-record HBAI data (accompanying DWP 2014a). Reading note: 38.6% of the poorest tenth and 45.0% of the richest tenth in 2012–13 were adult men; 38.3% of the total population were adult men.

Individuals from pensioner couples, and couples with and without children, are under-represented in the poorest tenth relative to their numbers in the population as a whole (see *Family type*). Over-represented are single female pensioners, individuals in lone parent families, and childless singles. In the richest tenth, almost all groups are under-represented, with one striking exception. Childless couples are substantially over-represented, and account for more than one-third of the richest tenth though they comprise only 18 per cent of the population.

Looking at *Economic status*, Table 7.2 shows that over- and under-representation at the top and bottom is closely associated with participation in paid employment. For example, individuals in benefit units in which all adults are in full-time work are substantially under-

represented in the poorest tenth (5 per cent compared with their population proportion of 26 per cent) and substantially over-represented in the richest tenth (46 per cent compared to 26 per cent). The situation is reversed for non-pensioner families in which the head or spouse is unemployed: individuals in this group comprise almost 4 per cent of the population, but nearly 15 per cent of the poorest tenth and less than 1 per cent of the richest tenth. By contrast, individuals belonging to a family with self-employment income are over-represented in both the poorest and the richest tenths. The *Region* panel illustrates that, although there is no difference in the composition of the poorest tenth, people living in London and the South East form a substantially greater fraction of the richest tenth than would be expected from their relative numbers in the country as a whole (45 per cent compared to 27 per cent).

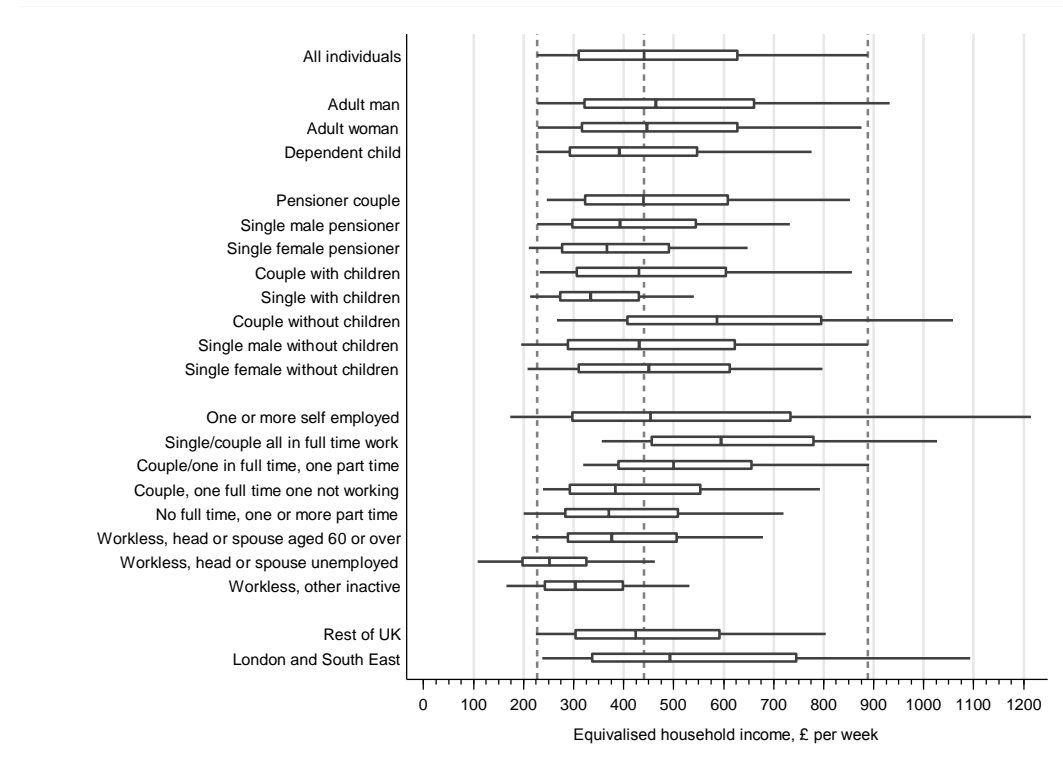
The range of incomes within each of the various subgroups is summarised in Figure 7.2 using boxplots. The left and right hand ends of the box for each group show the 25<sup>th</sup> and 75<sup>th</sup> percentiles for that group (half the group have incomes within this range). The end of the ‘whisker’ extending left from the box shows the 10<sup>th</sup> percentile for the subgroup, whereas the end of the right whisker shows the 90<sup>th</sup> percentile (80 per cent of the subgroup have incomes within the range spanned by the box and whiskers). Subgroup median income (50<sup>th</sup> percentile) is shown by the black bar within the box. The vertical dashed lines show the 10<sup>th</sup>, 50<sup>th</sup>, and 90<sup>th</sup> percentiles for the population as a whole (‘all individuals’; as also shown in Figure 7.1), and hence demarcate the thresholds used to define the poorest and richest income groups in Table 7.2. When the whisker crosses the horizontal lines, the subgroup is over-represented in the top or bottom decile group, as we saw in Table 7.2.

The boxplots, therefore, illustrate both subgroup income levels and the range of subgroup incomes. Individuals in families with children, and dependent children in particular, tend to have lower incomes than other groups. Although the distribution among all women closely mimics that of the population as a whole, there are groups of women who are clearly worse off: look at the plots for single female pensioners and the ‘single with children’ group (most of whom are in families headed by lone mothers). In contrast, childless couples have relatively high incomes: almost three-quarters of this group have an income above the population median.

Figure 7.2 highlights again the importance of paid employment for income, with distributions further to the left (lower) as the degree of participation falls. For example, contrast individuals in benefit units in which all individuals are in full-time work (more than 75 per cent have an income above the population median) with individuals in a family with

an unemployed head or spouse (almost 90 per cent have an income below the population median). Families with self-employed members are a distinctive case because of the relatively high prevalence of both low incomes and (especially) very high incomes. Substantially more than one-tenth of this group have an income placing them in the richest five per cent of the population as a whole.

**Figure 7.2. Income distributions for population subgroups, UK, 2012–13**



*Notes.* Each subgroup’s boxplot shows the 10<sup>th</sup>, 25<sup>th</sup>, 50<sup>th</sup>, 75<sup>th</sup>, and 90<sup>th</sup> percentiles for the relevant subgroup: see the main text. The vertical dashed lines show the 10<sup>th</sup>, 50<sup>th</sup>, and 90<sup>th</sup> percentiles for the population as a whole (‘all individuals’). Graph drawn by the author using data from the spreadsheet accompanying IFS (2014) for ‘all individuals’ and his calculations using data from the public-use file of unit-record HBAI data (accompanying DWP 2014a) for all other groups. Incomes in the public-use HBAI file are rounded to the nearest pound.

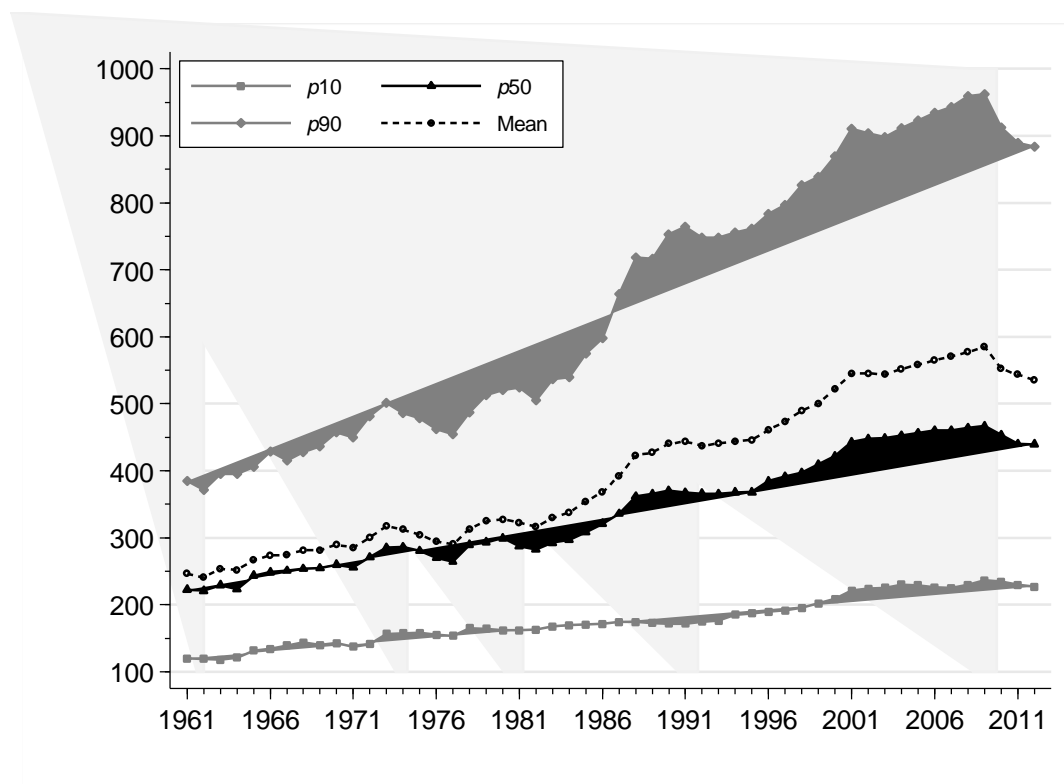
The bottom of Figure 7.2 highlights the relative affluence of most individuals living in London and the South East. The person at the 75<sup>th</sup> percentile for this region’s distribution is clearly within the richest twentieth of the population ranked by income (see Figure 7.1), whereas the corresponding person in the distribution for the rest of the UK is on the borders of the richest seventh and eighth tenths nationally. More than 10 per cent of individuals living in London and the South East are in the richest 5 per cent of the population.

## 7.2 Trends in real income levels since 1961

Have looked at the contemporary distribution of income, I now consider how the distribution has changed over time. Conclusions about the extent to which real incomes have been rising depend a lot on how long one looks back and which part of the income distribution one considers. See Figure 7.3, which shows income levels at the 10<sup>th</sup>, 50<sup>th</sup>, and 90<sup>th</sup> percentiles, as well as the mean. Grey stripes demarcate recessions. Appendix Table A1 summarises the trends shown in the graph, providing income growth rates for the period as a whole and subperiods within it. (All the Appendix tables and figures cited in this chapter are available at <http://sticerd.lse.ac.uk/dps/case/cp/casepaper186.pdf>.)

Looking at the fifty-year period since 1961, the general picture is of rising incomes for all, punctuated by short periods of slow or negative growth accompanying recessions. The sharpest deviation from trend is the period after 2007, i.e. following the most recent recession, though it should be noted that a slowing in income growth is also apparent earlier – from the beginning of the 2000s – and there was also a period of little growth in the early-1990s.

**Figure 7.3. Trends in real income levels since 1961**



*Notes.* Graph drawn by the author using data from IFS (2014). The grey strips identify periods with at least two consecutive quarters of negative real GDP growth.  $p_{10}$ ,  $p_{50}$ , and  $p_{90}$  are the 10<sup>th</sup> percentile, 50<sup>th</sup> percentile (median), and 90<sup>th</sup> percentile, respectively. The data refer to financial years from 1994 onwards, and the estimates to the UK from 2002–03 and Great Britain in earlier years. See Appendix Table A1 for numerical estimates of growth rates for the period as a whole as well as subperiods.

Also striking is the differential income growth across the income range: growth has been greatest at the top and small at the bottom. Over the five decades between 1961 and 2012, the 90<sup>th</sup> percentile grew by 130 per cent (equivalent to a rate of around 1.6% per year), the median grew by 97 per cent and the 10<sup>th</sup> percentile by 89 per cent (equivalent to 1.3% per year in both cases). Although income falls were greatest for the richest groups between 2007 and 2012 (the 90<sup>th</sup> percentile fell by 6.2% per year; the 10<sup>th</sup> percentile by 0.2% per year), this reversal of fortunes is small if compared with the longer-term trend of growing real incomes at the top.

The fall in real incomes across the income distribution after the most recent recession is not as dramatic as the squeeze on real wages reported by Gregg, Machin, and Fernández-Salgado (2014), particularly at the bottom of the distribution. Several factors are likely to explain this. For example, a fall in real wages of one household member might be offset by more work hours by another household member. Household composition may itself change: e.g. young people may be more likely to live with their parents or share with others. And the

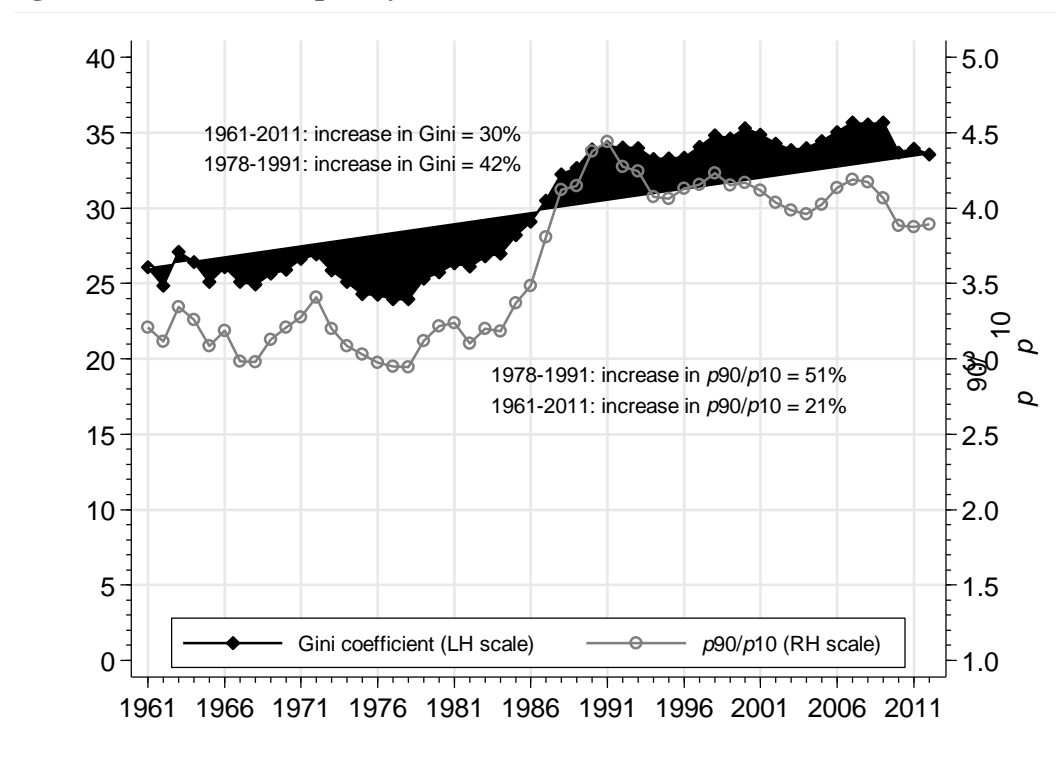
safety net income provided by benefits and tax credits has continued to provide a real income floor.

## **Inequality**

The growing gap between top and bottom incomes shown in Figure 7.3 implies growth in income inequality. Inequality is summarised directly in Figure 7.4, in terms of the ratio of the 90<sup>th</sup> to the 10<sup>th</sup> percentile ( $p90/p10$ ) and the Gini coefficient. Regardless of which index is used, the rise in inequality over the last fifty years has been substantial: between 1961 and 2012, the Gini rose by almost one-third and  $p90/p10$  by around one half. Most of that inequality growth occurred in the 1980s. Clearly this is an exceptional period: within both the preceding two decades and the subsequent two, the two inequality series are relatively flat, with relatively small year-on-year changes. Nonetheless, there is a small but distinct decline in  $p90/p10$  after 1991 that is not apparent in the Gini coefficient. This reflects changes in the distribution of incomes below the median to which the Gini is not as sensitive.

Inequality declined during the most recent recession, reflecting the larger income falls for those at the top compared to those at the bottom, but even this inequality decline is relatively small and a bit smaller than the decline in the early- to mid-1970s (when inequality was much lower).

**Figure 7.4. Income inequality since 1961**



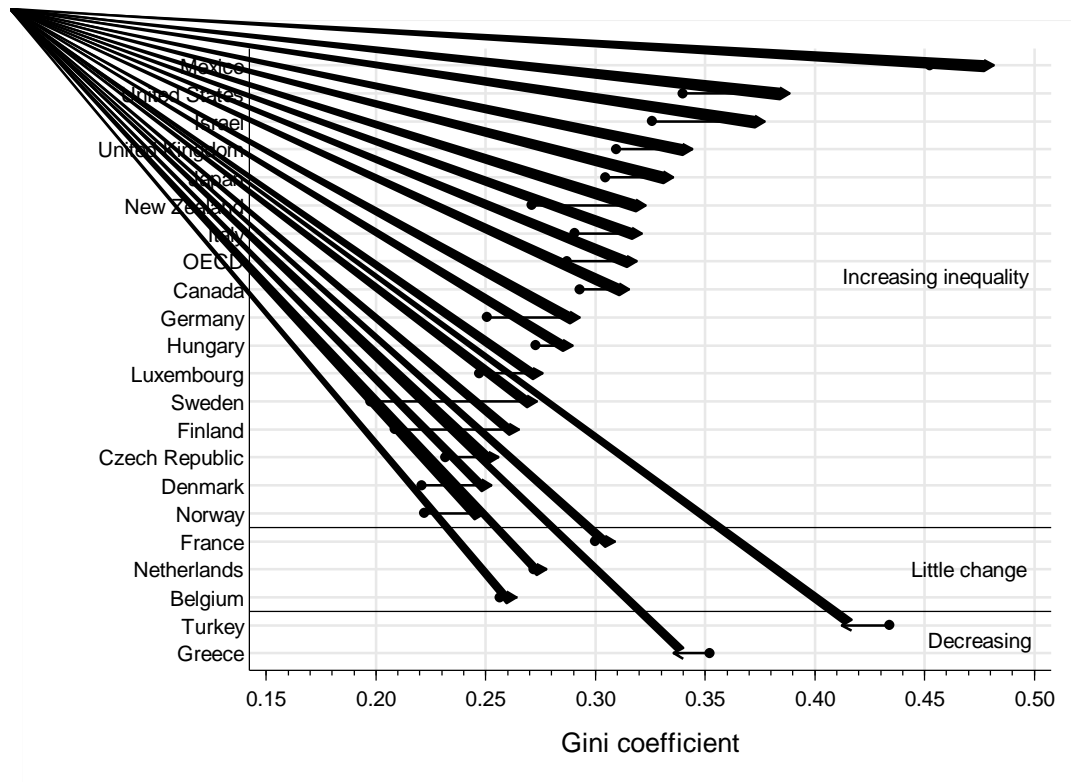
*Notes.* Graph drawn by the author using data from IFS (2014). The data refer to financial years from 1994 onwards, and the estimates to the UK from 2002–03 and Great Britain in earlier years.

The level and trend in inequality in the UK is compared with those of 20 other OECD countries in Figure 7.5 (the distributional definitions are similar to those employed in previous figures). Countries are grouped according to whether inequality fell, increased, or remained much the same, between the mid-1980s and 2011–12, with inequality measured using the Gini coefficient. The UK’s estimate for 2011–12, around 0.34, places it just above the average in the 21-country ranking (the OECD Gini was around 0.32) but, if middle-income countries such as Mexico and Turkey are excluded, the UK shows up more clearly as a high-inequality country relative to other rich countries. Inequality in the UK is not as great as in the USA, however.

Figure 7.5 also shows that the majority of OECD countries experienced inequality growth over the last quarter century; it was not only the UK. Moreover, the magnitude of the increase was greater in a number of other countries besides the UK, several of which were relatively low-inequality countries in the mid-1980s (Finland, Sweden, and Germany). Be aware, however, that the inequality-increase rankings are contingent on the period considered: the increase in the UK during the 1980s, shown earlier, was substantial by cross-national standards; and is only partly reflected in the change measured in Figure 7.5 since the

mid-1980s Nonetheless, we can also see that an increase in inequality is not inevitable: inequality changed hardly at all in France, the Netherlands, and Belgium.

**Figure 7.5. Income inequality in 21 OECD countries: mid-1980s and 2011/12**



*Notes.* Graph drawn by the author using data in the spreadsheet accompanying OECD (2014, Figure 1). This source provides details of the actual years compared for each country. ‘Little change’ in inequality refers to changes of less than 1.5 percentage points. Countries are ordered within each panel by their Gini coefficient for 2011/12. Income is household disposable income adjusted for household size.

If the comparison is with the EU-15 as a whole, income inequality in the UK has been greater for most of the last decade but in 2013 was about the same. At the beginning of the 2000s, the UK Gini was around four percentage points greater than the EU-15 Gini, but the former subsequently declined and the latter increased. (See Appendix Figure A2.)

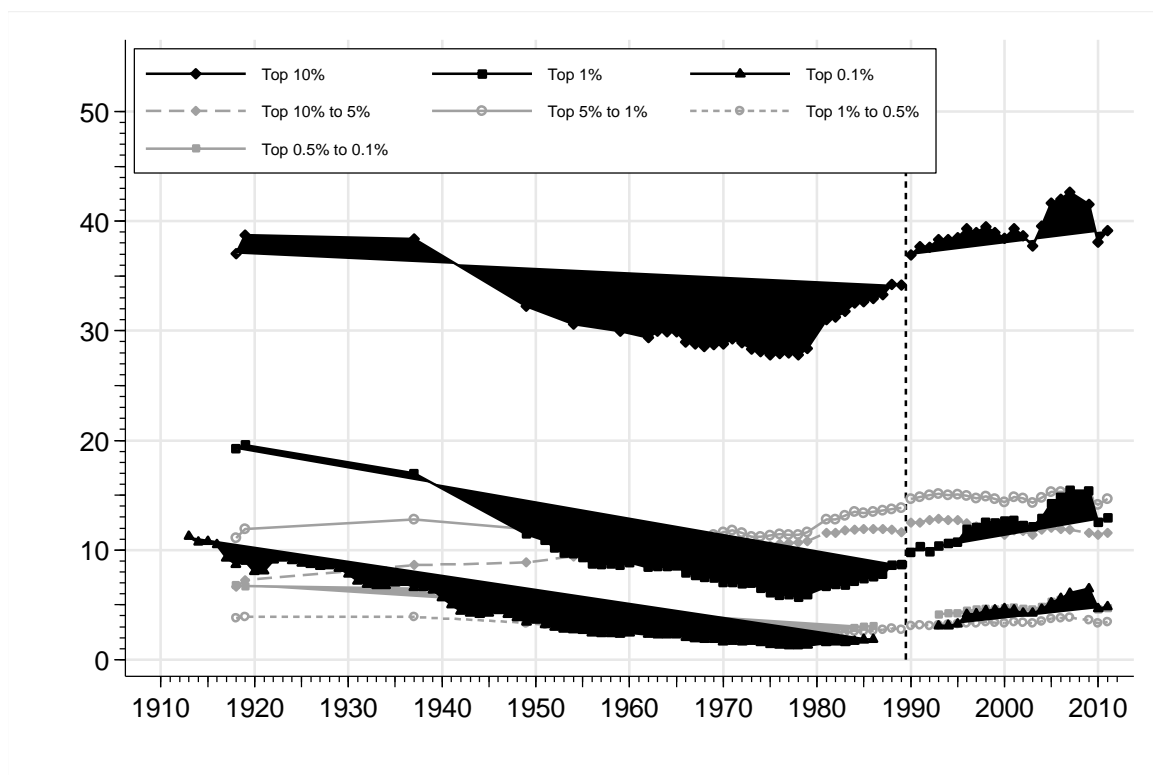
Much of the trend in UK inequality has been driven by what happens to top incomes and yet estimates derived from household surveys (such as shown in Figure 7.3) may miss what is going on at the very top of the income distribution. In contrast, income tax data have better coverage of the richest incomes and provide estimates for a much longer period.

Estimates of top income shares derived from tax data are shown in Figure 7.6 and go back almost a century. The series shown in black shows trends in the share of total income held by the richest 10%, 1%, and 0.1%. The share of the top 10 per cent in 2011, around 40 per cent of total income, is much the same as it was just after World War I. Over the



subsequent six decades, the share declined by around 10 percentage points, but increased steadily thereafter albeit with a pause associated with the most recent recession. A U-shaped trend is also apparent for the shares of the top 1% and top 0.1%, though the inequality increases since the late 1970s have not taken the shares back to World War I levels. Also shown are trends in the shares of nearly-top groups variously defined (the series in grey) and, intriguingly, there is no distinct U-shape to these series to the extent that there is for the others. This implies that the U-shape trends for top income shares are mostly being driven by what is happening to the very richest group (the richest 0.1% in this case).

**Figure 7.6. Top income shares (%) in the UK over the last 100 years**



*Notes.* Graph drawn by the author using data from the World Top Incomes Database (Alvaredo et al. 2014). The vertical dashed line marks the change in the definition of the tax unit from the family to the individual in 1990.

Thus, even though inequality in the UK has not grown much over the last two decades according to HBAI-based measures (Figure 7.4), the evidence from tax data about top income shares suggests a continuing and substantial rise in inequality over this period. Put differently, recent inequality trends are a story of greater differentials that are driven by increasing advantage of the best off. The UK experience is similar to that of other ‘Anglo’ countries such as the USA, but is less apparent in other countries such as Germany, and especially France where the long inequality decline has not been followed by a large

inequality rise. See Appendix Figure A3 and, for more extensive cross-national comparisons, Atkinson, Piketty, and Saez (2011).

### **The prevalence of poverty**

Historically, social policy has been particularly concerned with the prevalence of poverty rather than other aspects of income distribution (see Chapter 1). As this volume makes clear, one should think of the organisation of society along a continuum of advantage and disadvantage, and looking at the whole of the income distribution reflects this position. Nonetheless, the situation of the worse-off people in society is often of pressing interest because of individual welfare considerations. Trends in income poverty are therefore the subject of this section.

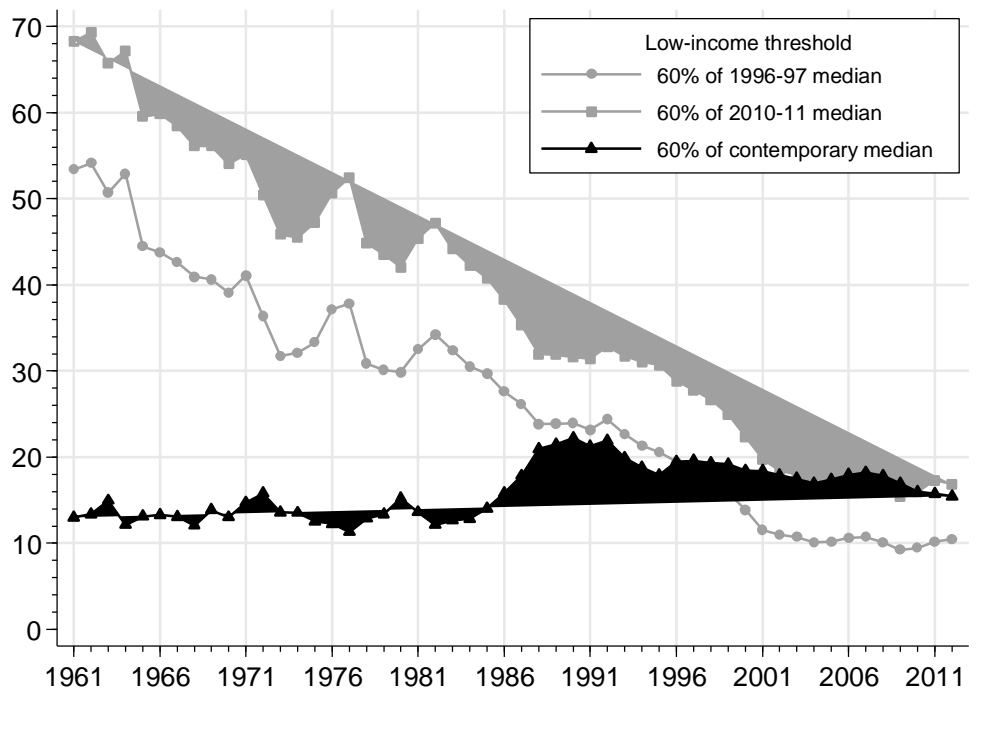
A fundamental issue is how the income cut-off that differentiates poor people from non-poor people should be defined. The threshold most commonly employed by the European Union, and the UK as well, is 60 per cent of contemporary national median income. The ‘contemporary national’ tag means that the poverty line varies from one year to the next (as median income changes), and differs in real terms across countries: UK median income is substantially greater than Romanian median income, for instance.

This ‘relative poverty’ definition implements – in a particular way – the idea that ‘[p]eople are said to be living in poverty if their income and resources are so inadequate as to preclude them from having a standard of living considered acceptable in the society in which they live’ (Council of the European Union, 2004: 8). Although a relative poverty definition has many conceptual attractions, it can lead to implausible estimates in times of economic boom or sharp recession when the median income itself can change substantially (Jenkins et al., 2013: chapter 1).

This suggests that more ‘absolute’ poverty threshold definitions be employed in tandem with relative ones. However, few would seriously argue that a fully absolute definition – a real income cut-off that is fixed over time and the same for all countries – is appropriate for rich countries such as the UK. More commonly used for assessing trends are ‘anchored’ poverty lines. The idea is that poverty in the current year and previous years be assessed using a threshold that is fixed at the value of the relative poverty line for an earlier (but relatively recent) year. Thus, DWP HBAI publications supplement estimates based on a cut-off of 60 per cent of contemporary national median income with estimates based on a

threshold equal to 60 per cent of 2010–11 median income or (previously) the 1998–99 median. The Institute for Fiscal Studies has provided data on anchored poverty rates using the 1996–97 median, which I use here alongside those for the 2010–11 median. Estimates of poverty rates for the last fifty years based on the relative and two anchored thresholds are shown in Figure 7.7.

**Figure 7.7. Poverty rates (%) since 1961: relative and anchored poverty lines**



*Notes.* Graph drawn by the author using data from IFS (2014). The data refer to financial years from 1994 onwards, and the estimates to the UK from 2002–03 and Great Britain in earlier years. The BHC income definition is used (see text).

Clearly, the choice of low-income cut-off makes a substantial difference to estimates of both the prevalence of poverty in recent years, and its trend over time. Using the relative poverty line based on contemporary medians, the poverty rate fluctuated between around 12 per cent and 15 per cent in the twenty years after 1961, then increased sharply to reach more than 20 per cent in the late-1980s, and has been gradually declining since the early 1990s. In particular, the poverty rate continued to decline during the recent recession – because the median also fell (Figure 7.3). According to the relative poverty line definition, the UK poverty rate in 2012–13 was 15.4 per cent, corresponding to around 9.7 million poor people.

The poverty experience differs for particular subgroups. Of particular relevance for policy in recent years has been child poverty and pensioner poverty. At the beginning of the

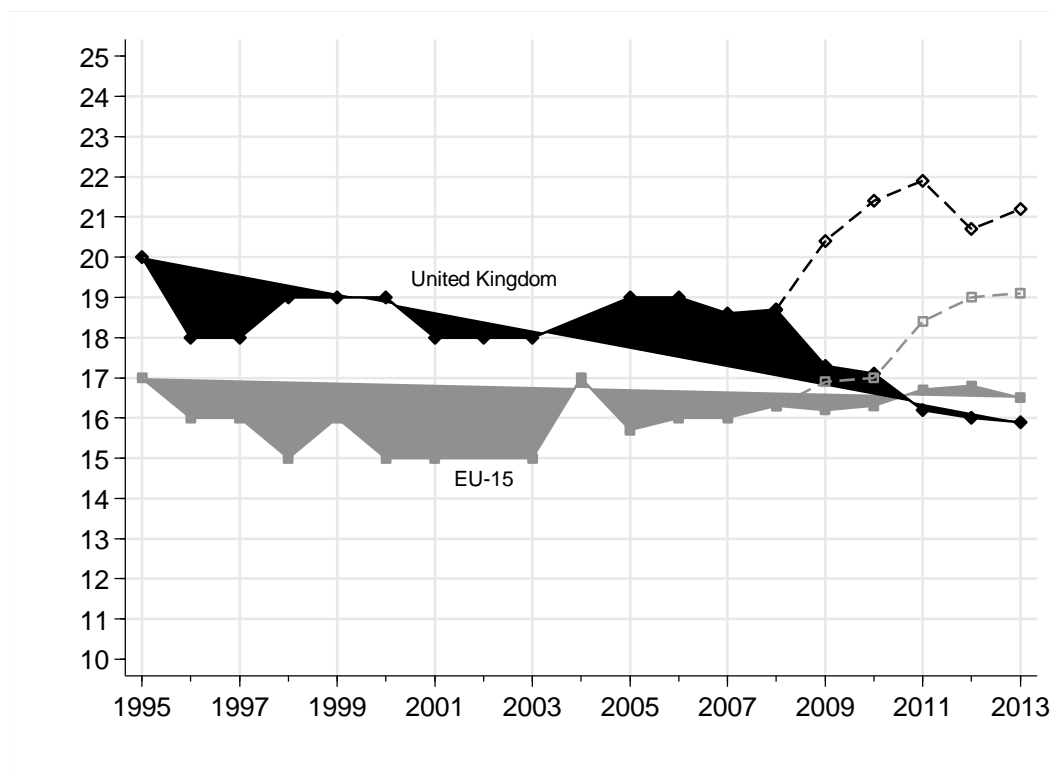
1990s, the child poverty rate was nearly 10 percentage points higher than the all-persons rate, but it has declined at a faster pace and was only two percentage points larger in 2012–13. The decline in pensioner poverty rates has been substantial, from around 40 per cent in the 1960s to the same as the all-persons rate in 2012–13, albeit with large increases and declines in between. See Appendix Figure A4 for details. For more extended discussion of long-run trends, see Cribb et al. (2013: chapter 5).

These estimates are based on a BHC income definition. If, instead, an AHC income definition is used, the picture of poverty levels and trends is different, especially since the 1990s. In 1990, the AHC relative poverty rate was 24 per cent (compared to a BHC rate of 21 per cent) but did not decline at the same rate thereafter. In 2012–13, the AHC relative poverty rate was 21 per cent (13.2 million people), i.e. around six percentage points greater than the BHC rate for that year. See Appendix Figure A5 for details.

The BHC series based on anchored poverty lines show a substantial decline in poverty rates over the last five decades. For example, according to the relative poverty standards of the mid-1990s, more than half of the UK population was poor in the early 1960s, but only one-tenth five decades later. The rate of decline in both anchored series slows noticeably from around 2000 onwards – which is unsurprising given the slowing of income growth rates at the bottom of the distribution around that time (Figure 7.3). Observe as well, and by contrast with the relative poverty series, that both anchored poverty series show a rise in the poverty rate with the recent recession (albeit a relatively small one).

The UK had a relative poverty rate two or three percentage points higher than the EU-15 average from 1995 until around 2009, after which the rates converged: the UK rate declined (reflecting the falling UK median) and the EU-15 rate increased slightly. See Figure 7.8. Again, using anchored poverty lines for each country (60 per cent of national medians in 2008) reveals a different picture for the post-recession period. In particular, both the UK and EU-15 poverty rates are estimated to increase by around two percentage points in the following four years, and so the differential is maintained.

**Figure 7.8. Poverty rates (%) using relative and anchored thresholds: UK and EU-15 average**



*Note.* Graph drawn by author using EU-SILC-based estimates reported in Eurostat (2014, series *ilc\_li02* and *ilc\_li22b*). The solid lines show poverty rates calculated using a relative threshold (60% of contemporary national median income); the dashed lines show poverty rates calculated using an anchored threshold (60% of national median income in 2008). Estimates of anchored poverty rates are available only from 2008 onwards.

### The prevalence of affluence

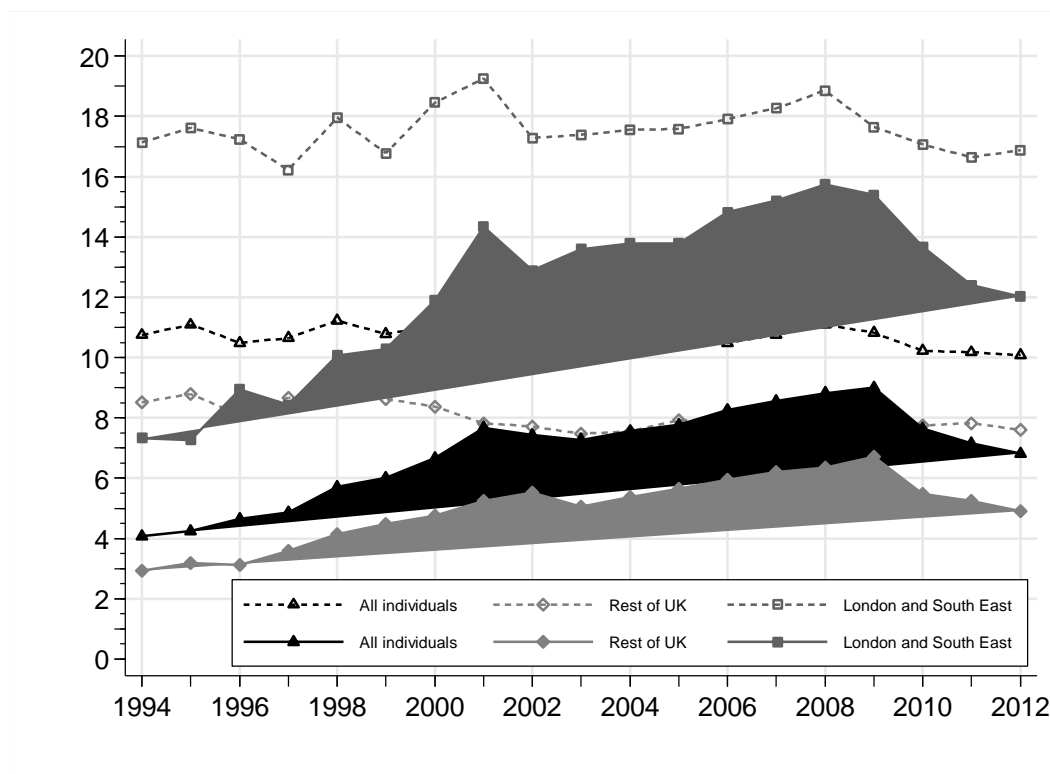
The prevalence of affluence can also be assessed in terms of relative and anchored thresholds and, again, the specific choice is somewhat arbitrary. (The few researchers who have looked at the prevalence of affluence have used a range of definitions; there are no commonly-precedents as in the poverty case. There is also the problem that the higher the threshold, the more statistically unreliable the estimates may be.) For the purposes of this chapter, I use twice the contemporary median as a relative threshold, and a fixed real income threshold equal to £1,000 per week in 2012–13 prices.

Estimates using these two thresholds are shown in Figure 7.9, and derived from the same data that are used to compile the DWP’s HBAI statistics. The proportion of persons with an income greater than twice the contemporary median has remained remarkably stable since the mid-1990s, at around 11 per cent. (Remember that the median, and hence the value

of twice-median threshold also rose over this period: Figure 7.3.) The figure also highlights substantial differences in the prevalence of affluence in London and the South East (a rate of around 17 per cent over the last two decades) with the its prevalence in the rest of the UK (a rate of around 8 per cent).

With the fixed £1,000-per-week threshold, the prevalence of affluence steadily increased, more than doubling from around 4 per cent in the mid-1990s to around 9 per cent in 2009, after which the rate fell by several percentage points. Again, individuals living in London and the South East had higher rates than those in the rest of the UK throughout the period, but the trends for each group mimicked the national picture.

**Figure 7.9. Percentages of individuals with an equivalised income greater than twice the contemporary median (dotted lines) or greater than £1000 per week (2012–13 prices) (solid lines)**

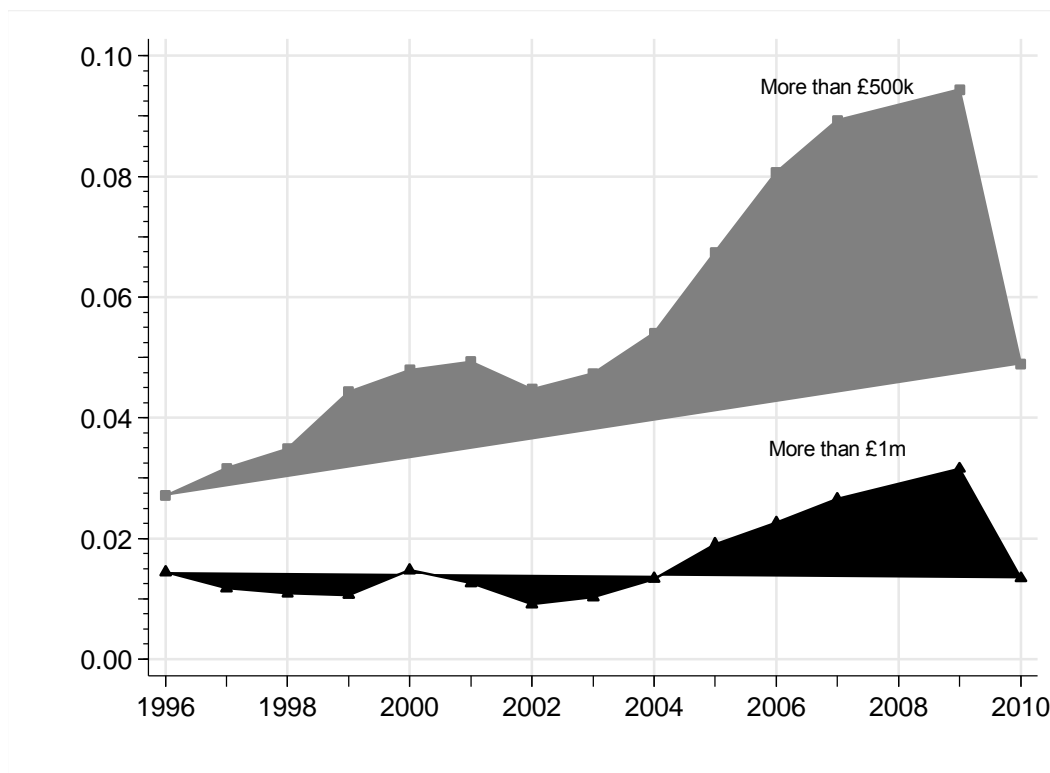


*Notes.* Graph drawn by the author using public-use files of HBAI unit record data accompanying DWP (2014a). The income definition is the same as the BHC definition used in Figures 7.1–7.4. The data refer to financial years from 1994 onwards, and the estimates to the UK from 2002–03 and Great Britain in earlier years.

The advantage of summaries such as Figure 7.9 is that they use the definitions of income and income-receiving unit routinely used to assess the income distribution in the UK. However, as discussed earlier, the coverage of the very top incomes in the underlying household survey data is not as good as that in income tax data.

Changes in the prevalence of affluence in the UK between 1995–96 and 2010–11 estimated from income tax data are summarised in Figure 7.10 using two absolute thresholds: £500,000 per year and £1,000,000 per year of after-tax income in 2012–13 prices. (These thresholds are substantially higher than the £1000 (equivalised) per week used for Figure 7.9.) By HBAI standards, an income above these cut-offs would place a person well into the top 1 per cent of the income distribution. These estimates refer to proportions of all taxpayers, not to proportions of the population as a whole (or to proportions of all adults as in the top income shares discussion). Most non-taxpayers have little or no income. (In 2010–11, there were around 31.3 million taxpayers, but the UK population was around 60 million, so to be expressed as fractions of the population or all adults, the percentages shown in the figure would need to be adjusted downwards.)

**Figure 7.10. Percentages of taxpayers with an after-tax income greater than £500,000 and greater than £1 million pounds per year (2012–13 prices)**



*Notes.* Years shown are financial years, e.g. 2010 refers to 2010–11. The data refer to taxpayers only, and are not available for 2008–09. Data for 1995–96 are not used because of a series discontinuity (introduction of self-assessment and changes to the SPI methodology). Graph drawn by the author using data from the public-use files of the *Survey of Personal Incomes* (various years). Incomes converted to 2012–13 prices using within-year averages of the monthly Consumer Price Index for each financial year.

Figure 7.10 shows that the proportion of taxpayers with an after-tax income of more than £500,000 per year rose fivefold between the mid-1990s and the late-2000s, from around

0.02 per cent to nearly 0.10 per cent. The growth in the prevalence of taxpayers with an after-tax income of more than £1 million per year is more muted. The proportion remained at around 0.01 per cent from the mid-1990s until the early 2000s, but increased thereafter and by 2009–10 it was some three times higher. (The numbers of taxpayers involved is still only a few thousand.)

The marked rise in the prevalence of affluence appears to go into reverse after 2009–10, with both series showing much lower rates for 2010–11, with the fraction of millionaire taxpayers roughly halving for example. One obvious explanation for this reversal of fortunes is the recent recession. However, other more subtle changes mean that one has to be cautious about interpreting the 2010–11 estimates. In particular, a 50 per cent marginal rate of income tax was introduced in April 2010, and the announcement and introduction of this tax rate provided incentives for high income tax payers to bring forward income to 2009–10 that would otherwise have been reported in 2010–11 income tax returns or possibly later years.

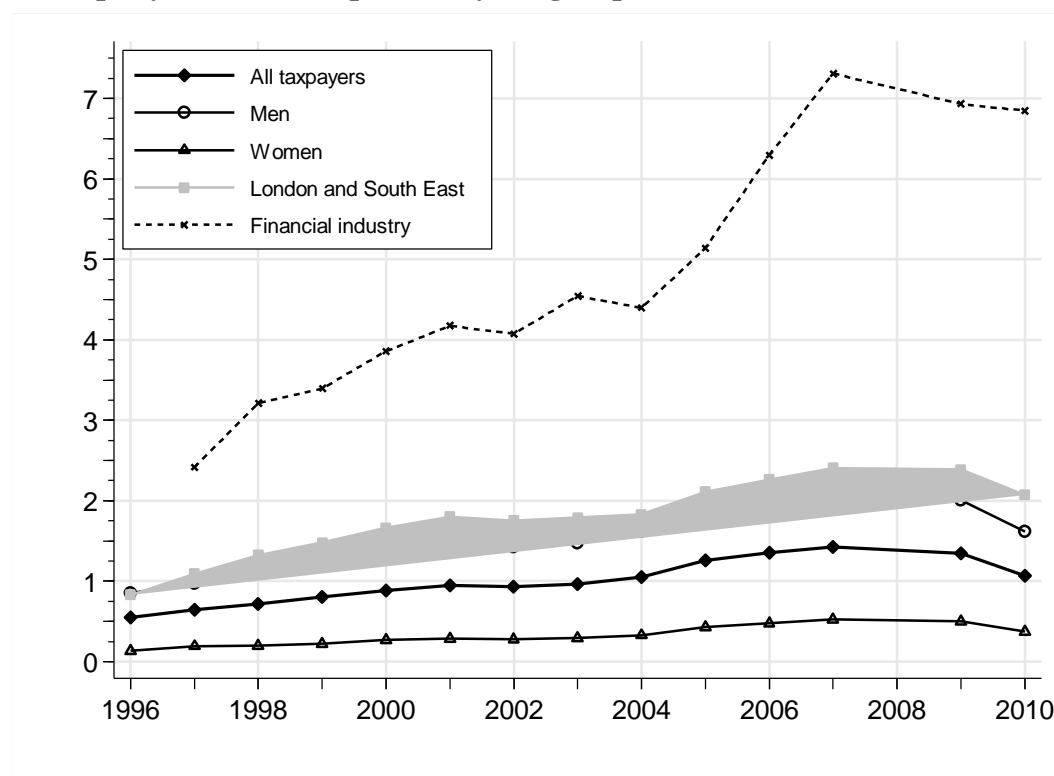
This is the process of ‘forestalling’, discussed in more detail by HM Revenue and Customs (2012) and Cribb et al. (2012, 2013). Reverse forestalling in reaction to the reduction of the top marginal tax rate to 45 per cent (from April 2013) is also likely to affect reporting for later years. These issues make assessment of recent trends in the income distribution problematic for any summary measure that is calculated using top incomes, including the Gini inequality index (Cribb et al., 2013). However, the effects on the Gini (cf. Figure 7.4) are likely to be minor compared to their effects on estimates of the prevalence of affluence based on fixed real income thresholds as in Figure 7.9 and especially Figure 7.10.

The growth in affluence is shown for selected subgroups in Figure 7.11 using a threshold of £100,000 per year (2012–13 prices). The chart shows that such high after-tax incomes are much more prevalent among male taxpayers than female taxpayers, and among taxpayers in London and the South East than among all taxpayers. Prevalence rates rose for all groups between the mid-1990s and the onset of the late-2000s recession. Figure 7.11 also highlights the relatively large prevalence of high incomes among taxpayers working in the financial industry: in 1997–98 about 2½ per cent of this group had after-tax incomes over the £100,000 threshold; in 2009–10, the proportion was 7 per cent.

For further discussion of top incomes through to the mid-2000s, the income tax data, and comparisons with HBAI series, see Brewer, Sibieta, and Wren-Lewis (2008). On recent trends in top wage income, see Bell and Van Reenen (2013).



**Figure 7.11. Percentages of taxpayers with an after-tax income greater than £100,000 per year (2012–13 prices), by subgroup**



*Notes.* Years shown are financial years, e.g. 2010 refers to 2010–11. The data refer to taxpayers only, and are not available for 2008–09. Data for 1995–96 are not used because of a series discontinuity (introduction of self-assessment and changes to the SPI methodology). Graph drawn by the author using data from the public-use files of the *Survey of Personal Incomes* (various years). Incomes converted to 2012–13 prices using within-year averages of the monthly Consumer Price Index for each financial year. Reading note: 7% of taxpayers working in the financial industry had an after-tax income of more than £100,000 in financial year 2009–10.

## Income mobility and poverty dynamics

The perspectives on distributional trends employed so far do not take account of the fact that someone who is poor in one year may be non-poor in the following year (or vice versa). Similarly, there is mobility into and out of middle- and top-income groups. The group of people that is poor – or rich – is not fixed over time.

Evidence about income mobility throughout the income range is displayed in Table 7.3. Individuals are classified by their quintile group origins in 2000 and their income group membership is tracked over the following eight years. The table shows that mobility is common but most of it is relatively short-distance. Only around one-seventh of individuals in the poorest fifth in 2000 remained in the poorest fifth in all nine years, though nearly one half spent all or the majority of years in that group. But this also means that 45 per cent spent the majority of years in the period in a higher income group. At first glance, downward mobility

among those who were in the richest fifth in 2000 is less common than upward mobility from the poorest fifth, since just over a quarter of individuals with richest-fifth origins remained there all years, but around 40 per cent spent the majority of years in a lower income group. There is more scope for both upward and downward mobility for those starting in the middle: around two-thirds of those in the middle fifth in 2000 spent significant periods in a different income group.

**Table 7.3. Where in the income distribution individuals spent the majority of their time over the nine-year period, 2000–2008**

|  | <i>Quintile group in 2000</i> |        |       |        |                  |                    |
|--|-------------------------------|--------|-------|--------|------------------|--------------------|
|  | Bottom<br>(poorest)           | Second | Third | Fourth | Top<br>(richest) | All<br>individuals |
| All years in the same quintile group as 2000     | 14                            | 3      | 2     | 4      | 26               | 10                 |
| Majority of years in same quintile group as 2000 | 41                            | 36     | 32    | 36     | 34               | 36                 |
| Majority of years above 2000 quintile group      | 45                            | 31     | 25    | 16     | ...              | 23                 |
| Majority of years below 2000 quintile group      | ...                           | 14     | 25    | 29     | 40               | 22                 |
| None of the above                                | ...                           | 17     | 15    | 16     | ...              | 9                  |
| All individuals                                  | 100                           | 100    | 100   | 100    | 100              | 100                |

*Notes.* ‘Majority of years in same quintile group’ row: five or more years out of nine in the same quintile group as in base-year but does not include the individuals in the ‘All years in same quintile’ row. ‘None of the above’ implies that the individual has neither remained in the same quintile group as the base-year, nor been in a higher or lower quintile group for five of the nine years. ‘...’: no estimate (not logically possible given definitions of groups). Source: Department for Work and Pensions (2010, Tables 3.2 (BHC) and 3.3 (BHC)), derived from British Household Panel Survey data. See Appendix Table A2 for corresponding estimates for the 1990s.

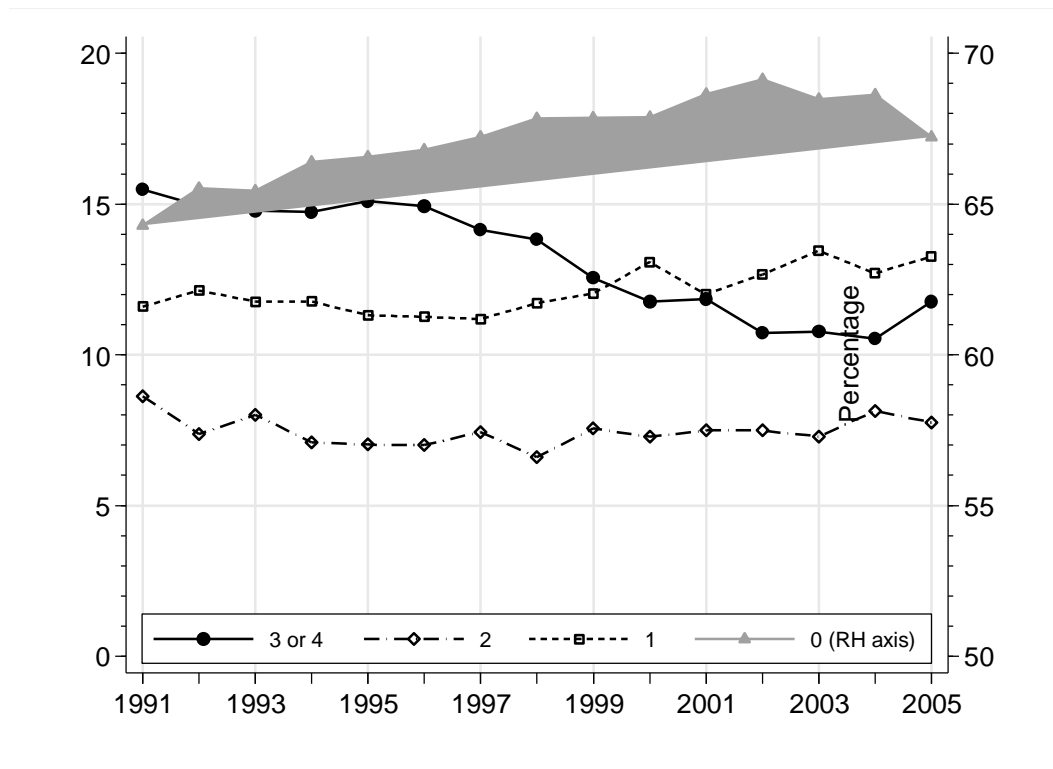
Despite the changes in the income distribution during the 1990s and 2000s shown earlier, the patterns of mobility were very similar in the two decades. See Appendix Table A3 which provides estimates for the two periods in the same format as Table 7.3. The no-change conclusion is also reported by Jenkins (2011) using an extensive portfolio of mobility measures.

The experience of poverty is likely to be more detrimental the longer that it is experienced; thus, there is particular interest in the extent of poverty persistence. Information about trends in poverty persistence is provided by Figure 7.12. This shows the distribution of the number of times that individuals are poor within successive four-year periods. (The first calculation is for 1991–1994 and then the observation window is moved along a year at a time; the latest period is 2005–2008. The BHPS ended in 2008.) Using DWP (2010) definitions, an individual is persistently poor if he or she is poor three or four times in the four-year period. Figure 7.12 shows that since the mid-1990s, the persistent poverty rate has declined substantially, by around one-third from 15 per cent to nearly 10 per cent, between

the first four-year period and the one beginning in 2004. Over the same period, the number of people experiencing occasional poverty (one or two years poor in a four-year period) increased slightly, and the proportion never poor increased from 65 per cent to 70 per cent. As the recession hit, however, the earlier trends reversed somewhat. For example, for the 2005–2008 period, the proportion persistently poor was around two percentage points higher than for the previous four-year period, and the proportion never poor fell by roughly the same amount.

The downward trend in persistent poverty prior to the late-2000s recession reflects improvements that were greatest for families with children, especially lone parent families, and also single pensioners. See Jenkins (2011: chapter 8) for details.

**Figure 7.12 Percentages of individuals poor once, twice, or three or more times in a four-year period, by year**



*Notes.* Author’s calculations from British Household Panel Survey data (Levy and Jenkins, 2012). Year labels refer to the first year of each four-year period, e.g. ‘1991’ refers to the years 1991–1994. The poverty line for each year is 60% of median net household income (BHC). Poverty counts refer to poverty status around the date of the annual BHPS interview.

## Concluding remarks

Although social policy has often treated poverty as the main feature of the income distribution of interest, recent distributional trends in the UK suggest that other features demand as much attention and analysis. This chapter has drawn attention to the stagnation in real income growth for those at the bottom while at the same time incomes at the top have been growing, particularly at the very top. Issues for the UK of contemporary concern are as much the growth in the prevalence of advantage rather than disadvantage – growing inequality as much as poverty.

The reasons why the growth in economic inequality is an important social issue nowadays are threefold: there are views that greater inequality may have deleterious consequences for economic growth, that greater income inequality is associated with greater inequalities in many other spheres, and that the higher incomes are not fairly achieved.

The relationship between inequality and economic growth has long been controversial but recent research concludes that, among OECD countries, ‘when income inequality rises, economic growth falls. One reason is that poorer members of society are less able to invest in their education. Tackling inequality can make our societies fairer and our economies stronger’ (OECD, 2014: 1). Others have emphasised that stagnation in incomes at the bottom has been accompanied by unsustainable growth in household debt that may have led to the recent financial crisis or at least hindered recovery from it. For a review of evidence, see Lucchino and Morelli (2012).

There is a growing literature arguing that income inequality growth is harmful because it weakens the fabric of our society and social cohesion in its broadest sense. The fabric is represented by a shared experience of a common education system, health service, and pensions, as well as fundamental democratic principles such as one-person one-vote and equality before the law. The problem is that the very rich may increasingly opt out of, or be less willing to contribute to, the collective pot that finances benefits and services, or deploy their resources to secure outcomes that are favourable to their own interests via politics, media, or the law. (This is the idea of top incomes reflect ‘rent seeking’ behaviour rather than fairly reflecting talents, or skills.) To date, the literature on this topic has mostly been about the USA, no doubt reflecting the fact that inequality levels and inequality growth have been greater there than in the UK. (See, for example, Bartels (2008), Hacker and Pierson (2010), and Stiglitz (2012).) Given the distributional trends in the UK that have been described in this chapter, analysis of their consequences is clearly an important topic on this side of the

Atlantic as well. Extensive discussion of what can be done about economic inequality is provided by Atkinson (2015). These issues are developed further in the Concluding chapter.

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