

# WHAT WOULD THE NEIGHBOURS SAY?

HOW INEQUALITY MEANS THE UK IS POORER  
THAN WE THINK

## About the High Pay Centre

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution and set out a road map towards better business and economic success.

We aim to produce high quality research and develop a greater understanding of top rewards, company accountability and business performance. We will communicate evidence for change to policymakers, companies and other interested parties to build a consensus for business renewal.

The High Pay Centre is resolutely independent and strictly non-partisan. It is increasingly clear that there has been a policy and market failure in relation to pay at the top of companies and the structures of business over a period of years under all governments. It is now essential to persuade all parties that there is a better way.

The High Pay Centre was formed following the findings of the High Pay Commission. The High Pay Commission was an independent inquiry into high pay and boardroom pay across the public and private sectors in the UK, launched in 2009.

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# Income inequality in the UK

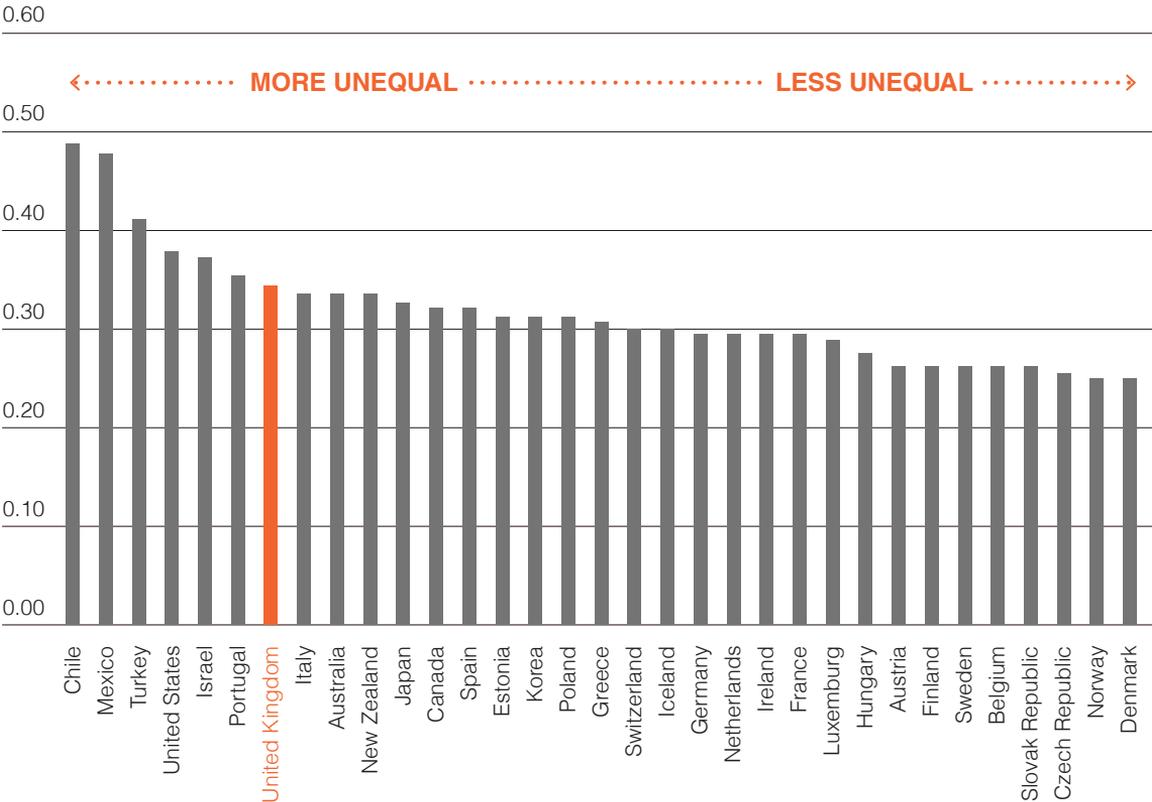
As George Osborne pointed out in his 2014 budget speech, income inequality in the UK has fallen slightly in the wake of the global economic crisis. However, what the Chancellor failed to mention is that, when set against the massive increases in inequality that the UK has endured since the 1960s and 70s, this decline barely registers. Since 1960, Britain has gone from being more economically equal than Sweden to being one of the most unequal countries in the developed world. Of the 32 members of the Organisation for Economic

Co-operation and Development (OECD), only Portugal, Israel, the United States, Turkey, Mexico and Chile are more unequal than the UK.<sup>1</sup>

Moreover, the recent slight fall in inequality is largely attributable to those at the top losing more money over the course of the recession. The Institute for Fiscal Studies predicts that, as the economy recovers, the increase in inequality will resume. The IFS say that income inequality will be 'about the same' as pre-recession levels by 2015-16.<sup>2</sup>

<sup>1</sup> OECD, Factbook 2011-2012: Economic, Environmental and Social Statistics via <http://www.oecd-ilibrary.org/sites/factbook-2011-en/03/05/01/index.html?itemId=/content/chapter/factbook-2011-31-en%20>  
<sup>2</sup> Institute for Fiscal Studies, Better-off hit hardest by recession initially; poor feeling the squeeze now, 4 June 2013 via [http://www.ifs.org.uk/pr/inequality\\_recession\\_june2013.pdf](http://www.ifs.org.uk/pr/inequality_recession_june2013.pdf)

**figure 1** OECD countries ranked by income inequality (measured using the Gini coefficient)



## What does higher inequality mean for living standards?

A considerable volume of commentary and academic work has been dedicated to the effects of inequality. Concerns range from the effects on public health and social well-being to the danger of social and political unrest if a tiny elite continues to capture a disproportionate share of a country's income. The IMF and others have argued that inequality is simply bad for the economy, rendering economic growth weaker and less durable.

As with most other economic measures, levels of inequality are often cited in relation to other countries, with performance judged on whether the UK is doing better or worse than similar-sized economies. We have already seen that the UK is one of the most unequal societies in the developed world, but this is usually framed as either simply a moral outrage, or in terms of the potential indirect consequences of inequality on things like crime, population health, and the general social fabric.

Surprisingly, what's less often mentioned is one of the most straightforward implications of inequality – that if a greater share of total income goes to those at the top, that means a lesser share for the rest of us. In most developed countries, we put a lot of stock into how much the economy is growing as a whole, as measured by GDP. But if all the economic gains are accruing to those at the top, then a growing economy is not going to do much for the living standards of ordinary people. Put simply, in

two equally rich countries, living standards for most people will be worse in the country where a small number of people take a disproportionately large percentage of total income.

This is important because income inequality does not happen by chance, but results from political, social and cultural choices in areas like taxation, public spending, industrial relations and public tolerance of high and low pay. Analysis of how income inequality shapes living standards in ostensibly similar countries enhances our understanding of whether the choices we are making as a country are the right ones.

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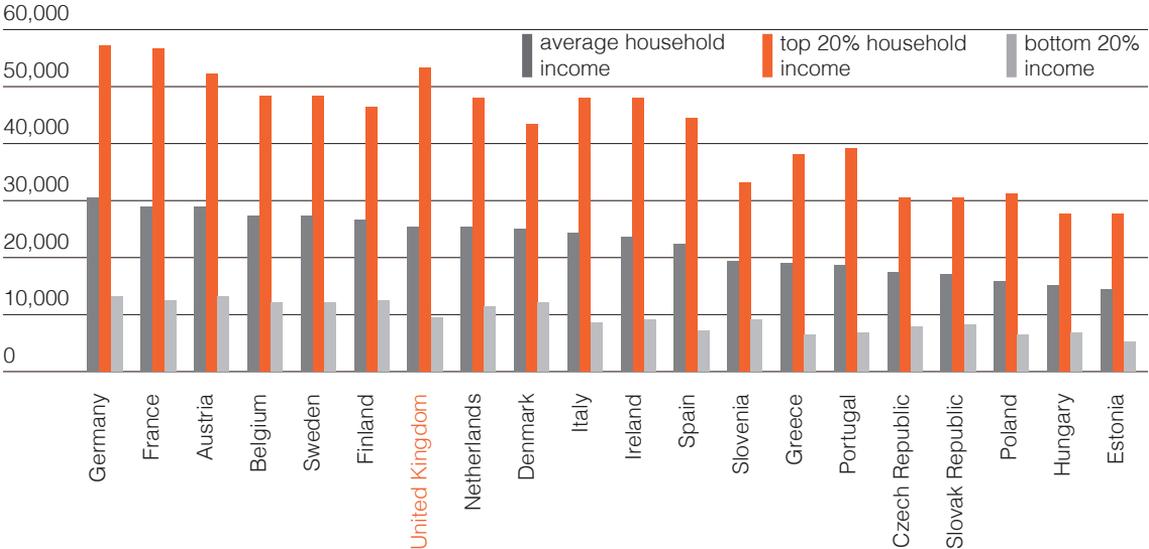
# What does income inequality mean for UK living standards relative to our neighbours?

In the UK we generally consider ourselves to have a similar standard of living to other Western European countries like Germany and France. Together with the UK, these countries are respectively the first, second and third largest economies in Europe, and the fourth, fifth and sixth largest in the world. The OECD Better Life Index estimates average net household disposable income in the UK at \$25,828, in the middle of the range of other Western European countries like Germany (\$30,721), France (\$29,322), Belgium (\$27,811), the Netherlands (\$25,697), and Denmark (\$25,172).<sup>3</sup> As such, it would be easy to assume that most people experience similar levels of prosperity in the UK as they do in these other countries.

However, the OECD also calculates average income for the richest and poorest 20% of households. This is a significant proportion of the population – 20% of the UK population equates to over 12 million people. With household incomes of \$53,785, the richest 20% in the UK are the third richest top fifth of the population in any EU country measured by the OECD, behind only Germany and France. However, the income for the bottom 20% in the UK is much lower than in other, more equal countries with a similar average income. The OECD calculates the average income of the bottom 20% of UK households at just \$9,530, much lower than the poorest 20% in France (\$12,653), Germany (\$13,381), Belgium (\$12,350), the Netherlands (\$11,274) and Denmark (\$12,183).<sup>4</sup>

<sup>3</sup> OECD Better Life Index via <http://www.oecdbetterlifeindex.org/topics/income/>  
<sup>4</sup> *ibid*

**figure 2 Average and bottom 20% household income in EU OECD member states (US\$)**



## The cost of the 1%

Simply, **for the millions of people comprising the poorest fifth of our population, life is much worse here than it is for the poorest fifth in virtually every other north-west European country** - countries we would like to think of as our equals. In fact, the living standards of the poorest fifth of people in the UK are much closer to those of the poorest in countries like **Slovenia (average income for the poorest 20% of households, \$9,138) and the Czech Republic (\$8,378)**. This was not inevitable. This has come about because we made political and economic choices that set us on the path of greater inequality.

A comparison of the share of total income taken by the richest 1% of the population reinforces the profound effect that inequality has on living standards. In the UK, the richest 1% takes 13% of total income, much more than in most other Western European countries.<sup>5</sup> Indeed, this figure is more than double the 6% share of total income that the richest 1% takes in the Netherlands and Denmark, for example.

The World Top Incomes Database put total incomes in the UK in 2011 (the most recent year for which records are available) at £1 trillion, so the 13% share taken by the richest 1% equates to about £130 billion per year.<sup>6</sup> If the share captured by the 1% were the same as in the Netherlands and Denmark, it would be worth £60 billion (this would still equate to an average £240,000 annual income per household, so would hardly impoverish the rich). The £70 billion difference distributed across the remaining 99% of the UK would put an extra £2,700 in the pockets of every household.<sup>7</sup>

It should be noted that the 6% share of total incomes captured by the richest 1% in the Netherlands and Denmark is the lowest recorded by the world top incomes database, but the share in other countries such as Sweden (7%), Finland (7%), Norway (8%) and France (8%) is also much lower than the UK. Again, if a £1 trillion sum equivalent to the UK's total income was divided between the richest 1% and poorest 99% of the UK's population in the same way as in these countries, the

<sup>5</sup> World Top Incomes Database via <http://topincomes.parisschoolofeconomics.eu/#Database>

<sup>6</sup> World Top Income Database via <http://topincomes.g-mond.parisschoolofeconomics.eu/#Country:United%20Kingdom>, 2 February 2014 (see 'methodological note by Anthony B Atkinson')

<sup>7</sup> Calculation based on 26.4 million households as noted by Office for National Statistics, Families and Households 2013, 31 October 2013 via <http://www.ons.gov.uk/ons/rel/family-demography/families-and-households/2013/stb-families.html>

## Conclusion

99% would be thousands of pounds better off each year.

Of course it's not as simple as all that. The more equal income distributions achieved in the Netherlands, Denmark, and elsewhere are the result of many interacting economic policies and forces which also have an effect on overall economic growth. If we'd followed this path in the UK, our total national income figure would probably be quite different from the £1 trillion currently shown by our national accounts. However, as we've noted, the IMF concluded that economic growth is stronger in more equal societies. Our proposed £2,700 might therefore be an underestimate of the true benefits of a more equal society.

This is not to say that other Western European economies are utopian societies and we should necessarily import every aspect of their social and economic model to the UK. But we should be clear of the facts:

- > The poorest fifth of the population are poorer here than in other Western European countries
- > The value of the difference in the income share of the 1% in the UK compared to more equal countries would be worth thousands of pounds in additional income to ordinary households

It is these facts, not just overall economic growth, that should be front and centre in our minds when we make choices about our country's economic future.

