

Summary of Households Below Average Income consultation on equivalence scales and other issues, November 2004 – May 2005

Background

1. The Households Below Average Income (HBAI) statistics rank individuals by income, by taking the income of their household and adjusting this for household size and composition; this is consistent with international conventions. The adjustment factors are known as 'equivalence scales.' Since its inception, HBAI has used the McClements scale. In recent years, HBAI has also presented – in an appendix - some key results calculated on an alternative, 'modified OECD,' scale.
2. In December 2003, the Government announced that the Child Poverty PSA target would be measured by low income statistics constructed using the modified-OECD scale equivalisation scale; this would facilitate comparisons with other European countries. This raised the possibility that attention would increasingly focus on results with this scale. DWP statisticians decided to consult users as to whether we should mainstream Modified-OECD based results – i.e. present most results on this basis, with a limited selection of results on the old basis in an appendix - or maintain the prominence traditionally given to McClements based results.
3. At the same time, a wider technical consultation note was issued to independent experts to seek advice on a number of other, more technical, issues.
4. HBAI reports on two income concepts: income before housing costs (BHC) and income after housing costs (AHC). The Government's new child poverty measure will use BHC income only. HBAI will continue to report, and give equal prominence to, income both BHC and AHC. The McClements scale has differing values for BHC and AHC incomes. The Modified OECD scale has been used only to report BHC income.

General user consultation

Choice of equivalence scale for main results in HBAI

5. We sought views from 38 NGO's with an interest in poverty, and 12 Government organisations, on the issue of whether to switch equivalence scales for mainstream results. The views of non-analysts were deemed relevant on the grounds that the issue was not one of which scale is technically superior, but rather which should receive more prominence, in relation to where public attention is likely to focus. We had responses from the Department for Work and Pensions, Her Majesty's Treasury and Child Poverty Action Group (CPAG).
6. All respondents indicated that a switch to using the modified-OECD scale would be preferable to maintaining the prominence traditionally given to McClements-based results.

Other emerging issues

7. CPAG suggested an alternative approach for use in equivalence scales that made use of a 'budget standards' approach. A budget standards approach to deriving poverty thresholds involves making explicit judgements as to what items, in what amounts, would be consumed in order for a family to attain a given standard of living; and then pricing these items and amounts. Comparisons of the results for different family types could generate equivalence scales.
8. The judgement of DWP statisticians is that, whatever the merits of the 'budget standards' approach in poverty analysis and debate generally, use of this approach would offer no clear advantage in relation to the choice of equivalence scale to be 'mainstreamed' in HBAI. Differences between different family types would depend on assessments made by experts as to how much more costly it is for a family of type Y to attain a given standard of living than a family of type X. And the issue, of how much prominence to give to results showing outturns compared to the Government's own declared target, would remain.

Expert consultation

9. The following independent experts in income analysis and social inequality responded to our consultation on technical issues:

Alissa Goodman (IFS)
Holly Sutherland (Essex University)
John Hills (LSE)
Richard Berthoud (Essex University)
Stephen Jenkins (Essex University)

10. A key issue was whether to switch to the Modified-OECD scale. As this scale has generally been used for BHC results only, a related issue was how to present AHC results if a switch to Modified-OECD was supported.
11. Other issues covered later were as follows:
 - Adoption of new grossing regime for HBAI results for 2003/4
 - Treatment of expenditure on insurance premia within the HBAI income definition
 - A bundle of presentational issues including: treatment of Northern Ireland and the United Kingdom with respect to coverage, and the choice of anchor years for absolute low income time series.

Choice of equivalence scale for main results in HBAI

12. On the main issue, the majority of experts supported a switch to reporting results using the modified-OECD scale.

Choice of equivalence scale for AHC incomes

13. The second equivalence scale issue for consideration by experts was which scale values to use for AHC incomes if a switch to using modified-OECD for BHC incomes was recommended.
14. One option for AHC incomes was to use the same Modified-OECD scale values as for BHC incomes. Against this approach, it can be argued that equivalence scales are meant to capture the ‘economies of scale’ which larger households enjoy in consuming some items, that these are generally thought to be larger for housing than for other aspects of consumption, and so that AHC scale values should be different, with lower economies of scale. Alternatively, in favour of using the same scale values for AHC as for BHC, it can be argued that there is no ‘correct’ equivalence scale – as all estimation techniques have large question marks over them – and bothering with differences between BHC and AHC is pointless when all values have a significant element of arbitrariness. This latter argument was initially favoured by DWP statisticians and independent experts. However, when results were produced on this basis, it emerged that they had the unexpected effect of changing estimated AHC poverty rates for pensioners very substantially – by up to 20 percentage points for single female pensioners. Such a large change in reported results would be defensible if we could assert that the change brought the results ‘nearer the truth;’ but otherwise they could be difficult to explain and defend.
15. In order to explore a wider range of options and further gauge user opinion, four sets of modified-OECD variant AHC results were provided to the independent experts who responded to the initial consultation. The variants employed different levels of economies of scale for the second adult in the household and for the relationship between children and adults in the household. The tables of comparisons that were provided to independent experts are located at the following URL: www.dwp.gov.uk/asd/hbai/variants.xls
16. There was no clear consensus of views on the issue of whether the modified OECD scale, or a variant, was preferred for the purpose of equivalising AHC incomes.

DWP recommendation on the choice of equivalence scale for BHC incomes in HBAI

17. Both strands of the consultation supported the switch to giving prominence to results using the Modified-OECD scale, for BHC incomes. DWP statisticians judge that this approach will reduce the risk of confusion that might otherwise arise. In the light of this, and consultees’ support for a switch to focussing attention on results on Modified OECD scales, we have decided to switch to reporting BHC incomes on the modified OECD scale.
18. To support a smooth transition between reporting results using difference equivalence scales, we intend to expand the publication reporting on 2004/5, due for release in March 2006, to include a wider range of results using the modified OECD measure, with McClements maintained as the mainstream results. The

2005/6 publication, due for release in Spring 2007, will be the first to mainstream modified-OECD results with an appendix giving results using the McClements scale (i.e. equivalent to the current presentation of modified OECD results in recent editions of HBAI).

Choice of equivalence scale for AHC incomes

19. DWP statisticians have given consideration to the views expressed. On balance we favour a variant that:

- when used alongside the Modified OECD scale values for BHC incomes, gives AHC results which come close to preserving the relationship, between BHC poverty counts and AHC poverty counts, reported with the McClements scales;
- and is consistent with there being lower economies of scale in consuming non-housing items than in housing;
- and maintains some of the structure of the modified-OECD scale, in the sense of which types of individuals are given different scale values.

20. The scale that we favour is as follows:

Household member	Variant factor	1 Description
1st adult	0.58	Much 'flatter' scale than modified OECD, to reflect lower economies of scale in non-housing consumption
Other 2nd adult	0.42	
3rd adult	0.42	
Subsequent adults	0.42	Equal to 2nd adult, as in modified OECD
Child under 14	0.20	Preserves the BHC (modified OECD) ratio of child to couple (as does McClements)
Child 14+	0.42	Equal to 2nd adult, as in modified OECD

21. This scale will be used to adjust AHC incomes when AHC incomes are presented alongside BHC incomes using the Modified OECD scale. As indicated earlier, HBAI will continue to give equal prominence to BHC and AHC results.

Other technical consultation issues

Insurance premia

22. Questions relating to payments of insurance premia will no longer appear on the FRS from 2005/06. It was decided to drop the block of questions because they were lengthy, and something had to go to make time on the survey for new material deprivation questions (having too many questions adversely affects response rates)

23. For consistency in the time series, this expenditure will be removed for all years. Rather than wait until 2005/6 to implement the change, resulting in an entirely new set of further revisions to the historic series, experts agreed that it was sensible to introduce the change in 2004/05 along with the introduction of the new equivalence scale.

24. This does mean that the income measure definition between results using McClements and results using Modified-OECD will not be strictly identical. However, the effect of this has been estimated as small, in that it mostly does not affect poverty counts to the nearest percentage point, but there are some revisions of no more than one percentage point for children, working-age adults and pensioners. This will be covered in further detail in an appendix of the next HBAI publication.

NI/UK

25. There was general support for a switch to reporting results on a UK basis with incomes compared against averages UK averages, though we will take note of the comments that this is an issue that should be looked into in more detail before a firm decision is made. We plan on issuing an analytical note shortly after the 2004/5 results are published which will include a proposal for future coverage of results, taking account of the Northern Ireland water rates regime. At this stage, further comments will be sought from users. We will need to confirm plans for funding of Northern Ireland households within the FRS before a firm decision to switch to a UK average approach can be made.

Anchor points

26. HBAI reports some results using 'absolute' low income thresholds. These compare, for different years, the numbers of people with incomes below a fixed level of income, expressed as a percentage of median income of a given year. The year in question can be thought of as an 'anchor' year. There was support for a proposal to switch the anchor reference year (currently 1996/7) for the absolute low income series from 1996/7 to 1998/9. In the consultation letter, we acknowledged that this was subject to the absolute low income threshold not becoming outdated; this could happen if evidence emerged that, for a relatively large proportion of those individuals measured to be in 'absolute low income', income appeared to be a poor guide to their living standards. This will be investigated further using new material deprivation questions which will shed additional light on household living standards.

Other emerging issues – with housing measure

27. In the discussions with independent experts on comparing BHC and AHC incomes, the concept of measuring incomes using 'income with housing' received support. This approach measures overall consumption capabilities by taking income (net of taxes etc), subtracting the actual housing costs incurred by the household, and imputing a value of their housing consumption. This has the potential to give fairer comparisons between owner-occupiers and renters – or indeed between owner-occupiers who have paid off most of their mortgage and those who have not. Arguably, only one income measure would then be required and hence the dual BHC and AHC measures could be dropped.

28. This topic was looked at during the mid-1990s review of HBAI, at which stage it could not be recommended as there was no single approach which overcame both

conceptual and practical problems. A key difficulty stems from it being unclear whether inter-regional variations in housing costs should be regarded as reflecting differing costs of living, or as due to the higher-costs regions yielding a higher value of consumption for a given physical standard of housing. Other issues concern the estimation of the consumption value of housing, the treatment of time trends in housing costs, and regional differences in these trends. Price indices which capture regional differences are not available, though ONS have made some progress on regional price indices, and have released some results at the URL: http://www.statistics.gov.uk/articles/economic_trends/ET615Wingfield.pdf However, a full time series will not be available for a number of years.

29. DWP statisticians judge that moving to a single 'with housing income' measure would have considerable attractions, if the conceptual and practical difficulties could be overcome. This topic will be kept under review, and we suggest it should be the subject of a specific investigation during the next major review of HBAI.

Other emerging issues – value of Free School meals

30. IFS raised the issue of the methodology estimates for the value of Free School Meals in HBAI methodology. This has been reviewed recently by the FRS team, who will report separately.

Other emerging issues – SPI adjustment

31. IFS asked whether the SPI adjustment would be the subject of a review in the near future. The HBAI team will look further into the issue as part of the next review of HBAI statistics.

Other emerging issues – archive

32. Essex University recommended that documented datasets be deposited with the archive, including records for those variables that are constructed using existing and historic definitions of income. The HBAI team will work with Essex University in order to meet the standards of documentation required, subject to achieving clearance from ONS's microdata release panel.