Not by pay alone

The idea that child poverty in the UK can only be effectively addressed by a combination of better pay and better state support is not a new one. Here, Donald Hirsch **revisits it, arguing that it is folly to rely excessively either on pay or on in-work support to secure acceptable living standards for working families, and suggests how a coherent narrative can be developed about the way they can be combined.**

Theresa May entered Downing Street promising to help 'just about managing' families. If that pledge rings somewhat hollow, it is because it follows previous promises to help the 'squeezed middle', to 'make work pay' and to reward 'hard-working families' – each pledge as worthy-sounding as it is imprecise. It is true that plenty of policies in the past 20 years have sought to make low-income working families better off, ranging from tax credits to higher tax allowances to the national 'living wage'. But they have not been backed by clarity either over what living standards they help families to reach or in stating how policies will combine to achieve this.

There needs to be a better understanding of the degree to which we expect parents to work a reasonable amount, employers to pay a reasonable amount and the state to contribute a reasonable amount in order to allow children to thrive

Recently, a contrast has developed between two competing narratives of how to help working families. One, associated with Gordon Brown and New Labour, is to encourage people to enter work on whatever terms the labour market will offer, and rely on government to top up earnings with tax credits, designed to lift more and more children out of poverty as billions of pounds are directed to this priority. The second, associated especially with George Osborne's introduction of the national living wage while cutting in-work support, is a new narrative of ending 'dependency' (for working families, not just those on out-of-work benefits) by requiring employers, rather than the state, to underwrite family living standards. Each of these is a caricature which greatly oversimplifies the stance of those politicians (Gordon Brown introduced the national minimum wage; George Osborne started to bring in universal credit). But what has been lacking throughout is a clear-cut account of how work, decent pay and state support can combine to get families to a given living standard. There needs to be a better understanding of the degree to which we expect parents to work a reasonable amount, employers to pay a reasonable amount and the state to contribute a reasonable amount in order to allow children to thrive.

What kind of living standard?

An important part of the political promise of recent governments has been that families with parents who are working hard to look after their children and do paid work should be able to reach a reasonable living standard. While this has often been pitched in terms of ending 'working poverty', the message implies that work should do something more than allow you to ‘just manage’, for example by being just above a poverty line. The minimum income standard research[1] that my team produces for the Joseph Rowntree Foundation is a good representation of a socially acceptable minimum: it is what groups of members of the public think you need in order to have the ‘opportunities and choices needed to participate in society’. While the issue of whether out-of-work families should be guaranteed such an income is politically fraught, it is hard to argue against the idea that families should, at least, have the opportunity to reach such a level through working.

This benchmark is a tangible, evidence-based representation of a minimum. Having such a standard matters a lot today for two reasons. First, because an income-relative poverty line has been falling further behind such a standard since the minimum income standard was first calculated in 2008. For example, in 2008/09 a couple with children aged three and seven needed 73 per cent of median income after housing costs (and thus an income just over a fifth higher than the relative income poverty line of 60 per cent median). But by 2014/15 this had grown to 80 per cent (so a third higher than the poverty line). Over this period, median income has fallen relative to the basic cost of living, so someone on the relative poverty line has become significantly worse off.

A second important reason for paying attention to the minimum income standard line is that it can help show whether a system of in-work support is fit for purpose. Our systems of means-tested support for low-income working families (tax credits and the universal credit system that is replacing them) require policy choices over three quantities: the baseline level of support; the earned income above which it should start being withdrawn (the disregard, or ‘work allowance’); and how rapidly this means testing should occur (the ‘taper rate’). If families who are not managing to make ends meet face a rapid loss of income as their earnings rise, this creates a classic ‘poverty trap’. If, on the other hand, people receive state help sufficient to allow them to reach a reasonable living standard if they work a certain amount, rapid withdrawal of such help for those earning above this level can feel more acceptable.

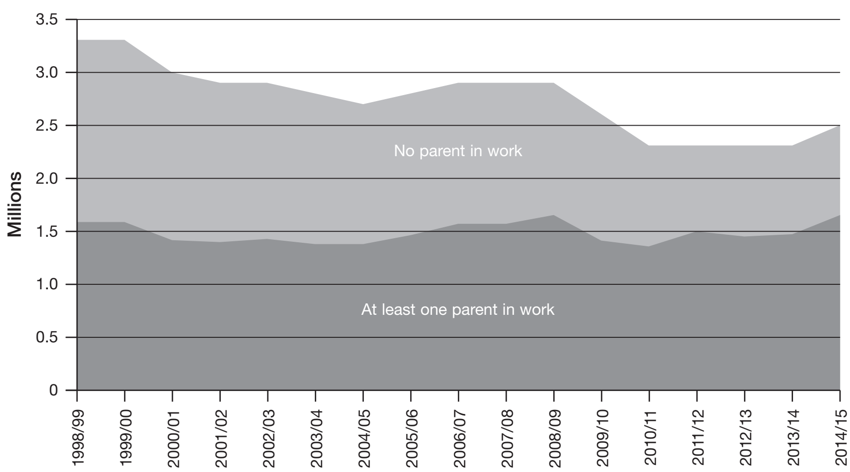
Why over-reliance on income transfers cannot be replaced by over-reliance on pay

The tax credit system was never supposed to provide an excuse for low pay, but it was introduced at a time when the minimum wage was very low: in 1999, it was introduced at £3.60 an hour for adults over 22, equivalent to just £5.70 today (in contrast to the current £7.20 rate for over-25-year-olds) when adjusted for the increase in median wages. Gordon Brown’s emphasis was on improving employment rates – his New Deal back-to-work programmes were associated with a ‘work first’ ethos, prioritising quantity over quality of jobs – and on topping up pay with tax credits. He seemed less inclined to put pressure on employers to pay more, and in some of his budgets he talked of the ‘effective hourly wage rate’ including this top-up. There is some evidence that, in practice, tax credits have depressed wages,[2] although the strength of any causal link is hard to determine. They have certainly encouraged part-time working among lone parents, which has great advantages for families, but the cluster around the 16-hour eligibility minimum for working tax credit has contributed to a large bill for the government, with some working lone parents getting more from tax credits than in wages. In the Brown years, increasing tax credit entitlement without making serious inroads into low family earnings meant that the tax credit bill rose to nearly £30 billion a year, but child poverty in working families did not fall. Figure 1 shows that the net fall in child poverty came entirely from a fall in out-of-work poverty. Tax credit top-ups *did* take many children in working families out of poverty; others moved from out-of-work to in-work poverty, entering jobs with low pay and/or few working hours.

Willingness to foot a high bill for policies that did not seem to be tackling the fundamentals of child poverty reached its limit with the coalition

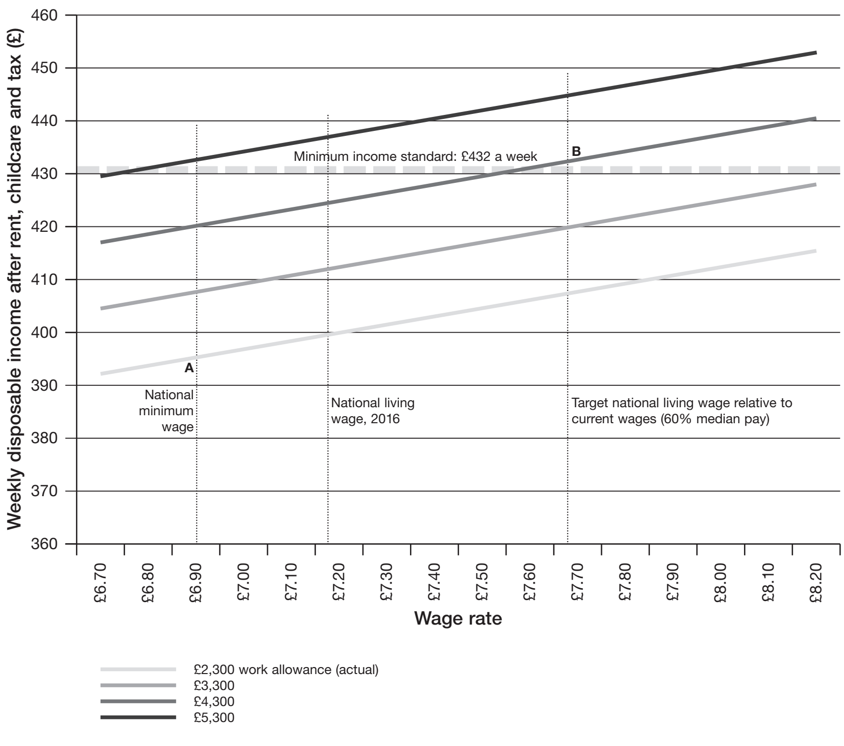
The tax credit system was never supposed to provide an excuse for low pay

Figure 1: **Child poverty in working and non-working families, 1998–2015 (Number in households below 60% median before housing costs)**



Source: Department for Work and Pensions, *Households Below Average Income: an analysis of the UK income distribution: 1994/95–2014/15*, 2016 government, which introduced serious cuts. In 2015, these were accelerated by the Conservative government. At that point, George Osborne diverged clearly from the previous strategy of trying to help low-income families without serious improvements to pay: his 'national living wage' was set to increase the minimum wage for over-25-year-olds by 38 per cent between 2015 and 2020. But in proclaiming a new 'low welfare, higher wage' approach, he neglected three fundamentals. The first is that, for many families, only a wage higher than the median would be enough to reach an adequate living standard with no support at all – for example, a couple with two children without tax credits would both need to work full time on £13 an hour, about £1 above the median, to reach the minimum income standard.[3] So higher minimum wages can only be one part of the solution. The second point is that given therefore that most families receiving even a higher minimum wage will depend on tax credits, which fall sharply with rising earnings, reducing the level of this support in conjunction with raising the minimum wage is bound to create a net loss in most cases. But most importantly, the policy misses a third point: that the willingness to address wages actually provides an opportunity to increase the level of protection given by in-work top-ups, at no net pubic cost. Pay increases for families will partly flow back to the exchequer through means testing, making it more affordable to create a decent level of protection for families who still have low earnings.

Figure 2: **Options for combining the living wage and universal credit work allowance to meet the minimum income standard***



*Couple with two children, one parent working full time, the other part time

Note: figures are for 2016/17, but include assumption of 30 hours a week of free childcare for four- year-olds, being introduced in 2017

A more joined-up narrative for combining pay and in-work support

A significantly higher minimum wage marks an important departure by showing the government's willingness to intervene in labour markets to make pay a part of the solution. As has been widely pointed out, it can be only one part, since working hours and family size are at least as important in influencing the adequacy of family earnings as hourly wage rates. Yet it significantly changes how one might seek to give families the opportunity to reach an acceptable living standard through paid work.

An underlying question for the level of wages and in-work support is this: can a family reach a minimum acceptable standard of living by working for a reasonable number of hours on a given pay rate? This begs the question of what is considered reasonable, but let us take as a starting point a model where one member of a couple works full time and the other half time. This was the median response given by members of the public in a CPAG survey asking how many hours parents should have to work to avoid poverty.[4] Figure 2 looks at family income relative to the minimum income standard, assuming this amount of work, with different assumptions about wages and in-work benefits – using the universal credit system as an illustration.

Figure 2 shows how better wages and a more generous universal credit schedule can combine to get closer to guaranteeing a minimum living standard for a given family. Each line represents the effect of setting the universal credit work allowance at a different level, thus allowing workers to earn more before universal credit starts being reduced. With the old adult rate of the national minimum wage (presently applicable only for people aged 21–24) and the present work allowance level, a working family falls £36 a week short of the minimum (point A). Using universal credit alone, the work allowance would need to be raised by just under £3,000 a year to close the gap. On the other hand, a combination of adopting the national living wage at its new target level of 60 per cent median pay and increasing the work allowance by just under £2,000 a year (point B) would also get this family's income to the minimum income standard level. The net public cost of closing the gap in the higher wages case is further lowered by the reduction in universal credit entitlement for those whose pay increases. For a specific family moving from A to B in Figure 2, the state pays about the same amount in universal credit and takes more in taxation (so makes a net gain), while the higher wages allow the family to close the weekly £36 shortfall compared to the minimum income standard.

This example illustrates what governments could be aiming for: allowing better pay to complement adequate protection against low income, by ploughing back into universal credit the exchequer gains from better pay. Similar calculations could be made for lone parents working the amount that the public consider reasonable: about half time with a pre-school child, but longer when children are at school, according to the CPAG survey.

Enhancing working hours, reducing costs

It is important to note that for many working families, low incomes are strongly influenced by low or variable working hours. For example, for every 10 couples with children with incomes below the minimum income standard: about four have both parents working with at least one full time; four have one full-time working parent and the other not working; and two have both parents working, but neither in a full-time job.[5] Thus a policy seeking to ensure that a full-time and part-time job produce an adequate living standard would need to be accompanied by improved work opportunities to be effective. In particular, policies (such as greater access to childcare) that enable second earners to work can be crucial. Moreover, efforts to combat the increasing precarity of employment and the difficulty in securing regular working hours can be particularly important for family fortunes.

Another essential factor is family costs. The amount that working families pay for housing and childcare can critically affect their ability to make ends meet. One in four families with children now rent from the private sector and high rents are stretching family resources.[6] Childcare costs continue to make it hard for families to work and make ends meet, even where they are subsidised by universal credit. If the 30 free hours of childcare for three- and four-years-olds from 2017 and universal credit's 85 per cent childcare subsidy are delivered effectively, this will go some way to reducing those costs. Moreover, a system aiming to allow at least one parent to work part time and still enable families to reach an acceptable living standard could also help reduce the trap of work full time for little extra net income because of childcare costs.

Conclusion

The idea that child poverty and family living standards can only be addressed by combining better pay with better support is not new. In 2006, my landmark report, *What Will it Take to End Child Poverty? Firing on all cylinders*, argued that income transfers had to be combined with measures to improve family earnings to achieve the government's ambitious child poverty targets. A problem throughout is that while governments have been quick to agree that it is about improving earnings not just handing out tax credits, they have not had convincing strategies to deliver this – other than the perennial ambition to improve education and training, which has yet to produce a fundamental change in the structure of labour market rewards. The living wage movement and the government's new willingness to make serious increases in the compulsory minimum could start to change this landscape. If greater emphasis on pay provides an excuse for the state to withdraw its still much-needed financial support, child poverty will rise. If instead, better pay is combined with a determination to maintain a state commitment to helping hard-pressed families, it could represent a real opportunity to turn decent living standards for working families from a vague political ambition into a properly thought out plan. ■

Can a family reach a minimum acceptable standard of living by working for a reasonable number of hours on a given pay rate?

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1 www.minimumincomestandard.org
2 G Azmat, *The Direct and Indirect Effects of Tax Credits on Wages*, Centre for Economic Performance, 2015
3 Author calculation based on MIS data.
4 L Judge, *Round the Clock: in-work poverty and the 'hours question'*, CPAG, 2015
5 M Padley and D Hirsch, *Households Below a Minimum Income Standard: 2008/09 to 2013/14*, Joseph Rowntree Foundation, 2016
6 K Hill, A Davis, D Hirsch and L Marshall, *Falling Short: the experiences of families living below the Minimum Income Standard*, Joseph Rowntree Foundation, 2016, p17