

Reducing in-work poverty: the role of minimum wages and benefits

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Summary

Relative in-work poverty has been steadily rising since 1994–95, meaning that the incomes of poorer working households have not been keeping up with those of middle-income households. Alongside falls in worklessness and pensioner poverty, this has resulted in a large shift in the nature of poverty in the UK: it is now primarily a matter of low incomes for households with someone in work. This represents a significant challenge for any government hoping to reduce poverty, and the Labour party have pledged to eliminate in-work poverty within five years. Achieving this target using benefits alone would be very expensive – likely costing many tens of billions per year – partly because about three-quarters of in-work benefit spending goes on households that are not in poverty. Minimum-wage rises, which have been proposed by both major parties, represent an ineffective way to tackle in-work poverty as only a fifth of minimum-wage workers are in poor households, and half are in the top half of the household income distribution – typically because they live with a higher earner. While there certainly are reforms that could make a dent in in-work poverty in the short run or have a larger effect in the long run, eliminating it entirely within five years is another matter. The statement of desire provides a sense of direction and an aspiration but as a specific target it is not plausible.

Introduction

The proportion of those in working-age in-work households who are in relative poverty has been steadily rising, from 13% in 1994–95 to 18% in 2017–18 (8 million individuals). As shown in previous IFS research,¹ important factors behind this rise have included increasing earnings inequality and rising housing costs for poorer working households. Combined with welcome falls in worklessness and pensioner poverty, this has led to six out of every ten people in poverty now being in a working household – up from four in ten in the mid-1990s. Table 1 shows how in-work poverty rates vary amongst various demographic groups.

¹ P. Bourquin, J. Cribb, T. Waters and X. Xu, 'Why has in-work poverty risen in Britain?', IFS Working Paper W19/12, <https://www.ifs.org.uk/publications/14154>.

Table 1. In-work relative poverty rates (after housing costs), 2017–18

| | In-work poverty rate |
|---------------------------------------|----------------------|
| <i>Family type</i> | |
| Single adult, no children | 17% |
| Single adult, with children | 33% |
| Couple, no children | 9% |
| Couple, with children | 21% |
| <i>Employment status of household</i> | |
| At least one person self-employed | 23% |
| No one self-employed | 17% |
| <i>Housing tenure</i> | |
| Owner-occupier | 10% |
| Private rent | 30% |
| Social rent | 38% |
| All | 18% |

Source: Table 1 from P. Bourquin, J. Cribb, T. Waters and X. Xu, 'Why has in-work poverty risen in Britain?', IFS Working Paper W19/12, <https://www.ifs.org.uk/publications/14154>.

As argued in an earlier briefing note,² rising in-work poverty rates represent a major challenge for any incoming government looking to reduce poverty. The Labour party have pledged to eliminate in-work poverty within five years.³ In this briefing note, we discuss what policy options are available to a government looking to reduce, or even eliminate, in-work poverty.

How one thinks about what poverty *is* can clearly affect how one tackles it. In the Labour party's case, it seems effectively to have a specific target (namely, to abolish in-work poverty within five years), which would require a specific measure against which to monitor progress. Their manifesto appears to indicate that they may use 'relative after housing costs income poverty'⁴ (a measure we define below), though they have

² S. Adam, R. Crawford, J. Cribb, C. Emmerson, P. Johnson and R. Joyce, 'Let's talk about six big economic challenges that need addressing', IFS Election Briefing Note, November 2019, <https://www.ifs.org.uk/election/2019/article/let-s-talk-about-six-big-economic-challenges-that-need-addressing>.

³ <https://labour.org.uk/press/corbyn-judge-a-labour-government-by-the-real-change-we-deliver/>.

⁴ The Labour manifesto says, "Of 14.3 million people in poverty, nine million live in families where at least one adult works... Labour will eradicate in-work poverty in our first term". None of the official poverty measures show 14.3 million people in poverty in the latest data (2017–18), though the relative after housing cost measure is very close (14.0 million) and in 2016–17 was 14.3 million.

also indicated that they may have a broader set of things in mind than the purely income-based measures used for the official statistics⁵ – a sentiment that has recently been shared elsewhere on the political spectrum,⁶ as well as by the independent Social Metrics Commission.⁷ In the rest of this briefing note, we focus on the relative after housing cost measure of poverty.

Currently, there are two broad official measures of income poverty that are most often used: relative poverty, where a household is in poverty if its income (after taxes, benefits and sometimes housing costs) is below 60% of current median (middle) income; and absolute poverty, where a household is in poverty if its income is below 60% of 2010–11 median income (in today's prices). While these measures are helpful for understanding the trends and patterns of low income, the precise poverty lines are arbitrary – there is nothing special about 60% of the current or 2010–11 median, and certainly neither should be thought of as an objective measure of a 'decent standard of living'.⁸ People can legitimately disagree as to whether an acceptable standard of living requires an income above or below these thresholds (and of course things other than income affect a family's broader 'quality of life').

The measurement point is pertinent here in part due to the nature, and in particular the time frame, of Labour's commitment. While there are many policies that could in broad terms improve the living standards of poorer working households, and many that could reduce in-work income poverty in the long run, the number that could drastically reduce the prevalence of low incomes among those in work *within five years* is considerably smaller. For example, improving healthcare might raise the living standards of low-income working households (and others), while doing little – if anything – to their incomes; and while education policy could be crucial in addressing low incomes, its full effects would not be felt for decades.

A full discussion of all ways of reducing in-work poverty, then, is a book-length endeavour. But two of the major policy areas that tend to come up in this context are benefits policy and minimum wages. They are at the centre of debates during this general election. They are also two of the few policies that can, in principle, have both

⁵ The shadow chancellor, John McDonnell, has said that 'Ending poverty isn't just about cash ... It's about being healthy, having a roof over your head, having access to education and skills training, living in a decent and safe environment, and enjoying life in all its wonderful cultural forms' (<https://labour.org.uk/press/john-mcdonnells-speech-resolution-foundation/>).

⁶ <https://www.gov.uk/government/publications/measuring-child-poverty-a-consultation>.

⁷ Social Metrics Commission, *Measuring Poverty 2019*, <https://socialmetricscommission.org.uk/social-metrics-commission-2019-report/>.

⁸ For this reason, *changes* in poverty are more informative than the *level* of poverty. Changes in relative poverty tell us about whether the incomes of poorer households are keeping up with those of middle-income households, while changes in absolute poverty tell us about whether the incomes of poorer households are increasing in real terms.

dramatic and immediate impacts on the income distribution, which is pertinent given the Labour party's ambition to eliminate in-work poverty within five years.

Benefits

The most straightforward way to reduce in-work poverty is by topping up the incomes of low-income working households directly.⁹ That is not to say that doing so is cheap. If the government increased benefit receipt for every working household in poverty – and for no other household – it could pull them all up to the poverty line for a cost of around £20 billion per year (for context, total in-work benefit spending is currently around £50 billion per year).

In reality, the true cost would almost certainly be vastly more than £20 billion, for two reasons. First, around three-quarters of benefit spending on working households goes to households that are *not* in poverty. Thus, increases in in-work benefits (such as working tax credit or universal credit's work allowances) would also represent a giveaway for a huge number of working households on benefits who are above the poverty line. Restructuring the benefit system to top families' incomes up to the poverty line but then rapidly withdrawing benefits as they earn more would focus support more tightly on the poorest and help keep the cost down, but would also substantially weaken work incentives. This is an inescapable trade-off of benefit design.

Second, such a large increase in means-tested benefits would likely result in some households reducing the amount of paid work they do, meaning that the net impact on incomes is less than the increase in benefit spending. (This could be mitigated by means-testing the payments less aggressively, or not at all, but that would exacerbate the targeting constraint mentioned above.)

An additional obstacle is that families frequently do not take up their full means-tested benefit entitlement, likely for a variety of reasons including the hassle of applying, lack of information and perceived stigma. Moving away from a means-testing model would help with that, but would increase the cost dramatically.

The Labour manifesto proposes an increase in working-age benefit spending which they cost at £8 billion. While this is a significant increase and would make some difference to in-work poverty, it would not get anywhere near to eliminating it.

⁹ Another option is to reduce the taxes of working households in poverty. This would likely be less effective than using benefits because many working households in poverty pay little or no direct tax.

Minimum wages

One popular suggestion for helping the low-paid is to increase the minimum wage. Both the Conservatives and the Labour party have pledged significant minimum-wage increases over the next parliament.¹⁰ But, perhaps counterintuitively, while a sensibly-used minimum wage can certainly be a good tool for helping the low-paid, it is a fairly ineffective way to reduce in-work poverty in the UK when seen through the lens of household income (and even more so if a relative notion of poverty is the one policymakers have in mind).

There are two key reasons for this. First, less than a fifth of minimum-wage workers are in poverty. That is because official income poverty statistics are measured using *household* income, and low household income and low individual hourly wages overlap rather imperfectly, partly because many minimum-wage workers live with someone on higher earnings, and partly because households' earnings depend on how many hours they work as well as on hourly wages. In fact, half of minimum-wage workers are in the top half of the household income distribution.

Second, those minimum-wage workers who are in poverty are often receiving in-work benefits. These are means tested, so when their earnings go up those benefits get steadily withdrawn. That means that a significant chunk of the increase in earnings that they see as a result of a minimum-wage rise would be clawed back in reduced benefits. These clawbacks apply much less for those minimum-wage workers who are higher up the household income distribution (and hence not in poverty) since they are less likely to qualify for means-tested benefits.

For these reasons, the direct consequences of raising the minimum wage would mostly benefit those not in poverty. As a result, it is especially poorly targeted at poverty if the poverty concept being used is a relative one. The full distributional effect of higher minimum wages is more complicated still, and would depend on whether the costs are passed on to workers through lower employment, consumers through higher prices, or shareholders through lower profits.

Of course, a government might well want to raise minimum wages for reasons other than poverty reduction. A separate briefing note looks in detail at the minimum wage proposals of the two main parties, and discusses the appropriate process for figuring out how high a minimum wage should go.¹¹

¹⁰ As discussed in further detail in J. Cribb, R. Joyce and X. Xu, 'The future path of minimum wages', IFS Election Briefing Note, 2019, <https://www.ifs.org.uk/election/2019/article/the-future-path-of-minimum-wages>.

¹¹ J. Cribb, R. Joyce and X. Xu, 'The future path of minimum wages', IFS Election Briefing Note, 2019, <https://www.ifs.org.uk/election/2019/article/the-future-path-of-minimum-wages>.

Conclusion

There are many policy options available to try to improve the living standards of low-income families in work, including benefits policy, public services, policies aimed at addressing the cost of housing, labour market institutions and regulations, and education, skills, trade, competition and infrastructure policy aimed at boosting productivity. The Labour Party manifesto does indeed cover many of these areas.

However, Labour's ambition to eliminate in-work poverty within five years represents not only a massive undertaking but also a significant narrowing of the policy options that could possibly help on the required scale that quickly. That is particularly so if their preferred measure of poverty were to retain income as a central component (as would be sensible and seems highly likely). Minimum wages and benefits are two of the few options that would have immediate effects. Minimum wages, however, are not well targeted at the problem of low household incomes – and there are risks to sharp rather than incremental rises. A significant increase in the generosity of in-work benefits could have a substantial effect on in-work poverty, but to get anywhere near eliminating it using benefits alone would require a colossal increase in benefit spending.

Of course, a future government could produce a new measure of poverty, as the coalition government mused over in 2013.¹² Depending on the measure, that could make 'abolishing in-work poverty' easier or indeed harder. But any large improvement in the living standards of a large number of people in such a short space of time would remain a very challenging task.

¹² <https://www.gov.uk/government/publications/measuring-child-poverty-a-consultation>.