Redefining the poverty debate:

Why a WAR ON MARKETS is no substitute for a WAR ON POVERTY

IEA Senior Research Fellow KRISTIAN NIEMIETZ summarises his acclaimed monograph on poverty. You can download it for free at www.iea.org.uk

In the late 1990s, domestic poverty became a top policy priority in the UK. This manifested itself in the adoption of explicit poverty targets and of a comprehensive set of policy measures, which have not been fundamentally altered after the 2010 change in government. It was a predominantly state-centric approach to poverty alleviation, based on a steady expansion of cash benefits and publicly provided services (see Hills et al, 2009). It was a programme that largely coincided with the recommendations of the vast network of poverty campaign groups active in this field, sometimes loosely described as the 'poverty industry'. The large-scale income transfer programmes which the poverty industry had long demanded became a reality.

ATTEMPTS TO COMBAT POVERTY THROUGH EVER-INCREASING LEVELS OF SOCIAL SPENDING HAVE BEEN TAKEN AS FAR AS THEY CAN GO

For a while, it seemed to work rather well. Up until about 2004, living standards of the least well-off were rising according to a variety of measures, especially among families with children. But, by then, the strategy had reached its zenith. Since 2004, living standards of the least well-off have made no further progress, and according to some measures they have even fallen again. The turning point preceded the onset of the great recession. For the 'poverty industry', the only permissible explanation was that the government was still not doing nearly enough. They approved of the general direction of travel, but maintained that it was no more than a good start (e. g. CPAG, 2009).

This raises the question of what level of public spending, if any, would qualify as 'enough' for the poverty industry. It is worth bearing in mind how far the use of income transfers has already been taken. For households in the bottom quintile of the income distribution, the government is the main breadwinner, with cash benefits representing by far the most important income source. In the second quintile, cash transfers officially contribute almost as much to total income as market earnings, and probably more, given the extent

[1]Polly Toynbee: *'It's full-steam ahead for George Osborne's inequality drive', The Guardian, 19 March 2012.*

	Net social spending in % of GDP (public & publicly mandated)	Family Benefits in % of GDP
Denmark	23.9	3.3
Finland	22.6	2.9
Norway	20.0	2.9
Sweden	26.0	3.4
UK	22.7	3.6

OECD (2011) and OECD (2012)

Table 1: Summary measures of welfare provision in the UK and the Nordic countries, 2007

to which transfer income tends to be under-reported. Even households in the middle quintile receive at least a quarter of their income directly from the state (ONS & DWP, 2012, p. 36). The expansion has been strongest among families with children. At least 68 per cent of all children now live in a household receiving at least one major income transfer, not counting the quasi-universal child benefit (ONS & DWP, 2012, p. 110), and not counting benefits in kind.

Social expenditure in the UK has reached Nordic proportions. In 2007, net social expenditure in the UK amounted to just under 23 per cent of GDP, which would be a perfectly normal figure for a Scandinavian country. Looking at spending on family-related benefits in particular, the UK has overtaken all the Nordic countries.

It is remarkable how little all this has affected the social policy debate. Polly Toynbee continues to claim: "Nations can choose to be high tax, high social service, high social solidarity nations like the Nordics or they can choose to be the devil-take-the-hindmost US. Britain is heading down the American path."[1]

This type of rhetoric clearly indicates a strategy of denial. At least in the British context, the conventional textbook distinction between a high-spending 'Nordic model' and a low-spending 'Anglo-Saxon model' has become completely obsolete. Attempts to combat poverty through ever-increasing levels of social spending have been taken as far as they can go. A future anti-poverty policy must move beyond this agenda.

However, the impulses for a different type of anti-poverty strategy cannot come from within the current poverty industry, or those who share their mindset. The poverty industry consists mostly of single-issue campaigners. They insist that the poverty rate is almost exclusively a function of the level of benefits, and refuse to consider alternatives outside this framework.

This is a shame, because there are promising alternatives. There is one elephant in the room which the poverty industry prefers to ignore, and that is the UK's extremely high level of basic living costs. The poverty industry mentions living costs, but only insofar

THE POSITION OF THE POVERTY INDUSTRY IS TO DENIGRATE THE ROLE OF PAID EMPLOYMENT, AND INSISTING THAT WORK DOES NOT OFFER A ROUTE OUT OF POVERTY

as it underpins their call for higher benefits. They are wholly indifferent to the causes of this unusually regressive cost structure.

Living costs, not benefits

Housing costs in the UK are probably the highest in the world. The most straightforward measure of this is the 'median multiple' (MM), the ratio of median house prices to median annual incomes. In most English-speaking countries, historical long-term average MMs used to cluster around values of just below three. Today, MMs in most UK regions exceed a value of five, and values above seven are not unusual. Food prices are almost a fifth above Dutch or German levels, and almost a third above the Irish level (uSwitch, 2011), which are unambitious benchmarks because food prices in these countries are themselves inflated by the EU's Common Agricultural Policy.

Childcare costs can eat up about a quarter of an average family's income, despite the fact that childcare subsidies are just as extensive as in the Nordic countries. The cost of the government's green agenda accounts for 10 per cent of gas prices and 16 per cent of electricity prices (DECC, 2010). For households in the bottom quintile of the income distribution, alcohol and tobacco duties account for at least 5 per cent of their budgets, and probably a lot more given how heavily alcohol and tobacco consumption is under-reported in expenditure surveys. Duties on road fuel are also among the highest in the developed world.

Taken together, this leads to a situation in which the incomes of the least well-off are highly subsidised by government transfers (indeed, they often consist of little else), while at the same time, their cost of living is grossly inflated by government policies. This is akin to turning up all the heaters in a building to full power while leaving the windows wide open. Ignoring the systematic cost inflators and pumping more resources into the transfer machinery is just about the least cost-effective anti-poverty policy imaginable

And yet, the low level of cost-effectiveness of the benefits system is not the worst problem. We also have a policy mix that destroys work incentives. Many transfer payments are directly or indirectly linked to some aspect of the cost of living so, as the latter increased, more and more people needed income transfers to top up their budgets. As rents increased, more people came to rely on housing benefit; as childcare costs increased, more people came to rely on the childcare element of the Working Tax Credit, etc. As a result, more and more people became subject to means-testing in one form or another. Increases in these people's earned income are counted against their transfer income, weakening incentives to progress in the labour market. This can be seen by the high effective marginal tax rates (EMTR) which are common among groups with a weak labour market attachment. The majority of single parents, for example, face EMTRs in excess of 70 per cent (Adam et al, 2006).

And last but not least, as long as low-earners are so heavily reliant on government support, their living standards will always be a political football. The poverty industry is aware of this latter problem in principle, but cannot do anything about it, except accusing the tabloid press of 'manipulating' the public by writing about welfare abuse.

Slashing the cost of living through supply-side measures

So what could an anti-poverty agenda based on supply-side reforms look like? It would, have to start with a wholesale reform of the land-use planning system. The econometric literature on the determinants of housing costs shows conclusively that, in the long run, land use restrictions are the most important factor. For low-income households in rented accommodation, rent payments represent around 40 per cent of their total budgets, giving reforms in this area a high 'leverage'. The immediate first step should be the institution of a general presumption in favour of development: not 'sustainable' development, but development. But, on its own, this would be an unstable solution, because it would not address the incentives that make 'nimbyism' so attractive at the local level. In order to overcome this, the costs and benefits of residential development need to be significantly better aligned. This

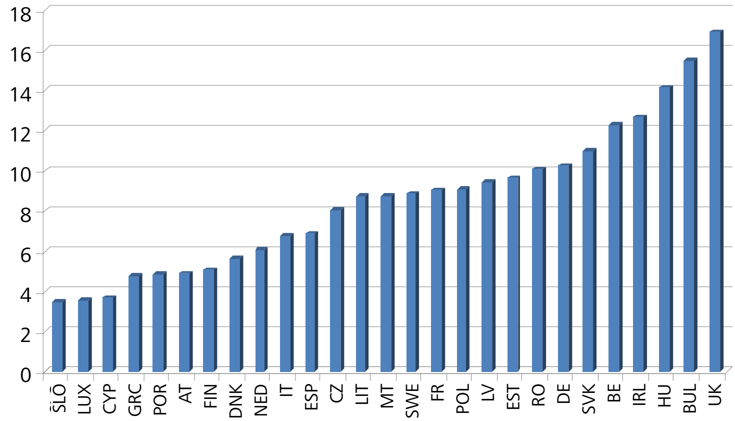

Figure 1: Percentage of children in workless households, EU-27, average 2000-2010 – based on data from Eurostat (2012)

is best achieved in a system of fiscal localism in which local authorities can keep most of their residents' tax payments and thus have to compete for taxpayers. By the same token, local authorities should have to fund housing-related expenditure, such as housing benefit payments and the cost of maintaining a social housing supply, from locally raised taxes. This would internalise some of the costs of nimbyism. All the fiscal incentives would then point towards permitting more housing development. If MMs could be brought back to the levels which prevailed until the early 1980s, house prices would fall by nearly half, dragging rent levels down with them. This would dramatically decrease dependency on housing benefit, improve work incentives and reduce taxes. Prices in space-dependent industries such a retail and catering would also decrease.

THE SECOND MAJOR PLANK OF A SENSIBLE ANTI-POVERTY STRATEGY HAS TO BE TO INCREASE LABOUR MARKET PARTICIPATION AMONG THE LEAST-WELL-OFF

Further, in the process of renegotiating the division of competences between the UK and the EU, agricultural policy should be a candidate for repatriation. However, the purpose of this should not be to replace the Common Agricultural Policy by a similar 'British Agricultural Policy', but to replace it with nothing – to allow unhampered free trade in foodstuffs. Farm-gate food prices in the EU are more than one tenth above world market levels, a situation which could not persist under conditions of free trade. In abolishing agricultural protection, the UK would do no more than follow the lead of New Zealand and Australia, where agricultural producers are expected to operate under market conditions. Food prices in these countries are almost identical to world market prices.

Childcare is another candidate for deregulation. The detailed input regulations that guide the day-to-

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day operation in this sector should be largely abolished. It should be up to childminding agencies to find out what kind of quality signals parents expect, and find ways to acquire these traits and signal them. As a first step, details such as minimum staff-to-children ratios should be abolished, and the funding stream should also be rationalised.

Sin taxes should be slashed. Given the low price elasticity of demand for the taxed 'sin products', this would not lead to a massive increase in 'sinning'. It would, above all, liberate resources in low-earners' budgets for other uses.

Strengthening labour market attachment

Taken together, these supply-side measures would slash the basic cost of living and raise low-earners' living standards. The second major plank of a sensible anti-poverty strategy has to be to increase labour market participation among the least-well-off. This is an area where the poverty industry's position is not just unhelpful, but actively counter-productive. Their work mainly consists of denigrating the role of paid employment, and insisting that work does not offer a route out of poverty. They argue the way to overcome poverty is benefits, not work. They use two major arguments to back up this position:

1. More than half of all children in (relative) poverty already have a parent in paid work.

2. The parental employment rate is already among the highest in Europe.

Both arguments are true when taken literally, but they do not show what the poverty industry claims they show.

The first point is simply explained by the high prevalence of part-time employment among parents. More than one in ten children live in a household with (at least) one adult in part-time employment, but nobody in full-time employment. 'Part-time', in this context, mostly means a working week of 16-hours, the threshold at which parents qualify for Working Tax Credit payments.

The second point is explained by the high proportion of dual-earner households, which drives up the aggregate parental employment rate. Nevertheless, no other European country has such a high proportion of children in a household with no adult in work, one of the many facts that the poverty industry conveniently ignores.

In order to overcome this situation, recipients of in-work benefits should be required to increase the number of their weekly working hours over time, eventually towards a level approaching full-time employment. The option of subsidised part-time employment should be available for those just (re-) entering the labour market, to smooth the transition, but not as a permanent alternative for full time employment. In-work benefits should act as a wage supplement, not as a wage substitute.

Support systems for the workless, meanwhile, should be devolved to the local level, and funded from local tax revenue. This would result in a variety of different welfare systems within the country. In all likelihood, most of these would tend towards some version of conditionality. Local funding would imply a much higher level of transparency. Local voters could see how much the system costs them, which would give them a much stronger incentive to monitor policy performance and demand 'value for money'.

With a combination of high work levels, high rates of work retention and work progression, and competitive product markets which make the basics of life easily affordable for everybody, the UK has the potential to truly eradicate poverty.

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