JOSEPH ROWNTREE FOUNDATION

INSPIRING SOCIAL CHANGE

Budget Submission 2014

Connecting more people and places to growth

Select recommendations from the JRF evidence base are that the Treasury should:

- With the Department for Business, Innovation and Skills specify in the Low Pay Commission's 2015 remit that it pay particular attention to the costs of living.
- Encourage the Department for Work and Pensions to use the negotiation of the next round of Work Programme contracts to consider how the system can be geared to better support job progression, with an emphasis on sustainable, personalised exits from poverty.
- Encourage city regions to use their Growth Deals to actively experiment with different approaches for increasing firms' demand for skills, balancing measures that support gradual improvements to the goods and services provided by existing businesses alongside the existing emphasis on attracting and/or nurturing high value sectors.
- Encourage HMRC to ensure that data collected through Universal Credit can be shared with agencies at the local level to improve the targeting of labour market interventions that reduce poverty.
- Revisit the proposed balance of funding between the voucher and universal credit aspects of the tax free childcare policy - targeting a greater proportion of the available resources at households in receipt of UC is likely to have a greater impact on employment rates and the number of hours worked.
- Commission a review to scope the possibility of encouraging more private sector led equity finance products within the housing market.

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Executive Summary

The 2013 Autumn Statement contained several welcome measures around housing, youth unemployment and the cost of living. However assuming that official forecasts prove correct the damage done to household incomes by the recession will still take several more years to repair. With the economy gathering strength policy makers now face choices about the speed and nature of the recovery.

For the first time in decades families where at least one adult is in work comprise the largest group experiencing poverty in the UK. The Chancellor has previously suggested that achieving a budget surplus by 2018-19 will require a further £12 billion reduction in social security spending after the General Election.

Should this fall disproportionately on working age benefits (including tax credits) it is difficult to see how - in the context of low household income growth - a further widespread deterioration in living standards would be avoided unless work was established as a reliable route for people to escape poverty, independently of ongoing state support.

This requires action both on low pay as well as further measures at the bottom end of the labour market to: raise workers' skills; increase employers' *demand* for such skills and ensure progression opportunities. The barriers that often prevent people from accepting more work also need to be addressed.

The Chancellor recently predicted that the inadequate supply of housing is likely to persist into the medium term, meaning that prices will continue to rise. In response current policy seems to be focussed on restoring 'business as usual' for high loan-to-value debt funding.

This is problematic for several reasons. Continuing debt fuelled volatility in the UK housing market threatens macroeconomic stability and means that people with large mortgages relative to incomes are vulnerable to economic shocks. Fluctuating prices also pose threats to the plans of owners whose homes are an increasingly important post-retirement asset. whether as a means of funding long term care or supplementing under-performing/non-existent pensions.

Equity finance addresses a gap by enabling home-buying households to share the costs and profits of their housing investments directly or indirectly with one or more institutional partners through shared ownership and shared equity programmes.

To date Government has led in this area, aiming to improve affordability and support the construction industry through a range of equity-sharing products. Private-sector initiatives are less well developed. However, the benefits are such that an expanded range of products, properly regulated, ought to form part of the future funding stream for UK housing.

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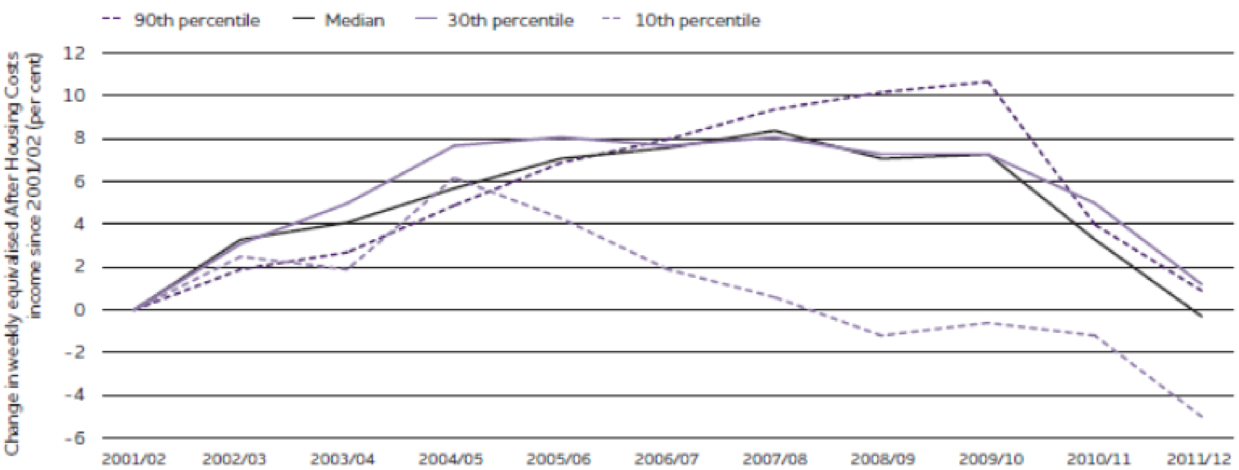
About us: Joseph Rowntree Foundation and the Joseph Rowntree Housing Trust

The Joseph Rowntree Foundation (JRF) is one of the largest social policy research and development charities in the UK. For over a century we have been engaged with searching out the causes of social problems, investigating solutions and seeking to influence those who can make changes. JRF's purpose is to understand the root causes of social problems, to identify ways of overcoming them, and to show how social needs can be met in practice. The Joseph Rowntree Housing Trust (JRHT) shares the aims of JRF and engages in practical housing and care work.

Introduction: poverty in the UK

Since 1997, JRF has funded the New Policy Institute (NPI) to track levels of poverty and social exclusion across the four UK nations. This has helped to provide an independent assessment of policies' impact on poverty rates**.** The latest of the NPI's reports for JRF was published in December 2013.[i] It confirmed that households at the bottom of the income distribution have seen proportionately smaller falls in their income than other groups during the recession due to a series of tax and benefits decisions. However it also showed that unlike the groups higher up the distribution, the incomes at the bottom started to fall in real terms in 2004/05, well before the recession's onset (see figure 1). Recent changes to the personal tax allowances have not made up for this loss.

Figure 1: Change in incomes since 2001/02



Source: Households Below Average Income, DWP; the data is for the UK

The report also charts the degree to which poverty and disadvantage remain unevenly spread across the country. The Government's urban growth agenda holds promise for supporting enterprise and job creation but the low base from which it starts in parts of the UK must be acknowledged. JRF has previously charted the emergence of a sizeable 'jobs gap' in many of Britain's major cities since 1981, with an increasing imbalance between labour supply and demand.[ii] Recently implemented cuts by grant dependent local authorities (generally those in more deprived areas) may also have implications both for services and public sector employment.[iii]

Successive governments have sought to combat disadvantage and poverty through a number of anti-poverty strategies, often focusing on particular groups, such as children or pensioners, or with a specific regional scope. These have had some effect, partly contributing to the changing composition of poverty over the past 30 years. However what has been lacking is an evidenced, all-age strategy to reduce poverty across the UK. To redress the gap JRF has initiated a major programme of research that will report in December 2015. Separate strategies for Scotland, Wales and Northern Ireland will follow in 2016.Our 'Anti-Poverty Strategies for the UK' work seeks to answer several questions.

Anti-Poverty Strategies for the UK - key questions:

- What meanings and measures of poverty should be used? What does 'a low-poverty UK' really mean?
- What kind of economy and society is compatible with low levels of poverty?
- What are the underlying drivers of poverty?
- What impact do different interventions have on poverty and its drivers?
- How much do these interventions cost and how do they interact?
- What are the barriers to action and how might they be overcome?

As part of the programme we have commissioned a range of evidence and policy reviews to better understand the existing body of knowledge on issues influencing poverty. Each of the thirty-three reviews examines the links between poverty and a specific policy area, looking for evidence about effective solutions in policy and practice. These will be published in the middle of 2014.

During 2014, we will begin to draw together the findings from the evidence and policy reviews, as well as from the various other projects, into a set of strategies to tackle poverty. To help us conceptualise how different policies and interventions interact, we will attempt to build a model of the 'system' of poverty. This will provide the foundation for our development of effective, as well as cost-effective, anti-poverty strategies.

In the continuing and regrettable absence of a strategic policy framework for poverty reduction this submission suggests some areas where we think Government could make further progress on living standards for people on low incomes/in poverty through the 2014 budget, drawing on our existing body of research. Its central theme is that as it seeks to overcome doubts that the current upturn is merely cyclical the Government should include a focus on developing the productive potential of the people and places most likely - in the absence of active policy intervention - to be left behind by the recovery.[iv] The recommendations that follow arise from two recent JRF research programmes in particular, focussed on the future of the UK labour and housing markets respectively.

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Work as a route out of poverty

Although families with no work face the greatest risk of poverty, families where at least one adult is in work are now the largest group experiencing poverty in the UK.[v] Ensuring that work forms a reliable route out of poverty requires action on several fronts. Institute for Fiscal Studies analysis has considered the relationship between poverty and employment characteristics and finds pay is the strongest predictor of how likely it is a person will experience in-work poverty.[vi] Other evidence separately indicates that improved pay at the bottom end of the labour market should have a direct impact on just over half of households in working poverty (as long as increases were not immediately deducted through the tax and benefit system).[vii]

This same research also shows that between 2001 and 2004 when the number of low-paid people fell, the minimum wage increased by 18 per cent. Between 2009 and 2012, it increased by only 7 per cent, at which point the numbers of low paid began to rise again. This smaller uplift reflected concerns over the impact on employment levels of increasing the national minimum wage (NMW). However as the Chancellor has noted, the labour market has been stronger in 2013 than a year ago, with both unemployment and the broader underemployment measures falling.

The slower rate of uplift from 2009 also coincides with an overall deterioration in living standards, with the proportion of people living in households below the JRF's Minimum Income Standard[1] increasing by a fifth between 2008/9 and 2011/12. Most of the increase came in the final year of this period. The most severe increase has been among single people of working age, where the percentage unable to afford this minimum acceptable standard of living rose from 29 per cent to 36 per cent. The dramatic deterioration in young people's circumstances is associated with growing unemployment, declining benefit levels and a sharp increase in private renting, where disposable income can be severely affected by high rent levels.[viii]

Recommendation 1: With the Department for Business, Innovation and Skills specify in the Low Pay Commission's 2015 remit that it pay particular attention to the costs of living.

Important as pay is, it alone it does not offer a sufficient response to the problem of in-work poverty. The NPI's report shows that 44 per cent of adults experiencing in-work poverty aren't low paid themselves and don't live with anyone who is. In nearly half of working households in poverty, all of the adults earn more than around £7.40 (the UK Living Wage is currently £7.65 per hour). Forty-five per cent live in households where one person is low paid. Only 12 per cent live in a family where everyone is low paid. In other words it is the *amount* of work that seems to matter to many households in working poverty. In nearly half of these households, one person works and one doesn't. Another quarter only have part-time workers.[ix]

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[1] Since 2009, household incomes have tended to fall in real terms. This has made it harder for many low-income households to make ends meet. The official poverty line of 60 per cent median income does not measure this phenomenon well, since if all incomes fall evenly, relative poverty will not change. An alternative indicator is the change in numbers falling below the Minimum Income Standard (MIS), based on detailed research showing what things members of the public think households need to maintain a socially acceptable quality of life. Further information is available here: http://www.jrf.org.uk/topic/mis

Considering the case of single breadwinner families demonstrates the way in which the labour market, tax and benefit systems interact to the detriment of some families. For example, one strategy to reduce in-work poverty for these families would be to support more second earners to work. However the work incentives within the benefits system are not strong for this group, and they are set to lose out in the transition to Universal Credit (UC), as it has no earnings allowance for second earners, meaning the value of UC payments reduces as soon as the second earner enters work.[x]

Financial incentives are particularly important for second earners in low income households to move into work or work more hours. To this end, introducing an earning disregard for second earners, so they can keep more of their pay before benefits begin to be withdrawn, is likely to help this group.[xi] Other barriers, however, frequently prevent it 'paying to work'. Chief among these is the cost of childcare and the challenge of balancing working and caring.

Good and accessible childcare plays an important role in preventing poverty. It can help prevent poverty now by enabling more parents to work and it can help prevent poverty in future generations through its contribution to child development. High-quality childcare in particular is associated with strong cognitive and behavioural development among young children in most cases. This is particularly true for young children from less affluent backgrounds, and evidence suggests high-quality childcare can help to narrow the gap in early development and school readiness between children from different backgrounds. As a result, childcare plays an important role in breaking the cycle of disadvantage across generations. Addressing the cost of childcare would also help to make work pay for lone parents.[xii]

Together, this evidence suggests taking steps to bring down the cost of childcare will have a significant impact on low income households where childcare costs constitute a larger proportion of disposable income. However, it is JRF's assessment that the policies consulted on last year and not yet finalised will fall short of these goals. Looking at the balance of resources announced £750million of the funding for tax free child care will be used for the tax-free childcare aspect of the policy, whereas only £200million will support the Universal Credit (UC) aspect of the policy. Most of the extra support will therefore be going to families with a high enough income to not to be in receipt of UC, including those households where both parents are earning just below the additional rate tax threshold (which is set at £150,000 in 2013/14). We would suggest there is a case to look again at the funding for these policies, and target more resources at households in receipt of UC. This is likely to have a greater impact on employment rates and the number of hours worked.

Recommendation 2: Revisit the proposed balance of funding between the tax free and universal credit aspects of the tax free childcare policy - targeting a greater proportion of the available resources at households in receipt of UC is likely to have a greater impact on employment rates and the number of hours worked.

The third area for action revolves around terms and conditions, job security and progression in work, all of which must also be addressed for work to act as a more reliable route out of poverty.[xiii] 'Bad' jobs, that do not fulfil these criteria, prevent paid work from performing this role. Compared to other developed countries, the UK has a relatively large number of people working in low-paid, low-skilled jobs.[xiv] This has implications for the country as a whole. The

UK's reliance on so much low-paid, low-skilled work holds back UK productivity, which compares poorly to other countries.[xv]

People in low pay are also more likely to experience insecure work.[xvi] This reinforces the observation that there is not simply a group of people that are in work and another that are out of work, with each requiring different sorts of policy intervention. Rather, people move between these states as they find and lose jobs, and for a minority these moves are frequent.

Currently, the welfare to work system is focused on moving people into work quickly, and – in the case of the Work Programme – sustaining employment (although there are questions about the programme's actual effectiveness in this area). A stronger focus on progression in work would help households move beyond in-work poverty, and turn 'dead-end' jobs into stepping stones. It would also help to move people out of the benefits system altogether, rather than simply moving them from out of work benefits to in work benefits. Our research suggests that national and local government and equality organisations have an especially important role to play in addressing unequal progression opportunities across ethnicities. However this would require a move towards more substantively personalised approaches than have currently been the case.[xvii]

The UK system is heading in this direction with the proposed introduction of in- work conditionality within Universal Credit, whereby claimants on low-wages and/or low hours will be expected to take steps to increase their earnings. However, this is an area where evidence of what works remains relatively light, as does the readiness of welfare to work providers to deliver it, with recent research suggesting that employment and skills providers gear their support towards attempting to sustain employment, rather than progression.

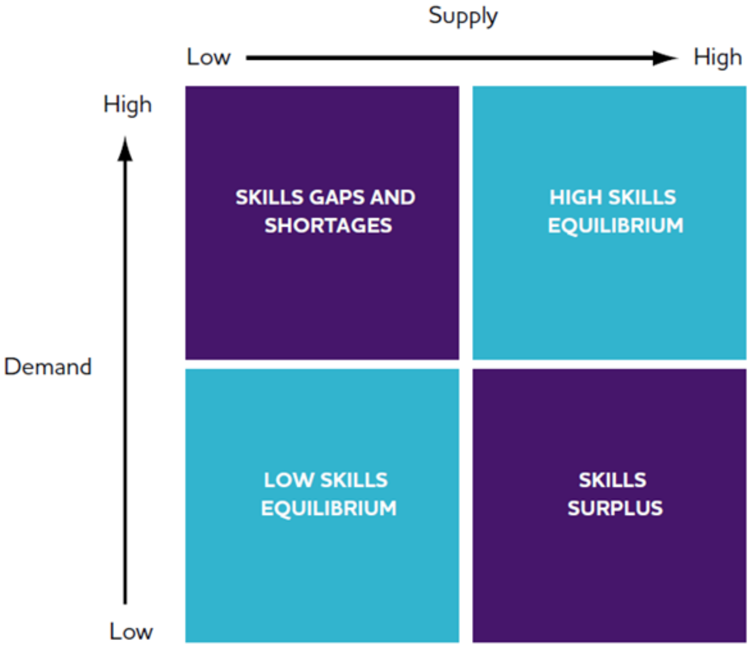
Recommendation 3: Encourage the Department for Work and Pensions to use the negotiation of the next round of Work Programme contracts to consider how the system can be geared to better support job progression, with a focus on sustainable, personalised exits from poverty

Shifting the system towards progression would require employers to also take a keener interest in progressing their low-paid staff. This further assumes that there would be jobs available for up-skilled employees to progress into; a major challenge when the nature of the labour market varies considerably between places. The idea of high and low-skills equilibriums is useful for identifying the main skills challenges in different parts of the UK (see figure 2). Areas of most concern are those with low-skills equilibrium, as they are characterised by a predominance of low-skill and low-wage firms operating with lower value added product market strategies which compete primarily on cost rather than quality.

Peripheral rural areas and former industrial areas are more likely to be in low-skills equilibrium. Skills surplus areas are also of concern, as skills are more likely to be under-used here, meaning people work in jobs they are over-qualified for and don't make use of the skills they have. Not only does this mean they risk their skills atrophying through lack of use, but also the productivity gain that should flow from higher skills is not exploited.[xviii]

To this end the role of employers is critical through their demand for skills - an arena public policy has been somewhat reticent to enter. Several reports for JRF's Future UK Labour Market programme focused on how employers can reduce poverty by ensuring people remain in work, and have the opportunity to progress; making it more likely that work would act as a route out of poverty.

Figure 2: Low and high-skills equilibriums



Taken from Sissons and Jones (2014)

The evidence suggests that integrating local skills strategies with economic development, innovation and business support strategies can result in more opportunities to shape firms' demand for skills. However, the precise interventions are less clear as this is an area where public policy is less established and more experimentation is needed. Nonetheless, research to date has highlighted:

- incremental innovation (gradual improvements to processes, goods and services): Low-wage sectors are often labour intensive, and it is skills, management and working practices that are likely to boost productivity rather than investments in technology[xix]. Strategies include moving to higher-value, more customised goods or services;

- structured progression programmes for low-earners: Developed in partnership with employers, these programmes promote advancement in work by linking training for low-wage workers with structured progression opportunities within their firm, sector or community;

- stakeholder involvement in the design and delivery of training: involving employers, trades unions and training providers in this process helps ensure course content delivers the skills needed by employers. Furthermore, research highlights employer networks as an effective way to spread good practice and reduce the cost of negotiating course content.[xx]

Within England, policy-makers have been moving towards decentralising skills responsibilities and budgets to city regions and employers. This should make it easier for different places to address the specific challenges in their area, and presents opportunities for functions to be joined up in a way that tends to approximately correspond to labour market areas.

However, the experience in one of the first city regions to gain a substantial skills settlement suggests further capacity building will be required for local skills strategies to help drive demand for skills and develop appropriate strategies to tackle poverty. Improved data availability – such as UKCES provision of employer skills survey data at city regional level – should help here. Further challenges identified include:

- having the skills and labour market intelligence to be able to identify the local priorities and challenges, and how these differ between different sectors;

- identifying measures to support high employment as well as high-value sectors. This is likely to require interventions such as incremental innovation programmes. However, this sort of thinking is less evident in city regions, which tend to be more focused on high-value sectors of the local economy;

- whether to target all firms or to focus resources on growing firms, firms with potential for growth, or firms creating 'good jobs'. How to effectively engage a lot of employers also remains a challenge.[xxi]

Separately, it has been suggested that the data collected through Universal Credit present an opportunity to better target interventions at households experiencing poverty, both in and out of work, as it will hold a wide variety of information about households that receive the benefit.[xxii] Although not all unemployed/underemployed people will be receiving state support, the principle of using and sharing data across local services is an important one for improving the targeting of labour market interventions to reduce poverty. However, information is often fragmented across agencies that are each restricted on how they use it by national departments.

Recommendation 4: Encourage city regions to use their Growth Deals to actively experiment with different approaches for increasing firms' demand for skills, balancing measures that support gradual improvements to the goods and services within existing businesses alongside the existing emphasis on attracting and/or nurturing high value sectors.

Recommendation 5: Encourage HMRC to ensure that information on households collected through the Universal Credit application process can be shared with agencies at the local level to improve the targeting of labour market interventions that reduce poverty (provided that robust governance procedures can be put into place).

Managing the risk of housing debt

Unsustainable house price booms are more likely to develop if there is an underlying shortage of housing. The balance between housing supply and demand is the fundamental long-term determinant of house prices. A cumulative backlog of housing has been created from persistently inadequate levels of new supply.

Modelling confirms that a far higher rate of addition to supply is required even to maintain current levels of housing affordability. If the average annual rate of 150,000 net additions to the number of homes in England continued until 2026, it has been predicted that the proportion of 30- to 34-year-old couples who can afford to buy a purpose-built flat will fall from over half now to around 28 per cent in 15 years' time.[xxiii]

The vast majority of new supply comes from private house building, but the capacity of the house building industry has been restricted by limited credit availability and the debts individual firms accumulated during the boom, while demand has been restricted by the tightened mortgage market. It is also essential that the planning system serves to facilitate and not to frustrate appropriate new development. Initiatives such as land auctions (pilots for which were proposed in the budget three years ago) and the taxation of vacant land may be required to overcome reluctance by landowners to release land. However, none of these approaches is without complexity.

The Chancellor's recent comments to the House of Lords Economic Affairs Committee suggest that the Treasury expects that the UK's relatively inelastic housing supply system will prevent new housing supply from keeping pace with increased demand, resulting in house price inflation. Higher housing costs in turn directly impact on living standards. Yet despite rising prices demand for owner-occupation remains strong.

Current policy focuses on restoring 'business as usual' for high loan-to-value debt funding. This is problematic for several reasons. Continuing debt fuelled volatility in the UK housing market threatens macroeconomic stability and means that people with large mortgages relative to incomes are vulnerable to economic shocks. Fluctuating prices also pose threats to the plans of owners whose homes are an increasingly important post-retirement asset, whether as a means of funding long term care or supplementing under-performing/non-existent pensions.

Debt funding will undoubtedly remain the dominant part of housing's financial future into the medium term. However the recent financial crisis exposes the limits to this model of housing finance, raising questions about the possibilities for, and practicalities of, other funding approaches. One potentially viable option, explored in a 2013 report for JRF, involves balancing traditional debt funding with innovations in equity finance.[xxiv]

Until now, equity finance have been geared primarily towards boosting ownership at the margins of the market by making entry costs and housing outlays more affordable through publicly subsidised shared equity and shared ownership schemes. They have also been seen as a way of enabling households with limited means to place a foot on the housing ladder and move incrementally towards full ownership.

Private-sector equity finance, in contrast, is in its infancy, with only a handful of products at or close to market. Funding is also at an early stage, making it hard to judge viability, sustainability or likely scale.

These fall into two main groups:

- **Home purchase products**, which enable buyers to share the costs and risks of buying, holding and occupying homes. They comprise three groups: shared ownership, where properties are jointly purchased and the occupier pays rent on the investor's share; equity share, where investors buy an equity stake and receive a return, sometimes deferred until the property is sold; and home purchase plans, which are 'rent'-to-buy arrangements that spread the purchase costs across an agreed payment period, with the provider levying an occupation charge.

- **Savings and investment products**, which potentially form a gateway to home ownership by encouraging larger deposits and reducing loan-to-value ratios on conventional mortgages. They are divided according to whether or not they are contractually linked to specific mortgages, and whether the returns are linked to interest rates or house prices. The latter are particularly innovative in protecting deposit savings against volatility.

To date there has been limited interest. Whether equity finance innovations can gain sufficient traction to spread from the margins to the mainstream depends on several factors, notably the sources and volumes of funding. Most funding to date has been from government for niche products. This is unsurprising since the market is not used to delivering equity finance, set-up costs are high, and returns are uncertain. Smith et al suggest that the future for equity finance depends on overcoming four key challenges:

- **Securing significant consumer demand**. Equity finance offers qualities that debt funding does not, such as: greater affordability with lower leverage; investment risk management, including potential protection against negative equity; and portfolio balancing to avoid concentrating wealth in a single home. Demand exists for the first of these, but success may depend on cultural shifts creating demand for the other two. The core issue is whether consumers value these attributes, find the products cost-effective and prefer them to more traditional debt funding.

- **Ensuring consumer capability and protection**. Equity finance is a new concept for most consumers and advisers, whose learning curve will be steep and require active support. Regulation is essential to protect consumers against mis-selling without exposing providers to unmanageable reputational risk.

- **Designing transparent, cost-effective products**. Few equity finance products are at or near the market today. Two critical design aspects are the apportionment of responsibilities (for repair, maintenance and eventual sale) and price. Transparency is key to both. Regardless of how products are priced, the challenge of securing attractive returns for investors while delivering cost-effective products for consumers is considerable.

- **The question of scale and the possibilities for systemic stability**. The future for equity finance may turn on the government taking a lead in developing the product range, supporting the principles of equity finance, addressing regulatory matters and perhaps providing guarantees. This may be justified if it is possible to achieve sufficient scale to stabilise housing markets and benefit the wider economy. Currently, however, government is backing traditional debt funding through extensive guarantees, limiting the scope for innovation.

This vision of a housing system in which owner occupiers can separate housing investment decisions from those around housing consumption (purchase of housing services) may be a long way off. But by adding to the product range, equity finance promotes welcome diversity. There is also the promise of greater financial inclusion – in that renters could have a stake in the housing market too – and easing of the tensions generated by restricted access to home ownership.

As the dominant provider of equity loan products, the Government is central to this market's future. However, the policy agenda is driven primarily by concerns with easing access to home ownership rather than by comprehensive risk reduction or any attempt to reform the underlying structure of the housing system. Whether equity finance will prove to be more or less costly, appealing, sustainable or policy relevant than debt funding is not yet clear. However equity finance offers a potentially complementary approach that could ease affordability, reduce volatility and add to macro-economic stability.

Recommendation 6: The Treasury should commission a review to scope the possibility of encouraging more private sector led equity finance products within the housing market.

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