Reducing poverty through policies to cut the cost of living

An IEA approach to reducing poverty

by Kristian Niemietz

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The UK has higher rates of material deprivation (a consumption-based poverty indicator) than most of its neighbours. Contrary to popular belief, this is *not* due to inadequate levels of social spending: when adjusted for differences in the tax treatment of state transfers, the British welfare state has already reached Scandinavian proportions.

Poverty in the UK is mainly caused by a series of misguided policies which distort product markets and drive up the cost of basic essentials. This paper considers the effects of abolishing distortions in the following areas:

- housing;
- energy;
- childcare;
- food;
- sin taxes.

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1 Background

Following the definition developed by the JRF, poverty here means 'When a person's resources (mainly their material resources) are not sufficient to meet their minimum needs (including social participation)'.

The Institute of Economic Affairs started its poverty research project in 2008. The aim was to find alternative ways of measuring poverty, and ultimately to work out alternative ways of combating it. Topics covered included: different methods of measuring poverty and living standards, the historic evolution of UK poverty since Rowntree's days, the drivers of poverty in advanced economies, different welfare state models and options for UK welfare reform, the role of product markets and supply-side reforms, the political dynamics of anti-poverty policies, the role of vested interests in policy formation, and proposals for anti-poverty policies that are more efficient, more cost-effective and more self-sustaining than the ones currently employed.

The project highlighted the importance of the high cost of living in the UK , and specifically its interplay with poverty. One of the project's earliest findings was that existing anti-poverty policies were in a rut, and there was a fairly obvious alternative, and one which would avoid adverse incentive effects: tackling the fact that the UK is an unusually expensive place to live.

This alternative strategy 'would have to include a thorough overhaul of the land-use planning system, to enable a pronounced fall in the cost of housing and related costs …It would also involve facilitating market entry and competition in hitherto protected markets' (Niemietz, 2009, pp. 54). The project later developed a detailed anti-poverty strategy along these lines.

The term 'cost of living' means different things to different people. This paper returns to the IEA's original meaning.

2 Introduction: A note on the 'cost of living crisis'

Over the course of 2013, the term 'cost of living crisis' became a popular catchphrase in the UK, and it has been omnipresent since then. It dominates media headlines[2], features in political speeches, and forms part of the work of research institutes, trade unions and political campaign groups.[3] According to an Ipsos MORI (2014) survey, 80 per cent of the public agree that there is a cost of living crisis, with 55 per cent agreeing strongly, and only 12 per cent actively disagreeing. Every population subgroup – social class, age, region, gender, political orientation, tenure or employment status – has a very solid majority convinced of the existence of a cost of living crisis in the UK.

The Institute of Economic Affairs' poverty research project highlighted the interplay of the cost of living with poverty, and welcomes the almost universal recognition that cost of living is important. However there is some confusion, as the term means different things to different people.

This paper reiterates what was originally meant when we argued that poverty should be tackled through a policy mix aimed at cutting the cost of living, and how this differs from the way the terms 'poverty' and 'cost of living crisis' are currently used.

First of all, we define poverty in a broad sense, which relates not just to physical subsistence, but also to social participation and necessities that are specific to a social context. But for a number of reasons we reject the relative poverty line of 60 per cent of median income. Instead, the 'poverty line' should be defined as the total cost of a basket of consensually determined necessities, and those necessities should be selected through a large-scale survey (Niemietz, 2010; Niemietz, 2014).

Meanwhile, to some commentators, the 'cost of living crisis', simply consists of the fact that Consumer Prices Index (CPI) and Retail Prices Index (RPI) inflation have been relatively high for a number of years, while the rate of median income growth has been relatively low (Bourne, 2014, pp. 13–21). When used in this sense, 'cost of living crisis' is essentially just a clumsy way of describing falling average real incomes, which is not what the IEA's poverty project has been about.

The slow growth in nominal incomes is not a cost of living issue, and should not be conflated with it. Neither should the focus be on the general price level. If the cost of living crisis was merely a byword for high inflation, the obvious solution would be to adopt a tighter monetary policy, but this would not solve the type of problems that we are concerned about.

The IEA's anti-poverty strategy concentrated only on a very specific type of price inflator, namely those that fulfil the following conditions:

They must disproportionately affect low-income households. Rates of CPI/RPI inflation are only of limited relevance for poverty research, because different income groups face different inflation rates (Adams and Levell, 2014; Niemietz, 2011, pp. 136–146). A typical basket of consumer goods for low-income households would not simply be a downsized version of the CPI/RPI consumer basket. It would be altogether different, and it would respond to different kinds of price movements. The IEA project's focus has therefore been limited to the cost of goods and services that take a disproportionately large share in the budgets of low earners – not the general price level.

The effect on low-income households must be systematic. While different income groups face different inflation rates, much of the difference consists of random variations that may well cancel each other out over time. The IEA project is not concerned with these. It is only concerned with price changes that permanently inflate the cost of living for low earners.

The effect must be demonstrably linked to domestic policies over which policy-makers have full control. The IEA's project is not concerned with price changes that are driven by global factors, such as the price of crude oil or world market food prices. Nor is it concerned with domestically driven price changes as a result of scarcity. For example, for highly labour-intensive services with limited potential for productivity improvements, rising costs are not a sign of 'market failure', but a perfectly explicable economic phenomenon. The project has only been concerned with price increases that have been caused by policies which have been adopted deliberately, and which could be altered if there was a political will to do so.

There has to be a general economic case, on top of the anti-poverty case, against the price-inflating policy. There are a number of policies which systematically drive up the cost of living for low-income households, but which may still be justifiable on other grounds, for example, environmental taxes. The IEA poverty project has not been concerned with these. The aim of poverty alleviation can easily conflict with other valid policy aims, and we are not suggesting that poverty reduction should always be prioritised over other desirable outcomes. Rather, we are concerned with policies that drive up the cost of living for low-income households while also causing general economic distortions. In addition to the anti-poverty case, there has to be a solid economic case against the policy, so that the proposed alteration comes close to a win-win situation (Niemietz, 2012a, pp. 53–54).

Concerns about the soaring cost of living crisis are shared very widely, but not unanimously. *Independent* commentator John Rentoul has dismissed such concerns as 'the politics of pointing at things and saying how expensive they are' (Rentoul, 2013). But as the above clarification shows, at least as far as the IEA project's use of the term is concerned, this criticism does not hold. The approach consists of identifying very specific price drivers for specific goods and services, of evaluating whether these drivers are policy-induced, and if so, whether there are economic grounds for justifying their existence. To paraphrase Rentoul, it is the politics of pointing at things *selectively*, and explaining how *unnecessarily* expensive they are.

This is not about reinventing the wheel. There are various well-established critiques of market distortions by economists from across the ideological and the methodological spectrum. In many cases, the burden falls disproportionately on the poor but poverty campaigners have so far not picked up on these subjects, perhaps because this is rarely explicitly mentioned in the economic literature.. Part of the purpose of this paper is to act an as 'interpreter' between these two tribes.

3 Social spending and the law of diminishing marginal returns

The approach to dealing with poverty outlined here is not of itself superior to other approaches. The causes of poverty differ across countries, and so does the intensity with which different anti-poverty tools are already being deployed. For example where mass unemployment dwarfs all other drivers of poverty, it would be ridiculous to suggest an anti-poverty strategy primarily aimed at lowering household bills.

But anti-poverty strategies, like most endeavours, are characterised by 'diminishing marginal returns'. For example, if a country with no welfare state introduced a basic safety net to fill the gaps left by private provision, it could considerably improve the lives of its beneficiaries. But this does not mean that doubling the size of that welfare state would deliver improvements of the same magnitude a second time, or that further and further rounds of welfare expansion would lead to proportional additional improvements. The same is true for the strategy proposed here. There would be enormous initial gains, and considerable follow-up gains, but once these have been realised, pushing this agenda further and further would not replicate the same results over and over again.

The approach proposed here was born out of two observations. First, in the UK the cost of various basic essentials is far higher than in comparable countries. This raises the suspicion that those prices are systematically inflated by domestic policies. If lowering the cost of such essentials constitutes a viable anti-poverty strategy, it is clearly a strategy that has not been tried in the UK on a meaningful scale yet. So the point beyond which returns to scale begin to decline is still very far away, leaving a vast potential that has yet to be tapped.

The second observation is that contrary to popular perceptions, welfare spending in the UK is not low by international standards. Poverty campaigners often urge the UK to adopt the generous welfare policies of the Nordic countries and/or their closest continental European relatives (see Niemietz, 2012a, pp. 43–47). However, once differences in the tax treatment of transfer income are accounted for, the UK is already in the same league as the 'Germanic' countries in terms of social expenditure. As a proportion of GDP, net social spending in the UK is less than one percentage point below Swedish levels, virtually on a par with Danish, and well ahead of Norwegian and Dutch levels (see Figure 1).[4]

Figure 1: Net public social expenditure (as % of GDP) in the 'Germanic' countries, 2009

Source: Based on data from OECD (2012)

Nor are the tax and transfer systems of these countries generally more redistributive than the UK's. However this does not mean that the British welfare state is especially 'generous'. The level of social spending is not in itself a measure of generosity. In the UK, high social spending levels do not necessarily translate into high living standards for the recipients, because for the most part, they are merely a response to high basic living costs. What it does mean, however, is that the approach of reducing poverty through the tax and transfer system has already been taken much further than most poverty campaigners acknowledge. Of course, net social expenditure could be raised by yet another percentage point, to exceed Swedish and Austrian levels. But given the UK's starting point, the required political capital would probably yield vastly higher returns if it was 'invested' in an alternative and as yet underused strategy.

In short, the strategy suggested here does not necessarily conflict with others; it could be used as a substitute or it could be used as a complement. But given the current status quo as the point of departure, it is by far the most cost-effective strategy available.

4 Spillover effects: Breaking out of the iron triangle

A supply-side reform strategy to cut basic living costs is not just about cutting household bills. It is also the key to breaking out of what the social policy literature often refers to as the 'iron triangle' – the trade-offs faced in welfare policy design (Adam *et al.*, 2006; Adam and Browne, 2010). Its corners represent desirable aims that are in conflict with one another. These aims are:

- offering adequate financial protection against poverty;
- maintaining strong incentives for benefit recipients to (re-)enter the workforce, progress in it, and build up savings. This refers to incentives to take up employment or self-employment, increase working hours, acquire skills etc;
- keeping public spending on welfare under control, so that the tax burden needed to pay for it can be kept moderate.

Other things equal, it is not possible to improve one aspect of the welfare system without worsening another. However, other things need not be equal. A policy agenda that cut the basic cost of living would also loosen the constraints of the iron triangle. It would improve the welfare system across the board.

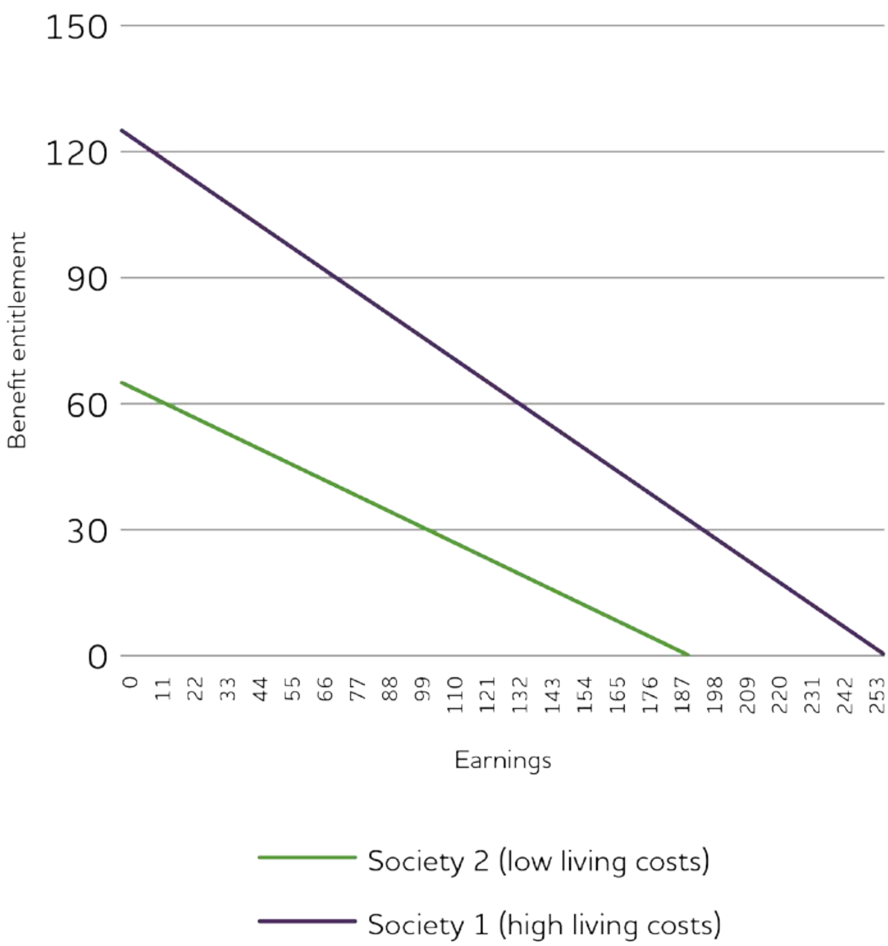
This can be illustrated by imagining a hypothetical society, with a hypothetical currency of thalers and kreutsers where 100 kreutzers equals one thaler. The median income is 250 thalers, and a low-skilled worker can earn 150 thalers when working full-time and year-round. Income differences are assumed to reflect differences in labour productivity, which are assumed to be fixed in the short/medium run. In this society people need 130 thalers to avoid poverty – this is the cost of a consensually determined basket of necessities. This society now introduces an income replacement benefit of 125 thalers, which is tapered at a rate of 50 per cent – for every 1 thaler earned, benefit payment is reduced by 50 kreutzers.

When evaluated through the iron triangle lens, this welfare system performs poorly on all three aims. The benefit level does not provide full protection against poverty, yet since benefit withdrawal produces an effective marginal tax rate of 50 per cent, the system also penalises work. Neither is the system cost-effective. Everybody earning less than 250 thalers is entitled to some benefit payment, and since this is also the median level, half of the population are in receipt of benefits.

The basic problem in this hypothetical society is not poor welfare design; it is not that the welfare system's parameters are poorly chosen. The basic problem is that external constraints *allow* no 'good' choices. The poverty line is simply too close to the earnings level of the low-skilled. Under such circumstances, a benefit level anywhere near the poverty line will inevitably produce a situation in which the low-skilled are not much better off working than not working. The same circumstances also make a high taper rate inevitable, because if the taper rate was kept moderate, benefit entitlement would cover an absurdly large share of the population, including people on high incomes. High withdrawal rates, however, reduce the payoff from increasing earnings. They discourage people from, for example, moving from part-time to full-time employment.

Now consider another hypothetical society, identical to the first one except the basic cost of living is substantially lower, so that a sum of just 65 thalers buys the same minimum basket of necessities. This society now introduces an income replacement benefit of 65 thalers, which is tapered away at a rate of 35 per cent with the recipients' income. This system is superior to that of the first society in every respect. It is fully poverty-proof, it provides relatively strong work incentives as recipients can keep 65 kreutzer for every additional thaler they earn, and benefits stop when income reaches three quarters of the median (so less than half of the population would be in receipt of benefits).

Figure 2: Benefits and benefit withdrawal in two hypothetical societies



Over time, the performance of the two systems would diverge further. In the second society, a greater proportion of the workless would take up jobs, and a greater proportion of those in minor and/or sporadic employment would move on to full-time, year-round employment. Thus, in the second society, the average duration of a period of benefit receipt will be shorter. At any given point in time, fewer people will be in need of benefits, which means that the tax burden can be permanently lower than in the first society – including for those on low- and middle-incomes. This would yet again lead to higher living standards for the low-paid and stronger work incentives. The first society is trapped in the iron triangle, the second one has created something more akin to a virtuous circle.

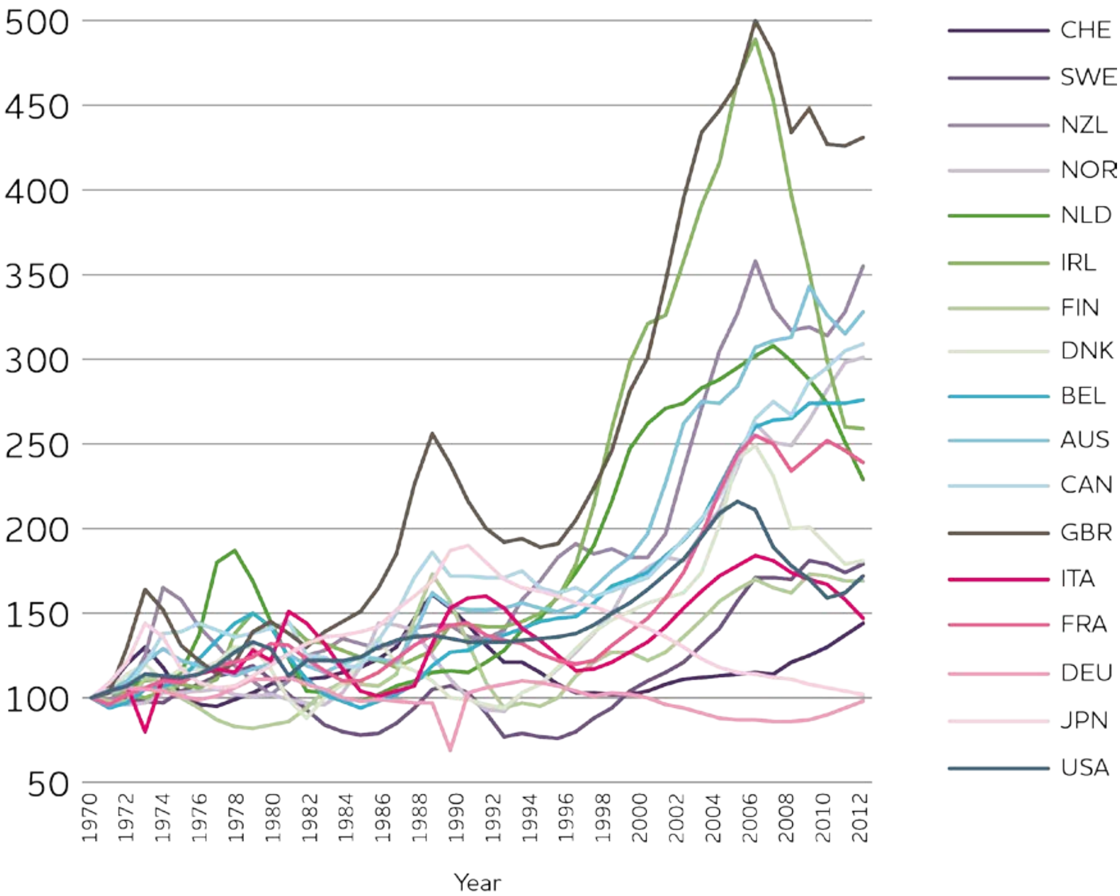
The first hypothetical society is, of course, not so 'hypothetical' at all. It is a stylised description of the UK's current welfare system, whereas the second hypothetical society is a stylised description of what the UK's welfare system *could* (and should) be like. The UK's welfare system currently performs poorly against the aims of the iron triangle. Very high spending levels (see Figure 1) do not translate into high living standards for its recipients, and even though the system is not overly generous, it does not encourage work. The reason is not primarily poor design (although that plays a role), but external constraints. As long as the basic cost of living remains anywhere near its present level, good welfare design is impossible.

5 Housing costs: The mother of the cost of living crisis

There are a number of markets in which policy-induced distortions systematically inflate the cost of living, hitting low-income households disproportionately. These are the markets for housing, energy, childcare, food, and products subject to 'sin taxes'[5] (Bourne, 2014; Bourne and Niemietz, 2014; Niemietz, 2012a). The housing market is the single most important one.

Housing costs in the UK are among the highest – perhaps the highest – in the world, both in absolute terms and relative to average income levels. This is the result of four decades of elevated house price inflation. Between the early 1970s and the mid-1980s, British house prices grew by 150 per cent in real terms, which was already the highest growth rate in the developed world. By the mid-1990s, house prices were twice as high as they had been two and a half decades earlier, again outpacing all other developed countries. But it was only then that the most extreme house price escalation began. Rent levels have followed suit. This housing cost explosion has no parallel in any comparable country.

Figure 3: House prices in real terms, 1970–2013 (1970 = 100)



Source: Based on data from OECD (2014a)

House prices in London are now the second highest in the world – second only to Monaco (Global Property Guide, 2014) – but the explosion of house prices has been a nationwide phenomenon, with London only representing the extreme end.

Across the country, house price growth has vastly outstripped earnings growth, leading to steady increases in median multiples (MMs) – the ratio of median house prices to median annual gross incomes. The historic norm for MMs was to move in a band between 2.0 and 3.0. Today, there is not a single housing market in England which still records MMs below 4.0. Instead, MMs of around 5.0 have become the new national norm, a figure which rises towards 6.0 and above in much of southern England, and to over 7.0 as one approaches Greater London (Demographia, 2014).

Table 1: Median multiples in English housing markets, 2013

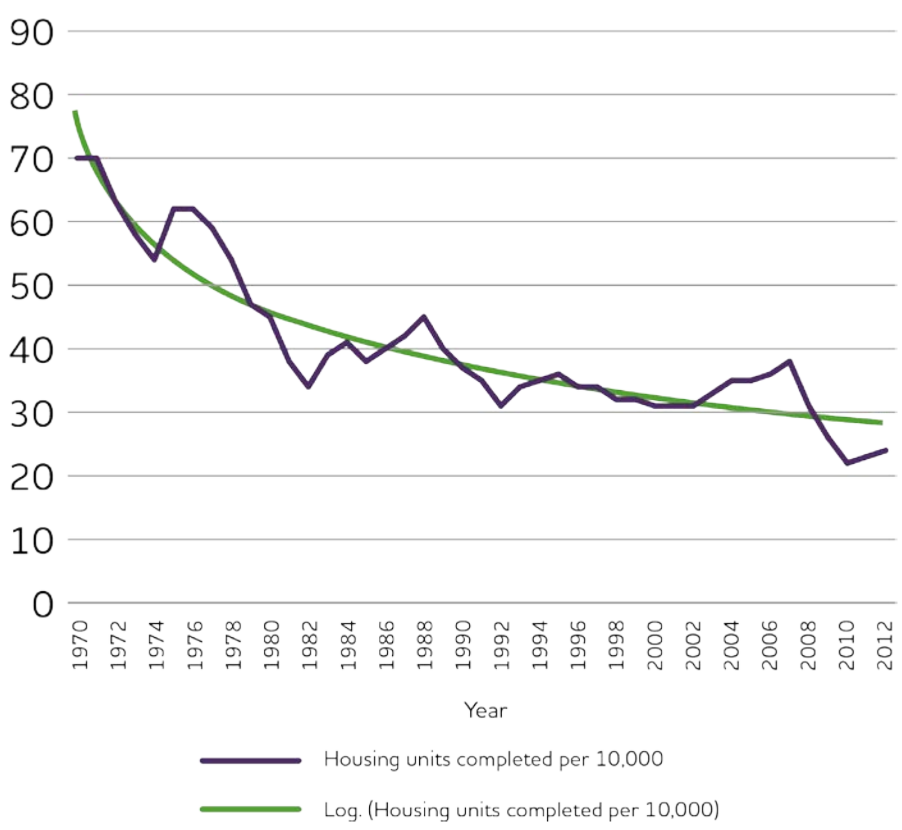
MM range	Housing markets
4.0 – 4.9	Birmingham & West Midlands, Blackpool & Lancashire, Derby & Derbyshire, Hull & Humber, Leeds & West Yorkshire, Greater Manchester, Middlesbrough & Durham, Newcastle & Tyneside, Northampton & Northamptonshire, Nottingham & Nottinghamshire, Sheffield & South Yorkshire
5.0 – 5.9	Bristol & Bath, Leicester & Leicestershire, Liverpool & Merseyside, Stoke on Trent & Staffordshire, Swansea, Telford & Shropshire, Warrington & Cheshire, Warwickshire
≥6.0	Bournemouth & Dorset, Greater London, London exurbs, Plymouth & Devon, Swindon & Wiltshire

Source: Based on data from Demographia (2014)

By international standards, these are extremely high multiples. Blackpool, Kingston-Upon-Hull and Manchester have higher MMs than Washington DC and Tokyo. Leeds and Derby are, on this measure, less affordable than Dublin and Las Vegas. Liverpool is less affordable than Singapore; Bristol and Bath are less affordable than Miami and Seattle; Plymouth and Devon are less affordable than New York and Toronto.

While much of the housing debate concentrates on demand-side factors, a cursory glance at the data shows that the problem is one of insufficient supply. Housebuilding rates have steadily declined since the end of the 1960s, and have become completely unresponsive to price changes. In the two decades before to the Great Recession, the annual number of new dwellings completed fluctuated between 30 and 40 units per 10,000 inhabitants. By a considerable margin, this is the lowest level of housebuilding in Europe (Eurostat, 2010).

Figure 4: Dwellings completed per 10,000 inhabitants



Source: Author's calculation, based on data from DCLG (2014a)

Unsurprisingly, decades of underbuilding have left their mark. When approximated by average floor space per household, the UK's level of housing supply is by far the lowest in Western Europe.[6] This rebuts the often heard suggestion that the housing stock was adequate, and just inefficiently used (e.g. Dorling, 2014).

Figure 5: Average residential floor space (in m^2) per household

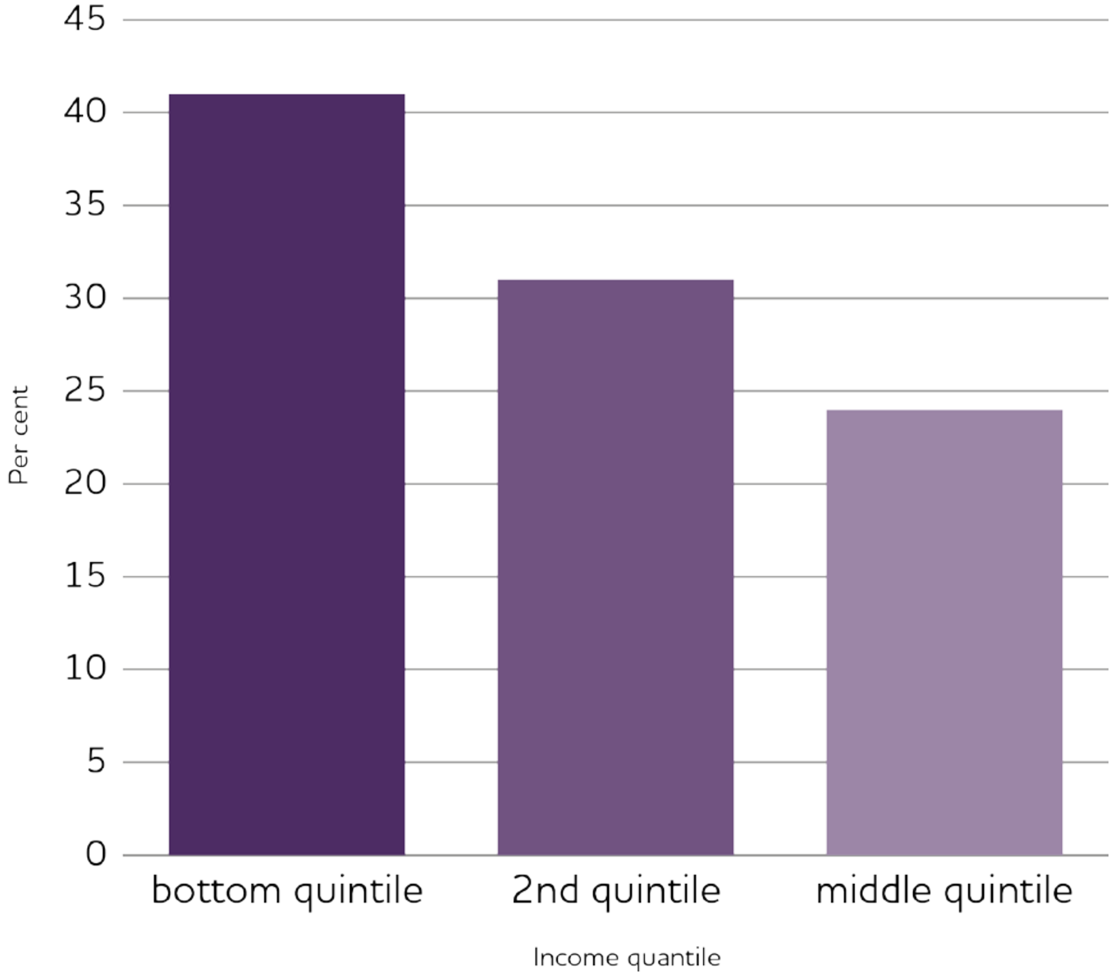
Source: Author's calculation, based on data from Entranze/Enerdata (2014) and OECD (2011a)

Direct effects on poverty

The decline in housing affordability has hit low-income households hardest. It has affected middle-income households as well, but this has mostly taken the form of adjustments in quantity – buying/renting less housing space or living in smaller dwellings – and young adults leaving their parents' home later (ONS, 2014a), living in flat-sharing communities for longer, and buying a house at a later age.[7] Generally speaking, middle-income households have found ways to compensate for the increase in housing costs. The ones that have suffered most are those on low incomes. This becomes clearest when looking at rental expenditure.[8]

Renters in the middle quintile of the income distribution spend about a quarter of their household budget on housing costs. For renters in the second quintile, this share already rises to about a third, and in the bottom quintile it rises to about 40 per cent. This is a weighted average for the private rental sector, council housing and social housing associations, so it already includes the implicit subsidies (below-market rents) received by tenants in the latter two sectors.

Figure 6: Rental expenditure as a proportion of total household expenditure by income quintile (per cent)



Source: Author's calculation based on data from DWP/ONS (2011)

This shows that reforms in this area would have a huge effect'. For households in the bottom quintile, a drop in rent levels by e.g. a quarter would, on average, liberate one tenth of household budgets for other purposes. As will later be shown, far bigger drops in rent levels are realistically achievable.

Another direct effect of the house price escalation is the lengthening of waiting lists for social and council housing. This is often misinterpreted as a specific lack of public and/or social housing, but it is really a general lack of low-cost housing across the board. Public housing and social housing account for one fifth of the total housing stock, which is one of the highest levels in the developed world (Niemietz, 2012a, pp. 70–73). The share has dropped since the 1980s due to the Right to Buy programme, but it has dropped from an extremely high level, and since it has turned a lot of council tenants into home-owners, Right to Buy has not just reduced the supply but also the demand for council housing. Focusing on one isolated sector within the housing market, as opposed to overall supply, is a blind alley. If there were more low-cost options for private rental and home-ownership, it would take the pressure off social housing, and the waiting lists would be shortened.

Intermediate effects on poverty

Figure 4 shows that when measured by residential floor space, the British housing stock is the most inadequate in Western Europe. This problem is, of course, not confined to residential housing. Commercial rents have experienced the same escalation, driving up business costs in space-intensive sectors like retail, which are then passed on to consumers. In this way, a failure to maintain an adequate building stock drives up the cost of living across the board (Niemietz, 2012a, pp. 79–80).

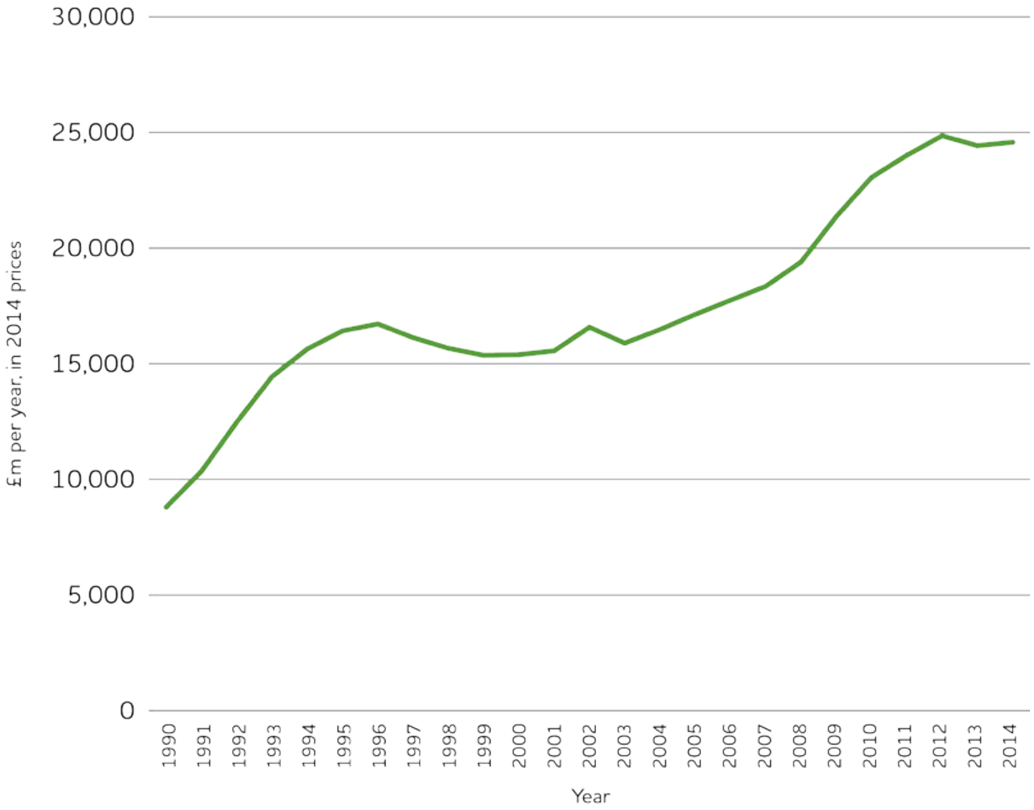
According to standard measures of industry concentration, the British retail sector is one of the most competitive in Europe (Francois *et al.*, 2007), which, on its own, should be a boon to consumers. Francois *et al* have estimated to what extent falling wholesale prices are passed on to consumers in the form of lower consumer prices in different parts of Europe. They find that in the UK, with its competitive retail sector, virtually all of the cost decrease is swiftly passed on to consumers.

Other things equal, the cost of essentials should therefore be lower in the UK than elsewhere, but this is clearly not the case. Food prices in the UK, for example, are almost one fifth higher than in countries which are similar to the UK in terms of other potential determinants of grocery bills, such as the Netherlands and Germany (Niemietz, 2012a, pp. 73–74). It is not far-fetched to ascribe the difference to the UK's property shortage, broadly defined, as the cost of business premises is a major component of business costs, and is the only obvious factor in which the countries differ notably. Thus, addressing this problem is not just a way to cut housing costs, but also to cut prices across the board, and especially retail prices.

Indirect effects on poverty

As I argue above, high levels of welfare spending are largely a response to high basic living costs, and because of these high costs the British welfare state performs poorly on all three aims of the 'iron triangle'. Housing Benefit (HB) is the clearest example of this is. Until very recently, HB levels have automatically tracked rent levels, so as rents escalated, HB expenditure escalated with them. This trend has been exacerbated by the recession, but it existed long before.

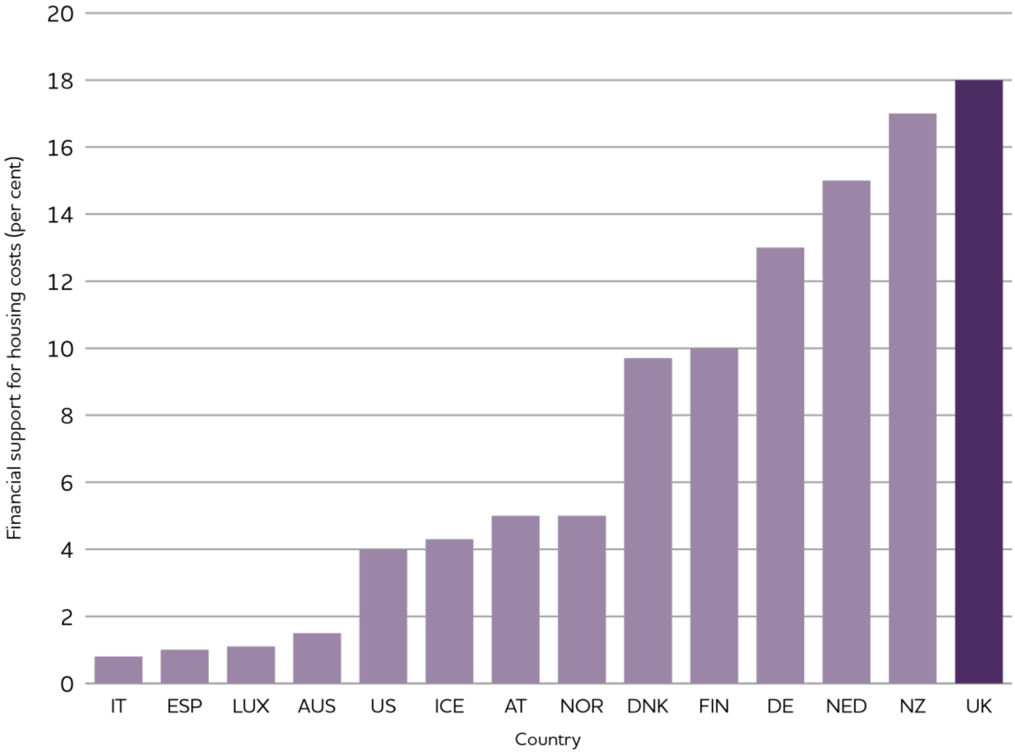
Figure 7: Expenditure on Housing Benefit, 1990–2014 (£m per year, in 2014 prices)



Source: based on data from HMRC (2014)

Rising rent levels have made more people reliant on HB, and thereby undermined work incentives. 18 per cent of the British population – 45 per cent of all households in the rental sector (DCLG and ONS, 2013) – now receive HB. This is in itself remarkable because as far as comparable data is available, there is no other developed country where such a large proportion of the population relies on financial support for housing costs (OECD, 2011b).

Figure 8: Proportion of the population receiving financial support for housing costs (Housing Benefit or equivalent), 2009 (per cent)



Source: Based on data from OECD (2011b)

HB recipients face a particularly steep withdrawal rate of 65 per cent of net income, which produces an effective marginal tax rate of 76 per cent when combined with income tax and employee national insurance contribution. This situation will remain about the same under the Universal Credit system, and there is little that could be done about it through changes in welfare design. High rent levels make good welfare design impossible. The cost of attaining a basic minimum living standard is simply too close to the earnings level that a lot of people could realistically hope to attain.

This is illustrated in Table 2, which shows the ratio of comparatively low private sector rents (for a two-bedroom flat) to comparatively low gross earnings in selected towns or boroughs. The rent levels do not represent average or median rents in the respective area, but rents at the lower end (the 25th percentile) of the distribution. This is likely to understate the problem: in the context of an overall shortage, not all households who are seeking a property in the lower quartile of the price spectrum will be able to find one, so some will be forced to rent more expensive properties. Gross earnings have been taken for somebody working 40 hours a week, year-round, at an hourly rate of £7.65 (the 2014 non-London 'living wage'). Rent levels of the areas included in the table are above the national average, so the table does not describe the situation of the country as a whole, but they are not unrepresentative either. High-rent pockets like Westminster, the City of London, Kensington and Chelsea etc have been ignored altogether, along with most of inner London.

Table 2: Lower quartile rents of a two-bedroom flat, as a proportion of a full-time gross salary at an hourly rate of £7.65 (per cent)

	Rent as a % of gross earnings
Birmingham	40
York	45
Southend-on-Sea	47
Canterbury	49
Southampton	49
Bristol	51
Milton Keynes	51
Bath	52
Wycombe	60
Slough	60
Reading	60
Cambridge	62
Brighton and Hove	64
Oxford	67
Guildford	67
Greenwich	70
Woking	71
Windsor and Maidenhead	72
Hounslow	83
Haringey	90
Ealing	95
Lambeth	98
Tower Hamlets	100
Hackney	103
Camden	123

Source: Author's calculation, based on data from VOA (2014)

A brief glance at the figures shows that under those conditions, it is simply mathematically impossible to design an affordable income replacement system which covers the cost of basic essentials, while also ensuring that those who work full-time at a modest wage are substantially better off than those who do not work. A sensible housing market reform, leading to falling rents, would make this task infinitely easier. Work incentives (whether measured by effective marginal tax rates or replacement rates) could be improved without compromising the living standards of those out of work, without exposing even more people to taper rates, and without increasing public spending.

The determinants of housing costs: A review of the empirical literature

The determinants of house prices are a well-researched topic in economics. The standard method in empirical studies on this subject is to express house prices as a function of a number of potential determinants, including an index that attempts to quantify the restrictiveness of land use planning policies. The empirical literature is remarkably conclusive: house prices can fluctuate for all kinds of reasons, but in the long term, the decisive factor is the severity of restrictions on development. The explanation which, in the British housing debate, is most often dismissed as 'simplistic' and 'ideological' (e.g. Lloyd, 2015; Jefferys, 2014; Jefferys *et al.*, 2014, pp. 39-40) also happens to be the correct explanation.

Table 3: Land-use planning policies and housing costs: the empirical literature

Study	Housing market(s) studied	Main findings/results
Brueckner (1990)	Literature review	*'There is now a large empirical literature documenting the effects of growth controls on housing and land markets. The evidence to date conclusively establishes that growth controls raise housing prices in communities where they are imposed.'* (pp. 327)
Pollakowski & Wachter (1990)	Washington	*'The results of our study confirm results found elsewhere: land-use regulations raise housing and developed land prices within a locality.'* (pp. 323)
Malpezzi (1996)	>50 US metropolitan markets	*'Our results suggest that regulation raises housing rents and values.'* (pp. 236)
Dawkins & Nelson (2001)	Literature review	*'The most important policy implication to be gleaned from this review is that local planners play a significant role in determining the severity of housing price inflation attributable to urban containment policies'* (pp. 11)
Anthony (2003)	Florida	*'Using data from the entire state over a 16-year period, with two measures of affordability and after controlling for alternate hypotheses, this research finds that Florida's GMA has had a statistically significant and negative effect on housing affordability in the state.,*
Glaeser & Gyourko (2003)	45 US metropolitan markets	*'The bulk of the evidence marshalled in this paper suggests that zoning, and other land-use controls, are more responsible for high prices where we see them. […] Measures of zoning strictness are highly correlated with high prices. […] [Our evidence] seems to suggest that this form of government regulation is responsible for high housing costs where they exist'* (pp. 35).
Chi-man Hui & Sze-mun Ho (2003)	Hong Kong	*'The analysis demonstrates that most of the planning variables affect housing prices statistically* (pp. 357)
Glaeser *et al.* (2005a)	US metropolitan markets	*'[N]ew construction has plummeted and housing prices have soared in a small, but increasing number of places. These changes do not appear to be the result of a declining availability of land, but rather are the result of a changing regulatory regime that has made large-scale development increasingly difficult in expensive regions of the country'* (pp. 20)
Saks (2005)	US metropolitan markets	*'Raising the degree of housing supply regulation by one standard deviation results in 17 percent less residential construction and twice as large growth in housing prices'* (p p. 21)
Glaeser *et al.* (2005b)	Manhattan	*'[O]ne-half or more of the value of a condominium can be thought of as arising from some type of regulatory constraint preventing the construction of new housing'* (pp. 367)
Andrews *et al.* (2011)	Literature review	*'[T]here is an emerging consensus that local land-use regulation has become a binding constraint on the supply of new housing units in some countries' (pp. 30)*
Hilber & Vermeulen (2014)	England	*'House prices would have been about 35 per cent lower (£147k instead of £226k) in 2008 absent of regulatory constraints. […]* *[H]ad the South East, the most regulated English region, the regulatory restrictiveness of the North East, still highly regulated in an international context,*

		house prices in the South East would have been roughly 25 percent lower in 2008'(pp. 2)

The most relevant study for this paper is the one by Hilber and Vermeulen (2014), which estimates that about 35 per cent of the price of a house in the England is directly attributable to planning constraints. They also explore regional variation in the severity of planning restrictions, and find it to be highest in the South East and London. The implication is that a sensible planning reform could cut national house prices by 35 per cent, and far more than that in the Southeast and London.

However the 35 per cent figure is almost certainly an underestimate. The authors do not define 'restrictiveness' in absolute terms, but relative to the level observed at the start of the time series (in 1974), and this level is, per assumption, set to zero. So the 35 per cent-figure really ought to be interpreted as the impact of *increments* in the planning system's restrictiveness since 1974, not the system's total impact, which is clearly greater.

The study is also quite generous in its definition of 'natural obstacles', which probably means that some of the variation in house prices which should have been attributed to the planning system will be misattributed to natural obstacles instead. Neither are spillover-effects accounted for. It is quite likely that planning constraints in e.g. London will also elevate housing costs elsewhere. It is not clear how important these aspects are, but it is safe to say that sensible planning reforms could cut house prices by far more than the 35 per cent suggested. Indeed, bringing median multiples back to historic norms would require house prices to fall by almost half, and more than that in the south-east. This would create its own set of transitional problems – in particular, negative equity – but there is no economic reason why it should not be achievable.'

The resistance to housing development

The suspicion that the UK's housing cost explosion is the result of planning constraints is borne out by the literature. And yet it is important to specify what exactly this means. Planning systems do not operate in a vacuum. Development is not just prevented by a set of abstract rules, but by well-organised resistance to it; resistance which is mediated through the planning system but not originally created by it (see e.g. Pennington, 2002, pp. 58–71; Evans and Hartwich, 2005).

It is a widely held belief that housing development is almost universally unpopular in the UK – The Economist writes about *'NIMBYish Britain'*[9] – but this is not corroborated by survey results. According to the latest British Social Attitudes Survey, a relative majority (47 per cent) is in favour of more development, not just in the abstract, but specifically in their area. Another 22 per cent are not explicitly in favour but not opposed either. This still leaves 31 per cent who are against development, but many of them do not seem to be *fundamentally* opposed: The survey also shows that relatively small changes to the wording of the question can lead to a large increase in support for development. It seems that a lot of people are opposed to specific aspects of development, but would support or at least tolerate it provided a number of conditions were met.

It turns out that people who would not accept development in their area under any circumstances are a relatively small group. But this relatively small group is infinitely better organised, and infinitely more active, than the supporters of development, and is therefore able to use its political muscle in order to block development (see Pennington, 2002, pp. 58–71; Evans and Hartwich, 2005). 'Nimbyism' as a vague sentiment may well exist everywhere in the world, but what makes Britain almost unique among developed countries is the existence of 'professionalised Nimbyism' (Pennington, 2002; Evans and Hartwich, 2005).

The work of anti-development campaigners takes place at various levels. At the national level, it mostly consists of lobbying policy-makers, influencing legislation and shaping the general terms of the housing debate. The latter usually means:

- Downplaying the link between housebuilding levels and house prices. For example, when the Barker Review recommended an increase in housing supply, the Campaign to Protect Rural England published a report arguing that 'such an increase would speed up the rate of countryside loss … but it would make very little difference to house prices – which depend far more on demand-side rather than supply-side factors …Demand-side factors offer a much better explanation for England's high house prices' (CPRE, 2005, pp. 3–4).

- Downplaying issue of undersupply more generally. In the same report, the CPRE argued: 'We disagree with her [Barker's] review's central conclusion – that there has been a serious and chronic under-supply of market housing across the country … The supply of new housing for sale is adequate and there is no overall housing shortage.' Plans to increase the housing supply are presented as not just unnecessary, but harmful: 'There is no chronic, nationwide undersupply of market homes. It follows that implementing the findings of the Barker Review would lead to excess housing.' (CPRE, 2005, pp. 31).
- Painting a negative picture of development as an activity that only lines the pockets of property developers, without serving any useful social purpose. For example, a report by CPRE Cornwall (2014, pp.1) on plans to increase the regional housing supply argues: 'This report by CPRE Cornwall will show that the speed and scale of such housebuilding …does not stem from local need. It is an invasion. The incursion is by those who can exploit a commercial opportunity in both property development and energy. Government policy …ignores the desperate local pleas for an approach that respects the interests of those who live here. Government has therefore failed to use its power to secure our natural rights.'
- Shifting the housing debate towards 'red herrings', i.e. relatively unimportant subjects that explain at best a minor part of the housing shortage. This includes the misleading assertions that there are millions of empty houses, that developers are needlessly hoarding land with planning permission, or that the housing shortage could be solved by building on brownfield sites (see Bourne and Niemietz, 2014, pp. 13–22).

Work at the local level involves mobilising residents opposed to housebuilding, encouraging them to participate in consultations and planning meetings, and to contact decision-makers about their objections. It also involves more conventional campaign activities like drafting petitions and getting media coverage. The two levels interlock, as the rationalisations produced at the national level are then used in and tailored to localised campaigns.

An illustrative example would be the activities of the Guildford Greenbelt Group (GGG), a local anti-development organisation.

The group's aims are easily defined: *We could have an acceptable and workable Local Plan. This could work if the borough was prepared to minimise the housing number to the lowest possible number that an inspector might accept.' (Parker, 2014)*

The linking of local activities to a wider anti-development narrative becomes clear in statements like:

> 'We recognised that all the campaigning groups have a common problem. The solution is not to say: "Not here but there," rather it is to question the assumption that it's necessary to build on greenfield sites…I think that it is dishonest of those who are promoting housebuilding to suggest that affordable homes will be built as a result of this housing policy … Those who need homes should realise that green belt will not be used for affordable homes …Using the green belt almost precludes building the affordable homes needed – more profitable, larger homes will be built.'

The interview is also representative of the media's generally favourable, or at least uncritical coverage, of anti-housing protests. Even papers that routinely decry the lack of affordable housing tend to portray anti-development activism in a sympathetic way.[10]

The current undersupply of housing has been caused by the interplay of a highly restrictive land use planning system and a well-organised resistance to housing development. The problem can only be overcome if the restrictions are eased, and if policy-makers find the courage to confront those vested interests rather than pander to them.

A three-step plan

The following three steps would go a long way to solving the housing crisis in the UK:

1. The tax system should be decentralised. The UK is currently one of the most heavily centralised countries in the world, with 95 per cent of all tax revenue accruing to the national level (see Figure 9). This destroys the link between the local tax base and local public finances, which makes Nimbyism not just viable, but even rational. All taxes that are vaguely related to development – capital gains tax, stamp duty, and most of income tax – should be handed over to the local level. The local level should also be given full control over the corresponding tax rates and tax structures. Tax revenue associated with development would then remain where it is generated. Permitting development would become a relatively easy means for local authorities to broaden their tax base. Blocking development, in turn, would come at a high cost. Pro-development localities would no longer be forced to share the gains from development with obstructionist localities. In areas that pursue obstructionist policies, the tax burden would rise, and the quality of public services would fall, while the opposite would happen in areas that take a permissive stance on development. The cost of Nimbyism would be localised, and thus, to some extent, internalised.

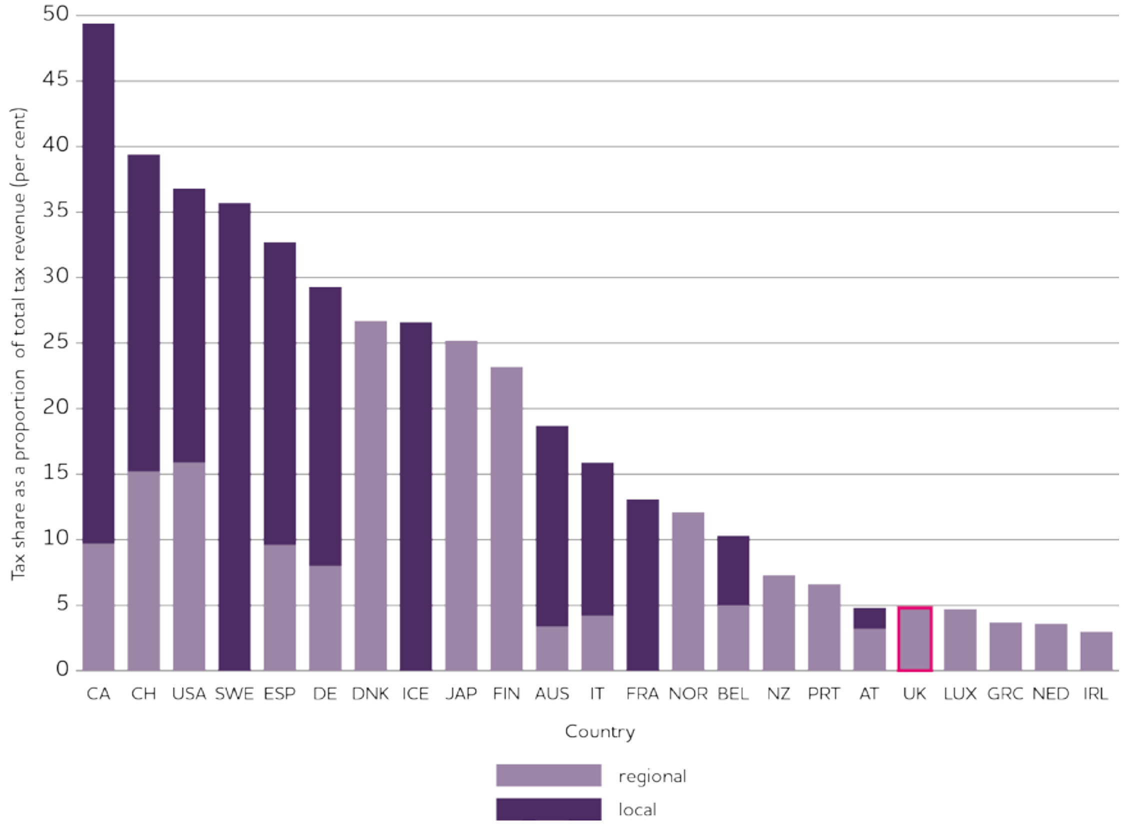
   This tendency would increase further over time. Under conditions of tax competition between localities, the weight of taxation would have to shift towards factors that are less mobile, the most obvious candidate being land. Local authorities could, for example, merge Capital Gains Tax, Stamp Duty and Council Tax, and convert the resulting package into some form of land value tax (LVT). Since land with planning permission is worth a multiple of land without it (Leunig, 2007), granting planning permission would become an easy way of broadening the LVT base.

   Greater fiscal decentralisation would reduce the scope for redistribution from relatively prosperous to structurally weaker localities, so at least in the short run it would exacerbate regional inequalities. However, under conditions of a decentralised tax system, a much greater shift of decision-making power and autonomy to the local level would become feasible. There is good evidence that such a power transfer would strengthen political accountability, increase the efficiency of public spending, and lead to a better matching of local spending to local preferences (Blankart, 2007; Blankart, 2008; Feld et al., 2004; Sinclair, 2014). Decentralisation is therefore not a zero-sum game, as places that lose out financially may gain in other ways.

2. Housing-related public expenditure should also be devolved to the local level. Housing Benefit and social housing subsidies should be paid from locally raised taxes. In places which fail to provide a sufficient supply of housing, taxes would have to be higher than elsewhere, because more people would require financial assistance with housing costs. Conversely, making housing more affordable by allowing sufficient levels of development would become an easy way for local authorities to cut unnecessary expenditure. The savings could be used for improving local public services, cutting local taxes, or a combination of both.

3. Green belt status should be abolished. Land should be protected from development in a selective manner, on the basis of a plot's own merits: its environmental, recreational and amenity value. There should be no undifferentiated blanket bans on development, and no general presumption against development just because a plot of land happens to be close to e.g. London, Oxford, Cambridge, Bristol or Bath.

Figure 9: Tax share of the local and regional levels as a proportion of total tax revenue (per cent)



Source: Based on data from OECD (2014b)

It is an unfortunate fact of the UK housing debate that while the opponents of housebuilding are able to build coalitions across political divides (see e.g. Spiers, 2014), supporters of housebuilding tend to be divided, especially along conventional state versus market lines. This is why a number of commentators have correctly described the symptoms of the crisis, but have then failed to see any connection with the planning system or with organised resistance to development, and have instead simply proposed an expansion in public/social housing (e.g. Jones, 2013). Yet it is important to realise that in the current situation, the question of whether the solution should be primarily market-led or state-led is a secondary question, because the constraints identified above are common to *all* sectors and *all* tenures. The same restrictions and the same organised resistance that currently stifle private housing development would equally stifle the development of public/social housing. So regardless of whether one prefers an increase in private rental accommodation, in owner-occupied housing, in social housing or in local authority housing – *any* solution has to begin by removing the constraints described above.

Allowing a massive expansion of the housing supply would benefit low-income households in a variety of ways. For households currently in rental accommodation, housing costs would fall, regardless of whether they wish to remain renters, or whether they wish become home-owners (which would now become a much more realistic prospect). The cost of business premises would fall, and under competitive market conditions, most (if not all) of the difference would be passed on to consumers. This would be particularly relevant in sectors like retail and the hospitality industry. Work incentives would also improve, as millions of households, especially those in work but on low earnings, would no longer require Housing Benefit. They would be taken off the benefit withdrawal rate altogether, which would reduce their effective marginal tax rate from 76 per cent to 32 per cent in a typical case. Under those conditions, more people would enter the workforce in the first place, and among those, more would progress within it, for example by moving from part-time to full-time employment.

The current undersupply is the result of a decade-long failure to build sufficient numbers of homes, which is why there is no quick fix solution even under the best of circumstances. But this does not mean that the policies described above are policies for the distant future. Current house prices are determined by current levels of supply and demand, but also by expectations about future conditions. At the moment, house prices reflect an implicit assumption that policy-makers will *not* stand up to Nimby interests, and that the issue of undersupply will *not* be sorted out. A firm and credible commitment to allowing an increase of the housing supply, even in the face of entrenched opposition, would change that expectation, and thus help to drive down house prices – not just in the distant future, but here and now.

6 Energy

Energy prices are mostly determined by wholesale prices, over which policy-makers have little control. This section is not about energy costs as such, but about the variation in energy costs that is policy-related.

As mentioned in the introduction, there are policies which demonstrably drive up the cost of living, and which affect low earners disproportionately, but which are nevertheless justifiable on other grounds. In principle, up to a point, environmental policies designed to reduce carbon emissions can fall into this category. But carbon abatement policies demonstrably differ widely in their degree of cost-effectiveness, and it is only the most cost-effective ones – those which achieve a given volume of carbon reduction at the lowest cost – that we consider justifiable. Any politically enforced reduction in carbon emissions inevitably entails an enforced reduction in living standards, but policy-makers have full control over whether or not this is done in a way which minimises the damage.

Among economists, there has long been a high degree of agreement across political and/or methodological divides that the most cost-effective carbon abatement policy is a source-neutral carbon tax (The Economist, 2013). (By implication, a carbon cap-and-trade system also qualifies, because it does the same thing as a carbon tax only from the reverse end.) Under a carbon tax or a carbon cap-and-trade scheme, the government sets the volume of carbon cuts, but remains neutral with regard to *who* exactly implements those cuts and *in what way*. It gives households and firms the flexibility to work out which ways of reducing emissions are least damaging to them, while also ensuring that those who are best placed to reduce their emissions contribute most to the overall reduction. It is an open-ended approach that allows experimentation with different carbon abatement technologies, and this experimentation is indispensable because it is impossible to know in advance what the optimal combination of abatement technologies is. This has to be discovered through trial and error, and any outcome reached in this process will only ever be a provisional one, contingent on a given state of technology, economic conditions, relative prices etc. A prescriptive approach, under which governments select favoured carbon abatement technologies and impose them on the population as a whole is therefore bound to produce major inefficiencies.

Unfortunately, this is exactly the path that the British government, along with many other European governments, has chosen. We do not object to the volume of carbon cuts set by the British government. We object to the fact that the British government (and in some cases, the EU) insists on dictating which abatement technologies must be used in order to achieve it. There is nothing novel about this critique, but economists have mostly focused on the aggregate efficiency loss. What deserves greater attention is the fact that the cost falls disproportionately on low earners.

The clearest examples are the various quasi-subsidies for renewable energy, which consumers pay through their energy bills. They already represent 4 per cent of the retail gas price and 12 per cent of the retail electricity price, with further increases scheduled (based on data from DECC, 2013).[11] Energy markets are also being distorted in numerous other ways with less quantifiable effects (Robinson, 2013; Alberici *et al.*, 2014; Bourne, 2014, pp. 55–65). And yet the impact of those policies goes well beyond household bills. Energy, like land, is a factor in the production of almost everything, so driving up its cost has knock-on effects on the cost of almost everything.

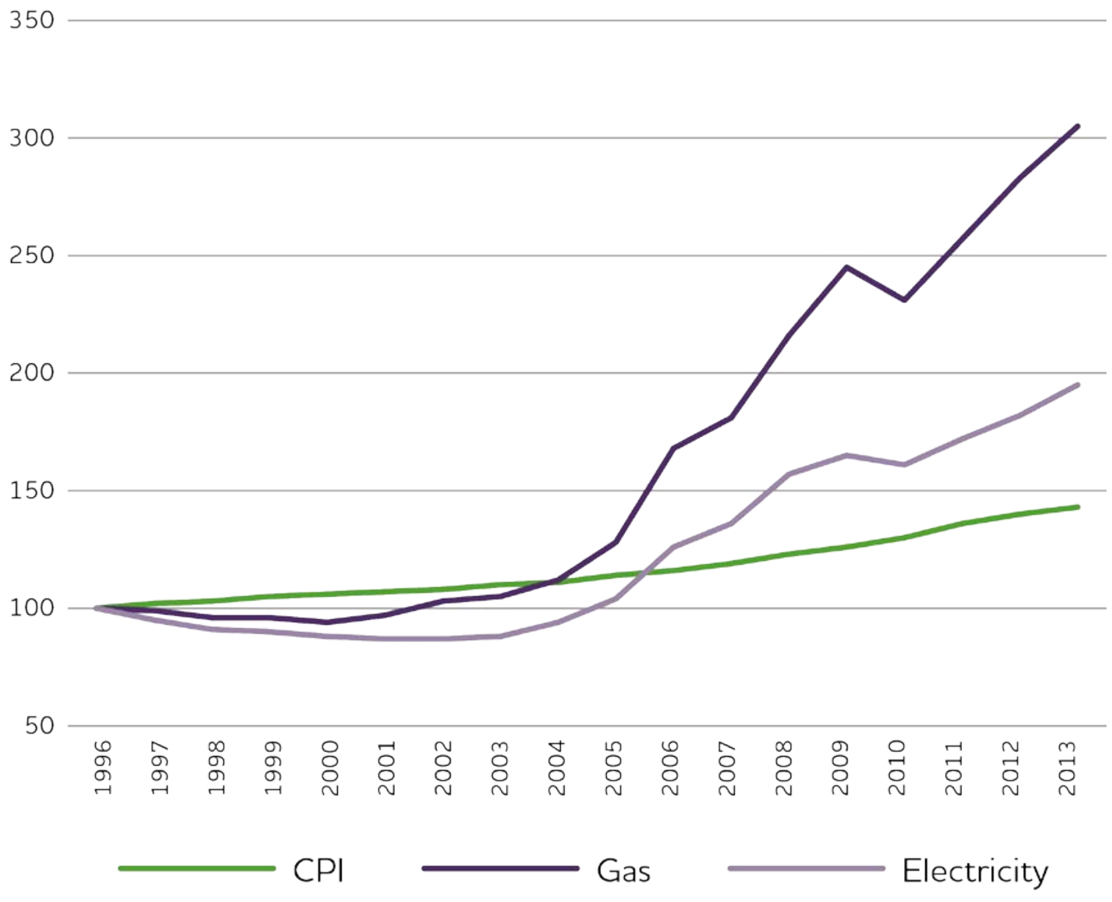
Subsidies for renewable energy could all be abolished without any increase in carbon emissions. The total level of emissions is already capped at the European level through the Emissions Trading Scheme (ETS). Within the confines of an overall cap, none of the other interventions into energy markets can have any further effect on the 'how much?', but only on the 'how?'. All they can do is reward specific ways of reducing carbon emissions, with no impact on the total. Unfortunately, renewable energy is among the least cost-effective carbon abatement methods available. Looking at the cost of renewable energy subsidies in Germany, and comparing them to alternative carbon abatement methods, Frondel *et al* (2009) show that the exact same volume of emission cuts could have been achieved at a fraction of the cost. Unless the UK's renewable energy sector is vastly more efficient than its German counterpart, the same must apply here.

The problem is renewable energy has acquired a symbolic status. Expressing support for renewable energy has become a way to signal 'green credentials' more broadly, as people's attitudes to renewable energy are erroneously taken as a proxy for their general level of concern for the environment. This is why opposition to renewable energy is frequently misinterpreted as indifference to the environment. This is where the terms of the debate have to change. Renewable energy should once again be seen as one carbon abatement method among many, not as a technology that possesses any intrinsic moral qualities. The same should apply to any other energy market distortions.

Reducing emissions does not require a plethora of different policy instruments. An overall emissions cap is enough. The details can, and should, be left to individual households and firms. The EU's ETS has had a terrible start, but recent reforms have begun to address its flaws, turning it into a workable solution (European Commission, 2013).

If all distortions of energy markets were abolished and if carbon abatement was left to the ETS alone, British energy markets could once again work in the interest of consumers. While there is surely room for improvement, the market is more competitive and consumer-friendly than it is generally given credit for. From the mid-1990s to the mid-2000s, the period in which market distortions were at their lowest level, consumer prices fell or remained constant in real terms.

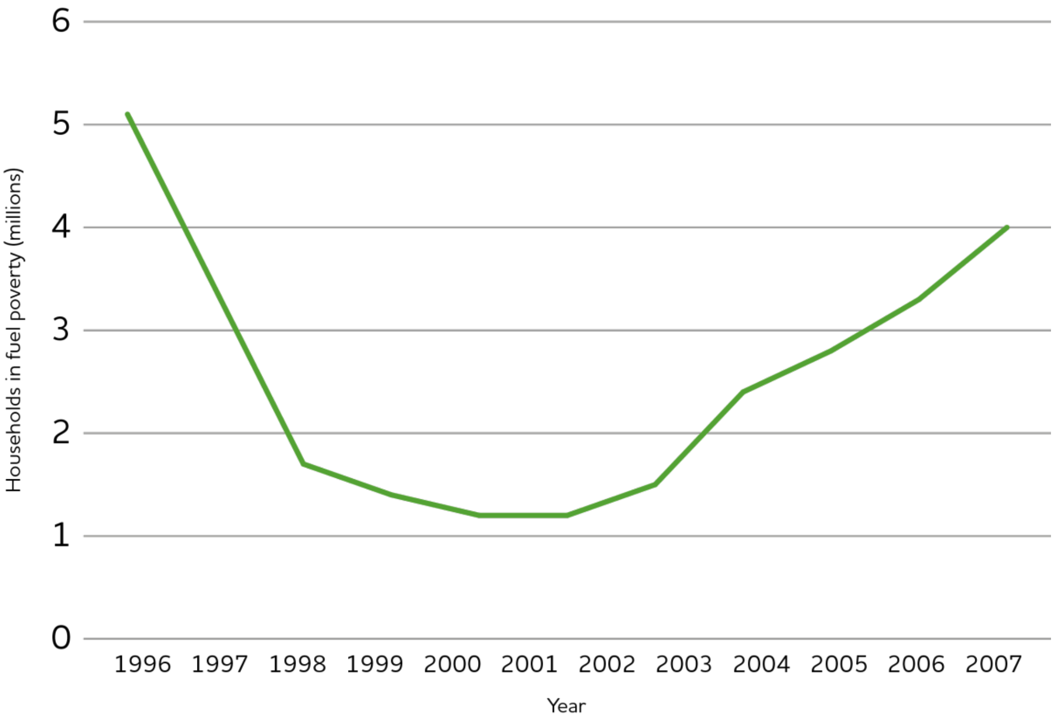
Figure 10: Electricity and gas price index versus CPI 1996–2013



Source: Based on ONS (2014b) and ONS (2012)

Combined with rising incomes and improvements in energy efficiency, this led to a period of falling fuel poverty. The policy aim should be to return to this trend. Assisting credit-constrained low-income households with energy efficiency improvements can be part of that strategy, but it cannot be a substitute for a functioning competitive energy market. [12]

Figure 11: Number of households in fuel poverty 1996–2009 (millions)



Source: DECC (2013)

7 Childcare

The importance of affordable childcare requires no explanation. But the debate on childcare has so far mostly focused on subsidy levels, whether in cash or kind (Bourne and Niemietz, 2014, pp. 51–53), which is why it is missing one important fact: in the UK, both private *and* public spending levels on childcare are among the highest in the world (Bourne, 2014, pp. 35–44; Niemietz, 2011, pp. 91–101). This is remarkable because it is not explained by higher enrolment rates, outstanding quality, or high remuneration in the sector (quite the contrary). Rather, unit costs are exceptionally high, and this is what the main focus of the debate should be.

The determinants of childcare costs are not nearly as well researched as the determinants of housing costs. Neither was there a 'golden age' of affordable childcare in the past, or a shining example from abroad. The recommendations of this section therefore have to be more general and more tentative. But it is striking that the cost explosion has coincided with a change in the nature and purpose of childcare.

Traditionally, childcare used to be a relatively informal activity. Since the 1990s, it has turned into a highly formalised, regulated and standardised profession (Shackleton, 2011). This has gone far beyond the setting of minimum quality standards. Detailed regulations (like minimum staff-to-children ratios) dictate *how* providers ought to achieve those standards. These regulations are enforced through regular inspections, the cost of which is also borne by childcare providers (and thus ultimately parents). Closely related to this, childcare has been converted from a 'supervised playground' into a type of formal education. This emphasis is somewhat surprising given that British children already start compulsory schooling at a relatively young age, so the need for an even earlier stage of formal education is not obvious.

The IFS (2014) tested the impact of the introduction of free early education for four- and three-year-olds on educational attainment and found that early education has a small positive impact on educational attainment at age five, which is somewhat larger for children from poor families, but the effect is entirely transient. At age eleven, it has completely disappeared.

A light-touch approach to regulation would be aimed at rooting out fraud and abuse, as well as increasing transparency and enabling parents to make well-informed choices. Unlike the current prescriptive approach, it would not interfere with the day-to-day operations of childcare providers, and it would not dictate what the purpose of childcare should be. It could well be that for many families, this would mean going back to an earlier approach, in which childcare is mainly about providing small children with a safe space to play rather than 'small-scale schooling'. Funding streams should also be consolidated into one. Decreasing unit costs, combined with a single well-targeted subsidy for individuals, is the best way to deliver affordable childcare for all. This, in turn, would allow an increase in parental employment rates and long-term earnings.

8 Food

There has long been a near-consensus among economists about the damaging effects of agricultural protectionism and agricultural subsidies (Whaples, 2009, p. 340). This is usually presented as problem of overall economic efficiency (Thies and Porche, 2007; Anderson *et al.*, 2006; Hoekman *et al.*, 2004). It is rarely spelled out that the impact is worst for those who spend the largest share of their budgets on groceries.

The total impact of the EU's Common Agricultural Policy on food prices is counter-cyclical; it varies inversely with global food prices, which is why it has been subdued in recent years. Over the decade from 2002 to 2011 as a whole, though, it has, on average, added 15 per cent to European food prices (Bourne, 2014, p. 51). This is the average for the EU as a whole, but presumably the impact is higher in high-income countries, with higher consumption levels for foodstuffs that are especially heavily protected (e.g. meat). Still, this measures only the static effect, not the (unquantifiable) medium-term effect of more intense agricultural competition and a more efficient international division of labour.

An abolition of CAP-style measures is possible. New Zealand abolished agricultural protection in the 1980s under much more difficult starting conditions, and with great success. Australia offers another example of a successful agricultural sector that is fully integrated into the global economy (Niemietz, 2011, pp. 110–116). For the UK, removing agricultural protection would require a renegotiation of the relationship with the EU, with an arrangement for agriculture more similar to that of EFTA members Norway, Iceland, Liechtenstein and Switzerland. As always, there is organised resistance to be overcome, but it would be a straightforward way to reduce living costs while improving general economic efficiency in the process.

9 Sin taxes

Sin taxes are among the most regressive components of the tax system. Corrected for under-reporting, on average people in the bottom quintile of the income distribution spend over one tenth of their household budgets on sin taxes (Niemietz, 2011, p. 140–145). That does not, in itself, make them unjustifiable, but it is surprising how little the regressive aspect of sin taxes is reflected in the debate. Sin taxes are generally presented as anti-industry measures, to shift the rhetoric from low-income consumers to 'the industry' as an easy target. But it is the most basic micro-economics that sales taxes are almost always effectively split between purchasers (in the form of higher sales prices) and sellers (in the form of reduced profits). In markets where demand is relatively inelastic while supply is relatively elastic, as is clearly the case for alcohol and tobacco, the bulk of the tax burden will be passed on to consumers. Sin taxes are primarily an anti-consumer measure, not an anti-industry measure.

A more plausible justification is that sin taxes merely internalise the social costs of the habits in question, especially NHS treatment costs, and the costs associated with drunk and disorderly behaviour. Up to a point, that is indeed what sin taxes do, and up to that point, they are justifiable. But the media tenor appears to be that in the case of sin taxes, 'higher' always means 'better' and 'more progressive', whereas the logic of internalising social costs is one of proportionality. When sin taxes are justified by the social cost of 'sinning', then inevitably there has to be a level which must be deemed sufficient, a notion which does not seem to exist in the public discourse on sin taxes.

Quantifying the external cost of alcohol and tobacco consumption is not an exact science, but current estimates suggest levels well below the revenue from sin taxes. In order to avoid the awkward implication that sin taxes are currently unjustifiably high, those estimates then add a lot of costs that are not, in any meaningful sense, external costs (see Snowdon, 2013). A decline in labour productivity, for example, is a private cost, at least up to the point where the productivity loss is so severe that it renders an individual unemployable and reliant on welfare payments.

A third argument, in line with the 'denial of agency' tradition, is to depict the payers as beneficiaries. The tacit assumption here is that nobody could truly want to engage in unhealthy habits, and that those who do so must therefore have been manipulated by 'the industry' into doing so. They are not people who *choose* to drink or smoke, but people who are 'at risk' of doing so. We will not address this argument here because it is essentially a philosophical, not an empirical question. But those who make that case should at least be more aware of the trade-offs involved. If demand for 'sinful' products is relatively inelastic, as most available estimates suggest they are (see Snowdon, 2012), then sin taxes must cut a sizeable chunk out of people's household budgets before they can lead to a small reduction in 'sinning'. Supporters of such policies should be prepared to explain to what extent they think the aim of cajoling people into adopting healthier lifestyles justifies forcibly reducing people's living standards. As soon as sin tax levels are thought of in those terms, rather than as curbing the 'power' of unfashionable industries, they lose a lot of their attraction.

10 Conclusion

There are a number of market distortions which systematically drive up the cost of living in the UK, which hit low-income households particularly hard, and which are not justifiable on economic grounds. The worst distortions are those that drive up the cost of housing by more than a third, and probably by *much* more. Since housing space is not just a consumer good, but also an input in the production of almost everything, the same distortions are also driving up the cost of almost everything. The effect is not distributed uniformly across the country, but is much more pronounced in the regions with the best employment and earnings prospects. Housing market distortions thereby lock potential jobseekers out of those areas, and literally prevent them from moving out of poverty.

The same logic applies to energy, although to a much lesser extent. Energy is not just a consumer good, but also used in the production of almost everything, so the distortions which raise energy prices also raise the cost of almost everything else. Childcare, too, is not just a consumer service, but also a work-related cost, and lowering it could raise parental employment rates. Agricultural protectionism and exaggerated levels of sin taxes also add, unnecessarily, to people's household bills.

If those distortions could be removed, living standards of most low-income households would rise considerably, even in a rather short period. But there would also be huge 'second-round gains', as getting the basic cost of living under control would allow a breaking of the 'iron triangle' of welfare design. In the UK, high levels of welfare spending do not translate into high living standards for the recipients, because they are, to a large extent, merely compensation for excessively high basic living costs. If fewer people needed that compensation, fewer people would be exposed to taper rates, with the steep effective marginal tax rates they produce. If the agenda outlined above was implemented, millions of people would witness a dramatic fall in their effective marginal tax rate, and thus a massive improvement in work incentives.

The agenda that has been developed here is not the answer to all problems; it would not, on its own, be enough to overcome poverty. For example it would not address the problems caused by a lack of educational opportunities, it would do little to assist the creation of stable jobs with well-defined patterns of career progression, and it would not address gaps in the healthcare or social care systems. Still, it is difficult to think of any other area of reform which has the potential to improve the living standards of the least well-off in so many different ways at the same time.

Notes

1 The project's main output was A New Understanding of Poverty (2011) and Redefining the Poverty Debate (2012); and the papers/chapters Poverty in Britain: Past and present (2009), Measuring poverty: Context-specific but not relative (2010), Transforming welfare – incentives, localisation and non-discrimination (2010), Abundance of land, shortage of housing (2012) and Armut in der Marktwirtschaft: Empirische Befunde (2012).

2 BBC News: 'Miliband stresses "cost of living crisis' in campaign2"', 2 May 2014; The Times: 'Cameron's adviser admits: "There is a cost of living crisis"', 22 June 2014; Channel 4 News: ' "Cost of living crisis" returns to haunt government', 11 June 2014; The Independent: 'The real cost-of-living-crisis: Five million British children sentenced to life of poverty thanks to welfare reforms', 30 September 2014; The Telegraph: 'Who's to blame for UK's "cost of living crisis"? Labour, of course', 17 March 2014; The Mirror: 'Bank of England chief Mark Carney warns cost of living crisis is threatening UK economy', 17 August 2014; The Evening Standard: 'David Cameron's adviser says Labour is right on "cost of living crisis"', 22 June 2014; The Sun: 'Brits squeezed before Coalition took power', 29 September 2014; The Express: 'Can he solve the cost of living crisis? Miliband doesn't know cost of weekly food bill', 20 May 2014; Mail Online: 'New fears on cost of living crisis', 16 July 2014.

3 Unite the Union (2014): 'Whose recovery? End the cost of living crisis', Campaign; Institute for Public Policy Research (2014): 'Cost of living crisis: are disabled people being forgotten?', Health & Social Care event; Unions Together (2014): Addressing the cost of living crisis in Britain', article by Katy Clark MP; Centre for Labour and Social Studies: 'The Great British Rip Off - Brighton: Tackling the cost of living crisis', event.

4 In the Scandinavian countries, income from state transfers is highly taxed, while in the UK, most transfer income is tax-free. There may be good reasons for the Scandinavian arrangement: Treating benefits as an income source like any other may reduce the social stigma effect, and treating all income sources alike may also avoid unnecessary tax bureaucracy. But it is ultimately an accounting trick. If a household receives £100 in state transfers and then pays £30 in income tax on those transfers, their transfer income is £70, whatever the justification for the arrangement. Yet in conventional comparisons of social expenditure, this welfare system would appear to be vastly more generous than that of a country which simply pays out a tax-free sum of £70. Figures of net social expenditure, which subtract the tax revenue raised through the taxation of transfer income, automatically correct for such anomalies.

5 Sin taxes are excise taxes whose official purpose is not to raise revenue, but to discourage certain types of consumption, on the grounds of them being unhealthy and/or 'socially undesirable'. In the UK, this includes taxes on alcohol, tobacco and gambling. In other places, sin taxes have also been applied to food.

6 Data in this format is only available for Europe. In all likelihood, the inclusion of North America and Oceania would accentuate the UK's undersupply even more.

7 The Telegraph: 'First-time buyers: two-thirds get parental help', 6 February 2014.

8 Figures for mortgage-paying owner-occupiers vary a lot more, depending on the timing of the purchase.

9 The Economist: 'The Polish paradox', 13 December 2013.

10 See especially the Telegraph's 'Hands Off Our Land' series, available at www.telegraph.co.uk/earth/hands-off-our-land/

11 This does not include the cost of the Emissions Trading Scheme (ETS), nor the cost of the Warm Home Discount. In this section, the cost of policies with a social objective – cutting fuel poverty – as

opposed to an environmental objective will be ignored, because their net effect will probably be beneficial to low-income households.

12 This is not to say that the energy market would reach this ideal if renewable energy subsidies were abolished. The section is not about structural features of the energy market, but about imposed price distortions that could be removed relatively easily.

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