



The effects of taxes and benefits on household income, 2007/08

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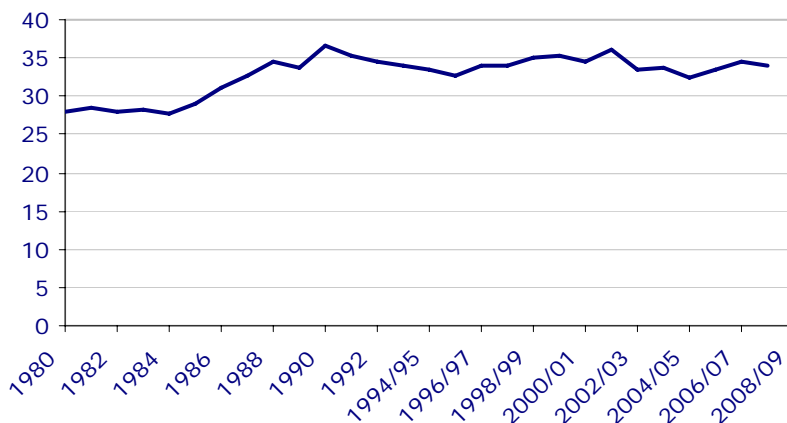
Coverage: UK Theme: The Economy

Income inequality almost unchanged

The distribution of income across households in 2007/08 was almost the same as in 2006/07. This follows a period of rising inequality of disposable income between 2004/05 and 2006/07. The general trend of increase between 2004/05 and 2007/08 was due to increased inequality of original income. It was due in part to the faster rate of growth of wages and salaries and investment income in the upper part of the distribution compared with the lower part. During the 1990s and 2000s, there were periods of both rising and falling inequality, but the level of inequality remained high by historical standards - the large increase which took place in the second half of the 1980s has not been reversed.

Gini coefficient for equivalised disposable household income

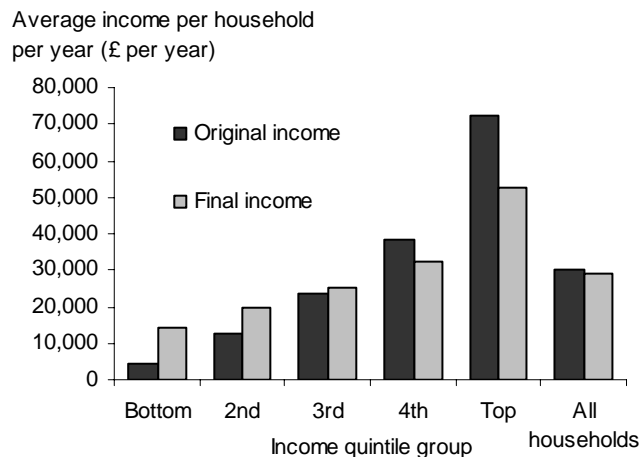
Percentages



These results, using the 'Gini coefficient', the most widely used summary measure of inequality in the distribution of household income, are published today on the National Statistics website.

The main focus of this analysis is on the effect that taxes and benefits have on household income in the UK. In 2007/08, original income (before taxes and benefits) of the top fifth of households in the UK was £72,600. This is approximately 16 times as great as the figure of £4,700 for the bottom fifth. After taking account of all taxes and benefits, the top fifth had an average final income of £52,400 per year compared with £14,300 for the bottom fifth of households, a ratio of four to one.

Original income and final income by income quintile group, 2007/08



The redistribution of income affects households in different ways. Overall, retired households are major beneficiaries from redistribution through the tax and benefit system. Retired households with two or more adults have an average original income of £13,100, but a final income of £22,200. Among non-retired households, single adults with children also have net gain, with average final incomes of £22,900 per year compared with original incomes of £11,000. Most other non-retired households pay more in tax than they receive in benefits. However, households with children do relatively better than those without children due to the cash benefits and benefits in kind (including health and education services) received by these households.

Cash benefits

Cash benefits such as Income Support, Pension Credit, Child Benefit, Incapacity Benefit and Retirement Pension play a major role in reducing income inequality. Of the total amount of cash benefits received, the bottom two quintile groups together receive 57 per cent. Cash benefits represent around 58 per cent of gross income for the bottom quintile group and 36 per cent for the second quintile group, falling to 2 per cent for the top fifth of households.

Direct taxes

Direct taxation, with the exception of Council tax and Northern Ireland rates, is progressive; that is households at the lower end of the income distribution pay smaller proportion of their income in direct tax compared with higher income households. As a proportion of their gross incomes, households in the bottom quintile group pay an average of 11 per cent in direct taxes compared with 25 per cent for those in the top quintile group.

Indirect taxes

Indirect taxes are regressive, taking a higher proportion of income from household in the lower part of the income distribution. The opposite effects of direct and indirect taxes on the level of inequality explain why the tax system as a whole has a much smaller effect on inequality than cash benefits.

Benefits in kind

The addition of benefits in kind to disposable income results in an estimate of households' final income. Households in the bottom quintile group receive more benefits in kind from the state (the equivalent of around £7,500 per year for the bottom quintile, compared with £4,100 received by the top fifth). Retired households are the biggest users of health services, as households with children benefit the most from education services. Both these groups are more likely to be at the bottom of the income distribution.

The Department for Work and Pensions (DWP) publishes analysis each year of the income distribution in its publication *Households Below Average Income (HBAI)*, based on data from the Family Resources Survey (FRS). It provides statistics on household income and individuals in low income households. This analysis provides more detail on the sources of income, and the way that taxes and benefits redistribute income. The FRS covers more households than the EFS, and the HBAI analysis also includes adjustments to correct the representation of those with very high incomes. Today's analysis includes estimates of non-cash benefits and uses EFS expenditure data to estimate the effect of indirect taxes. There are commonalities between HBAI and the estimates presented in this analysis. Where this is the case, the two publications are broadly consistent in the main messages and trends.

Background Notes

1. Today's analysis, which uses data from the Expenditure and Food Survey, can be found on the Office for National Statistics website at: <http://www.statistics.gov.uk/taxesbenefits> . A detailed article 'The effects of taxes and benefits on household income, 2007/08' is available free online at:
<http://www.statistics.gov.uk/STATBASE/Product.asp?vlnk=10336>
 2. The most widely used summary measure of inequality in the distribution of household income is the Gini coefficient. The lower the value of the Gini coefficient, the more equally household income is distributed. More details on how the Gini coefficient is calculated are available at: http://www.statistics.gov.uk/about/methodology_by_theme/gini/default.asp
 3. This analysis uses several different measures of household income. Original income (before taxes and benefits) includes income from wages and salaries, self-employment income, income from occupational pensions and investment income. Gross income includes all original income plus cash benefits provided by the state. Disposable income is that which is available for consumption, and is equal to gross income less direct taxes. Post-tax income is calculated by estimating the payment of indirect taxes, and deducting these from disposable income. Final income is calculated as post-tax income plus benefits in kind received from the state.
 4. Income quintile groups are based on a ranking of households by equivalised disposable income. Equivalised incomes are standardized to account for the fact that households of differing size or composition will require different incomes to achieve the same standard of living.
 5. Details of the policy governing the release of new data are available from the media office.
 6. National Statistics are produced to high professional standards set out in the Code of Practice for Official Statistics. They undergo regular quality assurance reviews to ensure that they meet customer needs. They are produced free from any political interference.
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