

Pareto Models, Top Incomes, and Recent Trends in UK Income Inequality

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Paper Abstract: I determine UK income inequality levels and trends by combining inequality estimates from tax return data (for the 'rich') and household survey data (for the 'non-rich'), taking advantage of the better coverage of top incomes in tax return data (which I demonstrate) and creating income variables in the survey data with the same definitions as in the tax data to enhance comparability. For top income recipients, I estimate inequality and mean income by fitting Pareto models to the tax data, examining specification issues in depth, notably whether to use Pareto I or Pareto II (generalised Pareto) models, and the choice of income threshold above which the Pareto models apply. The preferred specification is a Pareto II model with a threshold set at the 99th or 95th percentile (depending on year). Conclusions about aggregate UK inequality trends since the mid-1990s are robust to the way in which tax data are employed. The Gini coefficient for gross individual income rose by around 7% or 8% between 1996/97 and 2007/08, with most of the increase occurring after 2003/04. The corresponding estimate based wholly on the survey data is around -5%.