

FINDINGS

CAN IMPROVING UK SKILLS LEVELS REDUCE POVERTY AND INCOME INEQUALITY BY 2020?

Improving skills in the workforce is seen as fundamental to achieving a more competitive economy and maintaining productivity. Current and previous government policy implies that an increase in skills will reduce poverty and income inequality. This research investigates how improving UK skills levels will affect rates of poverty and income inequality.

The research suggests the distribution of skills projected for 2020 will:

- Reduce fixed (or absolute) UK poverty rates by 2.2 percentage points – equivalent to lifting about 1.5 million people out of poverty in comparison to the distribution of skills in 2008.
- Have a smaller impact if using a relative poverty measure, but still reduce relative poverty by 1.0 percentage point – equivalent to lifting 500,000 people out of poverty.
- Reduce poverty among families with children by about 4.0 percentage points using a fixed poverty line – equivalent to lifting 500,000 children out of poverty.
- Relative child poverty will fall by 1.8 percentage points lifting 250,000 children out of poverty.
- Reduce poverty in all four UK nations, with slightly larger effects in Wales and especially Northern Ireland.
- Have only a small impact on income inequality.

To conclude, policies to improve UK skills levels particularly those that meet or exceed the projected improvement in skills levels by 2020 could improve the absolute quality of life of large groups of people currently in poverty. However, to reduce relative poverty and income inequality more substantially, the skill levels of those at the bottom of the income distribution must be raised much further relative to those towards the middle and top.

The research

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BACKGROUND

This project explores the relationship between skills, poverty and income inequality. Each of these concepts is highly complex and there are three main challenges: defining and projecting skills scenarios; defining poverty; and reconciling individual level skills against household level poverty.

Developing skills scenarios

Improving skills among the working age population is seen as fundamental to achieving a more competitive economy, raising employment and maintaining productivity. Furthermore, world class skills are key for competitive advantage and improving social mobility – both Government aims.

This project explores the potential impact on poverty and income inequality in 2020 based on three scenarios:

- Skills levels in 2020 remain the same as in 2008 (the 2008 benchmark);
- Skills levels increase as projected by the UK Commission for Employment and Skills (UK Commission);
- The UK reaches a 'world class' standing in skills.

To define 'world class skills', this research has used an ambition for 2020 set by the previous Labour administration (as a result of the 2006 Leitch Review) for the UK to be one of the top eight OECD countries for jobs, productivity and skills. This required that by 2020 more than 90 per cent of adults be qualified to at least Level 2 (five or more GCSEs at grades A–C) and more than 40 per cent be qualified to at least Level 4 (first or other degree).

While the Government's 2010 skills strategy, Skills for Sustainable Growth, retained this commitment to 'world class skills', it abolished its specific targets. However, the UK Department for Business, Innovation and Skills (BIS), and others such as the Organisation for Economic Co-operation and Development (OECD) still measure the UK's progress internationally against these measures. Accordingly, they have been used in this project to analyse the potential impact of reaching world class skills levels on poverty and income inequality.

Prior to the removal of the 2020 goals, the UK Commission monitored UK performance against the ambition for world class skills. The most recently available projections indicated the Level 4 measure will be met but that attainment at intermediate and lower skills levels will not. This research uses these projections of skills levels for 2020 to explore the impact of the current trajectory of UK skills policy on poverty and income inequality.

Defining poverty

Poverty is defined in two ways in this research:

- Using a fixed poverty line ('absolute' poverty) set at 60 per cent of median income in 2006 – essentially a measure of spending power. People are brought above the fixed poverty line if incomes rise across all parts of the income distribution, regardless of whether those towards the bottom are catching up or slipping behind those further up.
- Using a relative poverty line which is also set at 60 per cent of median income but which reflects changes in the median caused by skill changes. This measure shows whether the gap between those in the lower and middle parts of the income distribution is widening or narrowing.

Reconciling individual skill with household poverty

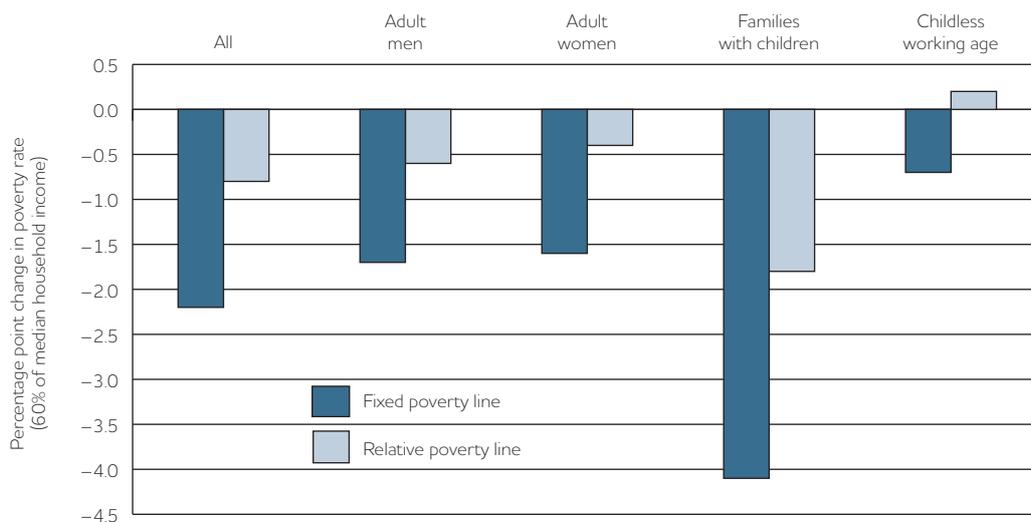
Although skills and wages relate to individuals, poverty and income inequality are concerned with household income and people tend to partner with similar people. Low skilled (and high skilled) individuals cluster within households which strengthens the link between low skill, low pay and unemployment across individuals and poverty and income inequality across households. Therefore the changes in skill profiles at the individual level are also likely to be reflected at the household level.

Impact of predicted skills distribution on poverty in 2020

The research suggests that all other things being equal, compared to the pattern of skills in 2008, achieving the UK Commission projected skills distribution for 2020 would (see Figure 1):

- Reduce absolute (or fixed) poverty rates in the UK by 2.2 percentage points lifting about 1.5 million people out of poverty.
- Reduce relative poverty by 0.8 percentage points lifting about 500,000 people out of poverty.
- Reduce fixed poverty among men and women by 1.6 percentage points – lifting about 600,000 men and 600,000 women out of poverty.
- Reduce relative poverty by 0.8 percentage points among men lifting 260,000 out of poverty and 0.5 percentage points among women lifting 170,000 out of poverty. These small gender differences between men and women are likely to reflect that a larger proportion of the employment gains among women associated with the up-skilling will be in part-time jobs.
- Have larger effects on poverty rates among families with children than on childless working age adults. For example it will:
 - Reduce fixed poverty rates among families with children by 4 percentage points, lifting 500,000 children out of poverty.
 - Reduce relative poverty by 1.8 percentage points among families with children, lifting 250,000 children out of poverty.
- Reduce fixed and relative poverty in all four nations of the UK, with slightly larger effects in Wales and especially Northern Ireland. The larger effects in Wales and Northern Ireland are caused by the relatively low current skills base in these countries relative to in England and Scotland, and so a larger up-skilling of the workforce is necessary to meet world class or predicted levels by 2020.

Figure 1 – Impact of predicted skills distribution on poverty in 2020



What explains these different impacts of changes in the skills distribution on poverty when using a fixed as opposed to a relative measure? Achieving world class skills or achieving the UK Commission projected distribution of skills implies that skills will increase across the whole distribution – the changes in skills affects both those at the bottom, the middle and at the top of the skills distribution. This raises incomes across the entire income distribution (and so reduces poverty measured using a fixed threshold), rather than raising the incomes of those at the bottom of the income distribution relative to those higher up the distribution (and so reducing relative poverty).

Changes to the skills distribution are predicted to have only a small impact on income inequality as a consequence of raising incomes across the whole income distribution. If skills levels remain the same as in 2008, households at the 90th percentile of the income distribution in 2020 are predicted to have incomes that are 4.0 times larger than incomes of households at the 10th percentile of the distribution. This ratio is predicted to fall to 3.9 if world class skills or the UK Commission projected distribution of skills for 2020 are achieved.

Conclusion

The changing distribution of skills by 2020 is likely to reduce poverty using a fixed measure which will considerably improve the absolute quality of life of large groups of people where there is clear income deprivation presently. Child poverty is strongly associated with a range of adverse life-course outcomes relating to employment, health and family stability. Therefore, there is the possibility of very long benefits to society as well as economic competitiveness from achieving the ambition of world class skills.

However, the picture is less clear when thinking of income inequality and poverty in relative terms. The main reason for the smaller impact on relative poverty and inequality is that the changing distribution of skills results in an increase in incomes across the entire income distribution. This raises the relative poverty line without significantly changing the differences in incomes between those higher and lower in the distribution. Consequently, there may be some people whose incomes increase, but who nevertheless slip into or remain in relative poverty as a result of the skills changes.

The current trajectory of changes to the skills distribution is predicted to have relatively modest impacts on relative poverty. While it is true that improving skills will reduce UK poverty and income inequality, it is clear much larger improvements in skills are necessary to have substantial effects. This is particularly the case considering the data used in this research pre-dated the recent economic recession, and the methodology used did not incorporate public expenditure cuts or planned changes in the benefit system. In order to reduce relative poverty and income inequality more substantially it is necessary to focus efforts on raising skill levels at the bottom of the skills distribution relative to those at the middle and top. The need to improve basic literacy and numeracy skills, and to support people who lack the basic skills to access employment has been identified by the current coalition government in its skills policy. A general increase in skills across the distribution has to be part of a wider strategy to reduce income inequality and poverty as it will not reduce relative poverty or income inequality substantially by itself.

About the project

This research, undertaken at the Institute for Social and Economic Research, was led by Professor Mark Taylor. It used data on around 10,000 individuals from the British Household Panel Survey (BHPS) on qualifications, employment and earnings, and income. The approach investigated changes in current poverty and income inequality levels if the skills distribution today matched 2020 ambition levels and UK Commission projections for 2020. The impact of improved skills on individuals' employment and earnings were estimated, and the results used to simulate the new distributions of household incomes.

These predictions are based on several assumptions. The first is that accumulating skills and qualifications leads to a greater likelihood of being in work and of having higher earnings, and that the values of skills in the labour market will not be affected by the increase in the supply of skills. The second assumption is that the tax-benefit system will remain unchanged. Finally, skills are measured using educational attainment and the research assumes that this reflects skills valued by employers.

FOR FURTHER INFORMATION

The main report, **Can improving UK skills levels reduce poverty and income inequality by 2020?** by Mark Taylor, Tina Haux and Steve Pudney, is available as a free download at www.jrf.org.uk

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