findings

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Combining work and welfare

Low pay increases working poverty and reduces incentives to work. This research, by Jane Millar, Steven Webb and Martin Kemp, clarifies some policy options for providing additional financial support to low-paid workers, and evaluates their likely impact on poverty and work incentives.

- About one-fifth of the employed workforce is low-paid. In 1994 about 4.6 million employees were earning less than two-thirds of median hourly wages. Women are much more likely to be low-paid than men.

- The overlap between low pay and household poverty has significantly increased. In the 1970s and 1980s, about 3 to 4 per cent of low-paid people were living in poor households. In the 1990s this has reached 12 to 13 per cent.

- Receipt of in-work benefits has been rising rapidly. Women are now the majority of family credit recipients, and those in receipt are fairly typical women workers. By contrast, male recipients are rather atypical male workers: more likely to be self-employed, working shorter hours, with very low wages.

- Couples use family credit to help them over periods when one partner is unable to work and, if they can, many would prefer to be two-earner families. Lone parents stay longer on family credit, partly because they can never take the two-earner option.

- Drawing on models used in the study, the researchers conclude:

  - a national minimum wage set at £3.75 per hour would reduce household poverty, improve work incentives and save up to £1.2 billion per annum.

  - a national minimum wage would, however, make the case for certain other policy options - such as introducing a 10p tax band or extending family credit to workers without children - weaker.

  - a reform package including higher family credit for school-age children, faster withdrawal as earnings rise, and reductions in social rents, would, alongside a minimum wage, have significant anti-poverty and pro-work effects.

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Introduction

For the past twenty years high rates of unemployment have been one of the most visible consequences of labour market restructuring. But there has also been a related rise in low pay. Low pay causes two main problems: first, it increases poverty as workers cannot support themselves, and their families, at an adequate level; second, it reduces financial incentives to take up or stay in work. Policies to increase the incomes of the working poor therefore have two main goals: supporting those receiving low or modest wages, and increasing incentives to work.

In the past, work and welfare have been alternatives. People in work were largely outside the benefits system on the assumption that their earnings were sufficient to support themselves and any family. However, working families have been gradually brought into the benefit system, at first through help with housing costs and local taxes, and more recently through family credit, a general wage supplement for low-paid families with children.

This growth in the number of people combining work and welfare raises important policy issues: are in-work benefits ensuring that working families are lifted out of poverty? Do in-work benefits provide the right incentives for unemployed people to take work, and for low-paid people to move up to better-paid jobs? In order to try and answer these questions, this study began by examining past trends in low pay, in order to get a picture of those most at risk and to better understand the relationship between low pay and poverty.

The distribution of low pay: 1960s to 1990s

The study defined low pay as a gross hourly wage rate of less than two-thirds of the median for all employees aged 16 years to pensionable age. The extent of low pay was examined using data from the Family Expenditure Survey, from the late 1960s onwards.

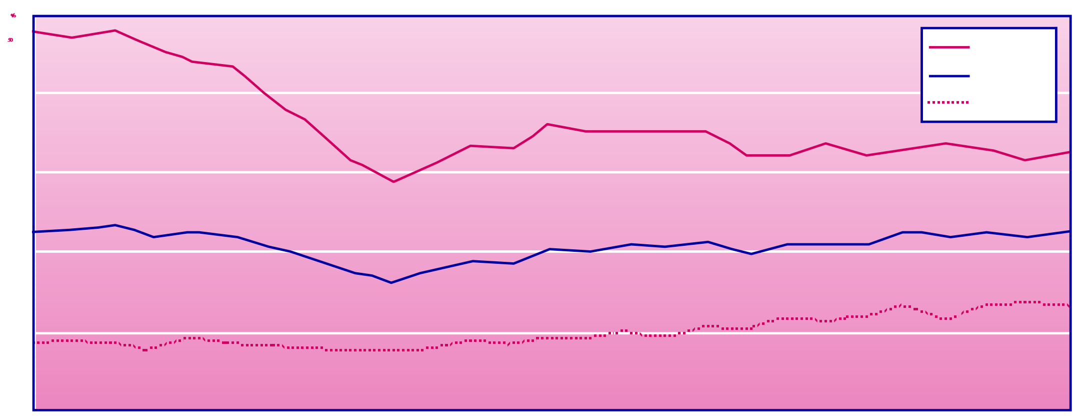
In 1994 around 4.6 million employees, 3.2 million women and 1.2 million men, were low-paid (earning below £3.87 per hour). This amounts to about 22 per cent of the workforce. There was a clear decline in the extent of low pay in the 1970s but by the end of that decade the rate of low pay was once again rising (see Figure 1). Among women, the low pay rate fell sharply between 1968 and 1977 from around 48 per cent to around 30 per cent, before stabilising at around 32 to 34 per cent for most of the 1980s and early 1990s. By contrast, the extent of low pay among men was fairly stable at around eight per cent for much of the 1970s, before rising during the 1980s to stand at around 13 per cent by the mid-1990s.

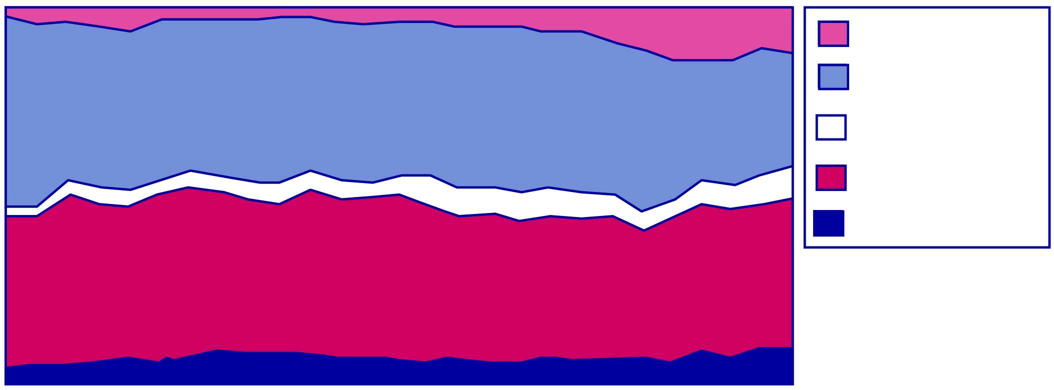
Twenty-five years ago, the typical low-paid worker was either a married woman or a young single person just entering the labour market. This picture is now only partly true. Women still make up the majority of low-paid workers but men, especially those aged 25 to 49, are increasingly at risk of low pay. In the past most men in this age range would have been the sole family breadwinner, but today many are likely to be married to employed women. For couples an increased risk of low pay may have been offset, in terms of family income, by the rise in the two-earner family. On the other hand, there are also more women living alone, and in particular more lone mothers, who are sole earners for their families. Continuing high rates of low pay for women, coupled with more female sole earners, may be putting more families at risk of poverty. Understanding the relationship between low pay and poverty, and how this has changed over time, thus depends on the interaction between changing family and employment patterns.

Low pay and poverty

Examining the relationship between low pay and poverty means examining the capacity of wages, alone and in combination with other income, to meet needs. The study used a novel approach which examined the impact of different income sources - earnings and benefits - coming into the household, and looked at how this has changed over time. For each low-paid individual, the research team asked 'which source of income is taking the household to which this person belongs out of poverty?', setting a poverty line at below 50 per cent of average household income, adjusted for household size. To answer this, the research team took that person through a series of five steps, examining whether their household had crossed the poverty line by means of:

1. that individual's own market income (for most people this means earnings from employment but it can also include other income, eg occupational pensions);
2. the market income of their spouse, if present (defined as above);





3. non-means-tested social security benefits;
4. means-tested social security benefits;
5. incomes of other household members (parents in the case of adult children, or adult children in the case of parents).

Thus whatever other sources of household income are available, if an individual had enough earnings to take the whole household over the poverty line, then the household moved out of poverty at step 1. If not, the analysis moved on to the next step and so on. The order of the steps was based on the empirical evidence that, in general, people prefer wages above benefits and own wages above having to rely on the wages of others.

It was found that, in the mid-1990s, only about eight per cent of low-paid workers earn enough themselves to prevent their households falling into poverty. However, having two earners can lift the household out of poverty, even if one is low-paid. Almost 41 per cent of low-paid workers have a spouse whose market income contributes to lifting the household's total income above the poverty line. A further eight per cent of low-paid employees are lifted out of household poverty through the addition of social security benefits. The final route out of poverty - the income of other household members - relates mainly to young single people, many of whom live with their parents. Just under one-third of low-paid employees were taken out of household poverty in this way.

However, 12 per cent, or one in eight low-paid workers, do not escape from household poverty, even taking into account other household income. Low-paid lone mothers and one-earner couples are the most likely to be living in household poverty (around one in three). Low-paid single people and two-earner couples are the least likely (under ten per cent), mainly because of the presence of other workers in the household. Employed husbands protect low-paid wives from household poverty, but employed wives also protect their low-paid husbands. Only for lone mothers does the benefit system play a significant role in preventing working poverty.

Figure 2 shows that the routes out of household poverty have been relatively stable over the past thirty years. The main change has been that reliance on other household members, typically co-resident parents, now applies to only about one-third of low-paid employees compared with nearly one-half at the end of the 1960s, reflecting both the fall in the numbers of low-paid single people and changes in household composition. Lone mothers are particularly likely to have been affected by the latter. However, perhaps the most important trend is that since the mid-1980s the overlap between low pay and poverty has increased quite considerably. For most of the 1970s and early 1980s only around three to four per cent of low-paid individuals lived in household poverty, whereas by the early 1990s the proportion touched 13 per cent before falling back slightly.

Family credit and other in-work benefits

In order to decide which future policy options to model, the study reviewed recent research on in-work benefits. About 700,000 families currently receive family credit and receipt has been rising rapidly. Both gender and family structure affect patterns of receipt. Women recipients, now the majority, are fairly typical women workers: concentrated in service sectors, in part-time jobs, with earnings that are low but not unusually so. Men recipients, by contrast, are atypical male workers: they are more likely to be self-employed, they work low hours, and their wages are in the bottom ten per cent of male earnings. Couples and lone parents use family credit in different ways: couples to help them over periods when one partner is unable to work (whether through unemployment or for other reasons) and, if they can, they prefer to access income from two earners rather than from one earner plus family credit. Lone parents receive family credit over longer time periods, partly because most are women and so tend to have low earnings and partly because they can never take the two-earner option.

Family credit has three main objectives: to increase income in work, to improve work incentives and to minimise the poverty trap. The evidence suggests that family credit does indeed boost income in work, but it does not eliminate family poverty and many families in receipt continue to struggle to make ends meet. As regards work incentives, those currently out of work are not easily able to access family credit to take them into work. A key problem seems to be the multiplicity of benefits involved; uncertainty about meeting housing costs is a particular source of concern. However, the poverty trap does not appear to be a problem in practice because people seem to take little notice of the way in which family credit is withdrawn as earnings rise. The six-month period of receipt, once the benefit is awarded, provides both a financial cushion against this and makes the high marginal tax rates largely invisible.

Future policy options

Looking to the future, the study first examined the likely impact of a National Minimum Wage, given that the Labour Government is pledged to introduce this in the near future. This was set at £3.75 per hour and the impact on household poverty and work incentives was examined, using the tax-benefit simulation model developed by the Institute for Fiscal Studies (TAXBEN, which uses Family Expenditure Survey data).

A minimum wage at this level would reduce the number of individuals living in poor households by about 300,000. It would save up to £1.2 billion per annum through reduced spending on in-work benefits and increased revenue from tax and national insurance. It would improve work incentives for women in particular and increase the number of individuals who are able to lift their household out of poverty through their own earnings. However, a minimum wage set at this sort of level would still leave other problems unresolved. Large numbers of people of working age would remain in poverty, and significant numbers of women and men would still find themselves little better off in work than on benefits.

It is therefore necessary to go further. One option - already being piloted - is to extend family credit to workers without dependent children. However, the case for this ‘earnings top-up’ seems to be rather weak. Many of those with the lowest earnings levels are young childless people who would already be helped by the minimum wage. The extra expenditure on the earnings top-up has only a limited additional effect on household poverty, although it does further improve the return to part-time work, in particular for currently unwaged men without children. Earnings top-up also extends in-work benefits to all groups of workers, which may have a depressing effect on wages.

Another option would be to complement the minimum wage with a lower starting rate of income tax, as promised in the July 1997 Budget. However, this measure achieves relatively little on top of the results already achieved by the minimum wage. The simulations show that the 10p tax rate would do virtually nothing more to reduce household poverty, nor would it substantially improve the work incentives of those who are currently unwaged.

The final simulation examined a package of measures based on its analysis of the main problems with the current system. This includes: an increase in the rates of family credit for children of school age (in order to increase the living standards of long-term family credit recipients, especially lone parents); an increase in the family credit ‘taper’ (which means that family credit is lost more quickly as wages rise); and a reduction in social rents (to reduce the number of people within the scope of the housing benefit system and so simplify the in-work benefit system).

The results show that a radical package of this sort can make a big difference both to poverty and to work incentives. This package, which is broadly revenue-neutral, taking account of higher tax and NICs from the minimum wage, lifts almost three-quarters of a million people out of household poverty. Equally importantly, it makes a large dent in the numbers of unwaged women and men with children for whom paid work is financially unrewarding. In particular, it reduces by half the number of unwaged family men for whom even a full-time job adds no more than 25 per cent to their income out of work.

Conclusion

It is clear that people will be combining work and welfare for many years to come. Even with a minimum wage regime in force, many families will still find that their household earnings are not adequate to lift the household out of poverty. However, the in-work benefit regime can be reformed in intelligent ways so that more people are encouraged to move off sole dependence on benefits and into work with benefit top-ups, and so that those who spend long periods on low wages are prevented from sinking into poverty.

About the study

The study included secondary analysis of 30 years of the Family Expenditure Survey and policy modelling based on TAXBEN, the tax-benefit simulation model developed by the Institute for Fiscal Studies.

Further information

The full report, Combining work and welfare , by Jane Millar, Steven Webb and Martin Kemp, is published for the Foundation by YPS. It is available from York Publishing Services Ltd, 64 Hallfield Road, Layerthorpe, York YO3 7XQ, Tel: 01904 430033, Fax: 01904 430868 (ISBN 1 899987 64 9, price £11.95 plus £1.50 post and packing).

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