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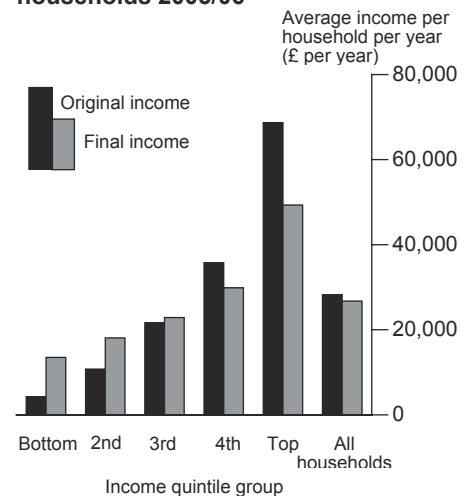
Coverage
United Kingdom
Theme
Social and welfare

Taxes and benefits – the effect on household income

In 2005/06, original income (before taxes and benefits) of the top fifth of households in the UK was sixteen times greater than that for the bottom fifth (£68,700 per household per year compared with £4,200). After redistribution through taxes and benefits, the ratio between the top and bottom fifths is reduced to four-to-one (average final income of £49,300 compared with £13,500). These ratios are unchanged from last year.

Some types of household gain more than others from this redistribution. Retired households pay less in tax than they receive in benefits and so gain overall. Among non-retired households, single adult households with children also gain. Most other non-retired households pay more in tax than they receive in benefits. However, households with children do relatively better than households without children due to the cash benefits and benefits in kind (including health and education services) which are received by these households.

Original income and final income by income quintile group, for all households 2005/06



Disposable income is commonly used to measure income inequality. The latest evidence for 2005/06, suggests that income inequality has increased over the previous year. There was a fall in inequality between 2001/02 and 2004/05, after an increase in the late 1990s. The latest increase is due to greater inequality of original income, rather than the tax and benefit system. Inequality still remains high by historical standards - the large increase which took place in the second half of the 1980s has not been reversed.

These results are published today on the Office for National Statistics (ONS) website in an analysis entitled "The effects of taxes and benefits on household income, 2005/06", which uses data from the Expenditure and Food Survey (EFS).

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Cash benefits

Cash benefits such as Income Support, Pension Credit, Child Benefit, Incapacity Benefit, and the State Retirement Pension play the largest part in reducing income inequality. They go predominantly to households with lower incomes. Cash benefits make up 61 per cent of gross income for the poorest fifth of households, 39 per cent for the next group, falling to 2 per cent for the top fifth of households.

Direct taxes

With the exception of Council tax and Northern Ireland rates, direct taxation is progressive; that is it takes a larger proportion of income from those households that have higher gross incomes. In 2005/06, the top fifth of households paid 25 per cent of their gross income in direct tax while the bottom fifth paid 9 per cent.

Indirect taxes

Indirect taxes are regressive, taking a higher proportion of income from those with lower incomes. For the top fifth of households, indirect taxes account for only 11 per cent of gross income, compared with 27 per cent for the bottom fifth. Since direct and indirect taxes have opposite effects on the level of inequality, the tax system as a whole has a much smaller effect on inequality than cash benefits.

Benefits in kind

Final incomes include an adjustment for the receipt of benefits in kind from the state, such as health and education services. Households with lower incomes tend to receive more benefits in kind from the state (£6,700 for the bottom fifth compared to £3,900 for the top fifth). Retired households and households with children, which are more likely to be in lower income groups, are the biggest users of state health and education services.

The Department for Work and Pensions published its latest analysis of "Households Below Average Income 2005/06" (HBAI) on 27 March 2007 which is based on the Family Resources Survey (FRS). The FRS covers more households than the EFS and the HBAI 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. The overall trends shown in this analysis are broadly similar to those in the HBAI analysis over the longer term but do not necessarily match each other from year to year.

BACKGROUND NOTES

1. Today's analysis can be found on the National Statistics website at:
www.statistics.gov.uk/taxesbenefits
2. 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.
3. 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.
4. Details of the National Statistics policy governing the release of new data are available from the Press Office.
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