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# Working out of poverty

## A study of the low-paid and the 'working poor'

By Graeme Cooke and Kayte Lawton

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**ippr**
30-32 Southampton Street, Covent Garden, London WC2E 7RA
Tel: +44 (0)20 7470 6100
info@ippr.org
www.ippr.org
Registered Charity No. 800065

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## About the authors

**Graeme Cooke** is a Research Fellow in the social policy team at ippr.

**Kayte Lawton** is a Research Assistant in the social policy team at ippr.

# Glossary of key terms

**Benefit unit**
A single adult, or married or cohabiting couple, and any dependent children.

**'Bite' of the minimum wage**
The value of the minimum wage in relation to median hourly pay.

**Dependent child**
A child aged under 16 or an unmarried 16- to 18-year-old in full-time education.

**Disability**
A long-standing illness, disability or infirmity, which means that an individual has a significant difficulty with day-to-day activities. Anyone identified as disabled by the *Family Resources Survey* would meet the definition of disability in the Disability Discrimination Act.

**Economic status**
The categories of economic status used in this paper are derived from those used by the Department for Work and Pensions' *Households Below Average Income* (HBAI) publications, rather than the International Labour Organization classification.

**Equivalisation**
The process by which household income is adjusted to take account of variations in the size and composition of households. All income referred to in this paper has been equivalised using Organisation for Economic Cooperation and Development (OECD) equivalisation scales (used for the official child poverty measures).

**Family/family unit**
See definition of benefit unit above: the two can be used interchangeably.

**Full-time work**
Normally 31 hours or more of work a week.

**Head of household**
The person who owns the household's accommodation, or is legally responsible for the rent, or is responsible for the accommodation by virtue of a relationship to the owner, if the owner is not a member of the household. Where this applies to more than one person in the household, the head of the household is the person with the highest income.

**Household**
A single person living at an address, or a group of people living at the same address who share either one meal a day or share a living room. A household can consist of one or more families (or benefit units).

**Housing costs**
These include: rent (gross of housing benefit); water charges; mortgage interest payments; buildings insurance premiums; ground rent and service charges.

**Means-tested benefits**
These are benefits where the amount received depends on the assets and incomes of individuals, families or households. They include Housing Benefit, Council Tax Benefit, Carer's Allowance, income-based Jobseeker's Allowance, and Income Support.

**Non-means-tested benefits**
These are benefits where the amount received does not depend on assets or incomes. They include Child Benefit, contribution-based Incapacity Benefit, Disability Living Allowance, Attendance Allowance, war pensions, industrial injuries benefits, contribution-based Jobseeker's Allowance and widows' and bereavement benefits.

**Other income**
For the purposes of the analysis in section 5, this may include income from investments, child maintenance payments or other payments received from people outside the household.

**Part-time work**
Normally under 31 hours of work a week.

**Poverty**
Poverty is measured at the household level and occurs when household income is less than 60 per cent of equivalised median contemporary household income. Income, and therefore poverty, can be measured before and after housing costs.

**Self-employed**
Those normally working as self-employed in their main job for 31 or more hours a week.

**Work**
A person is defined as being in work if they did any paid work in the seven days before the survey was carried out, or, if they did not do any paid work, they did have a job or business that they were away from in the seven days before the survey was carried out.

**Working poverty**
An individual faces working poverty when they live in a household in which someone is in work but in which the household income is nevertheless below the poverty line.

**Working-age household**
In this report we use this term to refer to households in which the head is aged between 16 and 64 years. This definition differs slightly from HBAI's, which defines working-age adults as those below state pension age. Therefore, our data includes a small number of households headed by women who are aged between 60 and 64.

# Executive summary

The rights to work and earn a decent living are timeless demands of the labour movement and basic characteristics of a fair society. However, almost six in ten poor households in the UK (57 per cent) have someone at work, up ten percentage points on a decade ago, according to new analysis presented in this report. For too many families, moving into work has not meant moving out of poverty. While work is undoubtedly the surest route out of poverty, it is far from an inevitable one.

This report uses new analysis to investigate the extent and nature of poverty among working families, with a particular focus on the relationship with low pay. We find that 'working poverty' is caused by a range of factors, requiring a sophisticated response. However, this complexity does not obscure the simple message that working poverty constitutes a drag on economic performance and a serious social injustice.

Below we summarise the findings of our analysis into the extent and nature of both low pay and working poverty, and set out recommendations for tackling them.

## Low pay

More than five million people – over a fifth (23 per cent) of all employees in this country – were paid less than £6.67 an hour in April 2006. This is based on a low pay rate of 60 per cent of full-time median earnings, equivalent to a little over £12,000 a year for a 35-hour working week. A labour market in which so many earn so much less than the average worker is a central factor underpinning high levels of poverty and inequality in Britain – holding back both individuals and wider society. And it means that millions of families are meeting their responsibility to contribute to society but are not receiving a fair deal in return.

The drivers of low pay are complex, rooted in inadequate skills, poor productivity, and unfairness and power imbalances in the workplace. Cross-national analysis reveals that there is nothing inevitable about our high rates of low pay, nor can international variation be fully explained by different proportions of the labour force with low skills. However, the causes and consequences of low pay are largely absent from current policy and public debate.

Evidence suggests that the proportion of workers who are low paid has declined slightly over the last decade, reversing the trend of the previous two decades which also saw wage inequality rise sharply. There is little doubt that the minimum wage has been instrumental here. Over the last 10 years the lowest paid have seen strong wage growth, largely thanks to a series of minimum wage rises above the rate of average earnings growth. This has slightly narrowed the gap between the bottom and the middle of the wage distribution, while keeping pay inequality in check. However, beyond the minimum wage – which only establishes a legal wage floor – there is no explicit government agenda concerned with low pay.

Underpinning the distribution of low-paid jobs are the interactions between the pay gaps faced by women and part-time workers and the gendered structure of working patterns. In 2006, nearly two-thirds (64 per cent) of low-paid workers were women and over two-fifths (41 per cent) were women working part-time. Overall, almost half (46 per cent) of part-time employees were low paid compared to around one in seven (14 per cent) of those working full-time. The gap between average full-time and part-time pay was 37 per cent, higher than the 22 per cent gender pay gap.

There is also a clear occupational and industrial aspect to patterns of low pay. In 2006, over six in ten of those employed in *elementary* and *sales and customer service* occupations were low paid, accounting for over half of all low-paid workers. Almost seven in ten (69 per cent) of those working in the *hotel and restaurant* industry were low paid, while a little under a third (29 per cent) of all low-paid employees worked in *wholesale and retail*. Younger workers faced the greatest risk of being low paid; this is perhaps unsurprising given they are at the start of their working lives. The proportions of low-paid workers varied from place to place, but was surprisingly even at the regional level (with the exception of London).

Reducing the proportion of workers who are low paid is not a political objective that can be addressed by passing legislation. There is a limit to the Government's role in directly regulating wage-setting between employers and employees. However, this does not imply that there is nothing that government can or should do. Equally, other actors and institutions – employers, trade unions and consumers – have agency to influence the extent of low pay.

## Recommendations for tackling low pay

### Introduce a higher minimum wage for London

In this report we focus on the crucial (though limited) role of the minimum wage, which has boosted the wages of the lowest paid without costing jobs. However, we find that its impact has been significantly weakest in London, where wage growth for the lowest paid has been slower than in all other regions. A decade ago London had the largest gap between low and median earners of any UK region. Ten years on this gap has narrowed everywhere else except London, where it has grown. Minimum-wage workers in London earn just over a third of median regional pay, a figure that is well over half in all other regions.

There is a strong case for investigating the impact of a higher minimum wage rate for the cleaners, checkout assistants and waiting staff that keep the capital running. The exceptional trends in pay in London's low-wage labour market require an exceptional response. Also, London's small number of low-paid jobs as a proportion of all jobs indicates there is some room to accommodate a higher minimum. Such a move would help to tackle London's high incidence of working poverty while improving the financial incentive to work.

**Boost the effectiveness of the minimum wage through…**

1. *Maintaining the value of the minimum wage at least in line with average earnings growth* – over an economic cycle to ensure the wages of the lowest paid keep in touch with those of the average earner.

2. *Tougher enforcement of the minimum wage* – including substantially increased fines for non-compliance, expanded enforcement action focusing on repeat offenders and the 'naming and shaming' of exploitative employers.

3. *Extending the adult rate to 21-year-olds while retaining lower rates for younger workers* – to protect the employment prospects of those starting out in the jobs market and to avoid dilution of the main adult rate.

**Reduce the incidence of low pay – a new agenda for fairness at work**

The minimum wage and measures to help people into jobs are crucial but not enough. Tackling low pay also requires a focus on what happens to people once they are in work. This means steps to enhance individuals' earnings potential and wage mobility on the one hand, and to boost the availability of adequately paid jobs that have prospects for progression on the other.

ippr has previously proposed targeting skills and careers advice to recipients of Working Tax Credit and extending the right to request flexible working to all employees to help them avoid a negative trade-off between work and family life. We can also point to a number of concrete steps that could be taken to reduce the incidence of low pay:

1. Strategic cooperation between government and social partners in low wage sectors, focused on boosting productivity and performance

2. Building 'fair wage' commitments into public sector employment contracts and the £125 billion spent each year by the Government on public procurement

3. The development of a 'gold standard' accreditation for employers paying decent wages, linked to wider employment standards

4. Ensuring that the new Local Employment Partnerships deliver sustainable, adequately paid jobs, with training prospects

5. Engaging civil society actions, like campaigns for a 'living wage' and people's desire to shop and do business with employers paying adequate wages.

Reducing the level of low pay in the UK labour market offers a route to improving incentives to work in a way that puts reducing poverty, rather than simply reducing benefit caseloads, as its primary objective. The big risk of a strategy based around cutting or time-limiting benefits is that people are forced to exchange circumstances in which they are not working and are in poverty for working and being in poverty (potentially going into jobs with poor retention rates and limited prospects for progression). Taking steps to ensure work does take people out of poverty is also about society living up to its side of the responsibility bargain.

Ultimately, action to boost pay and prospects at the bottom of the labour market may be a more politically feasible and sustainable strategy for tackling the gap between rich and poor than higher taxes and more expansive remedial redistribution.

## Working poverty

Since making the historic pledge to abolish child poverty, the Government has combined efforts to increase parental employment and 'make work pay' (relative to out-of-work benefits) with measures to directly boost the incomes of poor families. This strategy has lifted 600,000 children out of poverty, reversing two decades of child poverty growth. However, this headline figure masks the increasing significance of working poverty, where having a parent move into work has not lifted their child out of poverty.

There are now 1.4 million poor children living in working households, the same number as in 1997. During that period the number of poor children in workless households has fallen from two million to 1.4 million. Half of all poor children now live in a household in which someone is working, up from around four in ten a decade ago. Our analysis has also found that, over the same period, the number of poor workless households with children has declined by 300,000, but the number of poor working households with children has risen by 200,000. Efforts to reduce child poverty have not taken sufficient account of the particular challenge of working poverty, which has become a growing problem and is hindering progress.

Over the last decade the proportion of households in which someone is at work but that remain poor has gone up – now amounting to over one in seven. Almost six in ten poor households (57 per cent) are working households, up from under a half ten years ago. This trend is not explained by increasing employment rates. Over the same period the proportion of households that are workless has declined, but so has the proportion of workless households that are poor. Some households have simply swapped workless for working poverty.

Families with children face twice the risk of working poverty as those without. However, rates of working poverty vary considerably between different family types with different working patterns. Almost eight in ten working-poor families with children are headed by couples, though such families are twice as likely to have someone in work as lone parents. Nearly six in ten working-poor families with children are single-earner couples. Overall, the risk of poverty is twice as high for children in a lone-parent than a couple family. However, while worklessness is a more significant factor underpinning poverty in lone-parent families, working poverty is the key factor for couple families.

The risk of working poverty is very low among couples with either two full-time earners or one full- and one part-time, but rises substantially where there is just one earner (to over 50 per cent if the single earner is only working part-time). The risk of working poverty is twice as high for lone-parent families working part-time than for those working full-time. Full-time working lone parents face three times the risk of poverty as dual-earner couple households. More than four in ten working-poor family units are those without children, over seven in ten of whom are single people. Working households headed by younger people, those from ethnic minorities and those that include a disabled adult face higher risks of poverty.

To further unpick some of the causes and drivers of working poverty, this report also investigates the link between being low paid and living in a poor household. This relationship is not straightforward: partly because different family types need different amounts of money to enjoy similar standards of living, but also because an individual's wages is only one source of income on which a household might draw to avoid poverty. Our analysis reveals that in 2004/05 the risk of ending up in poverty was 18 times higher for low paid than non-low-paid working adults. While 7.2 per cent of low-paid adults ended up poor, virtually no one (0.4 per cent) who earned more than the low-pay rate was poor. At the minimum wage, a single earner in a couple family with two children would have to work almost 80 hours a week to avoid poverty through their wages alone.

## Recommendations for tackling working poverty

Analysis of the interaction between the minimum wage, in-work support and the poverty line for different family types confirms that work is not a guaranteed route out of poverty (even if all benefits and tax credits are claimed). However, the current architecture of in-work support does provide more reliable poverty protection for lone parents than for couple families. Combined with the high levels of working poverty among couple families with children, this underpins our proposals for reforming Working Tax Credit. A clear line also needs to be drawn under previous problems with the tax credit system to renew trust among those families who need it most.

Working Tax Credit is more generous, more widely available and has significantly higher take-up than any previous similar system of in-work support. However, its current structure creates weaker incentives for second earners, relative to first earners, in couple families to enter work and does not recognise that the poverty line is higher for couples than for single people (with the same number of children). Also, administrative problems and the nature of a flexible entitlement system has combined to cause real financial hardship for thousands of families as millions of pounds of overpaid tax credits have subsequently been clawed back. Beyond the media and political backlash, this risks undermining the efficacy of tax credits among the low-income families that need an effective system the most.

- ***Introduce a Personal Tax Credit Allowance (PTCA)* –** to boost the financial incentive to move into work for second adults in couple families. By effectively individualising the first Working Tax Credit threshold, this would allow both adults in eligible families to earn up to £100 a week before their entitlement started to be withdrawn. By balancing the incentive to work for both adults, this would also support the sharing of work and care within families. This stands in marked contrast to proposals for a Transferable Income Tax Allowance, which would boost the incentive for one adult, invariably the lower paid female, *not* to work. Under the PTCA, a family earning minimum wage would be £36 a week (or £1,872 a year) better off from a second adult moving into part-time work than under the current system. Restrictions on eligibility could be put in place to focus the improved incentive on the lowest-income working families and control additional costs.
- ***Increase the value of Working Tax Credit for couple families*** by a third to £91.31 a week (or £4,748 a year) from April 2008, reflecting the higher poverty line that exists for couples. This would benefit 1.6 million families, lifting 200,000 children out of poverty at a cost

of £1.6 billion. Introduced alongside the PTCA, this would be a balanced approach to improving support and incentives for low-income couple families, while dealing with misperceptions about the impact of the tax credit system on family formation. Also, to protect work incentives and ensure that low-income working families share in rising prosperity, the main elements of Working Tax Credit should be indexed to average earnings growth.

• ***Move to a system of fixed but flexible entitlement*** – where awards can rise but not fall between standard assessments. Fixed entitlements would effectively end overpayments, except in cases of misrepresentation or unreasonable error on the part of claimants (such as not reporting a change in partnership status, which requires a new award to be started). Awards could still rise between assessments if families reported changes of income or circumstance: retaining the benefits of flexibility. If families did not report such changes, back payments would not be made. This reform would build on the existing £25,000 disregard for changes in income, but send a very clear message about the stability of system. One way to control the costs of this change would be to move to bi-annual rather than annual assessments. However, this would be a complex change requiring thorough consultation and investigation (looking in particular at the operation of the childcare element of the Working Tax Credit).

• ***Write off existing overpayments to low-income families*** – despite the problems already caused, only a third of total tax credit overpayments have been recovered. The Government must question whether it is capable of reclaiming all the remaining money – and consider the financial and political costs this would entail. Around half of all outstanding overpayments are due from families earning less than £20,000 a year. These should be written off immediately as part of a tax credit relaunch campaign that communicates a focus on recovering overpayments from better-off families and efficient administration of future awards.

Our package of reforms would bring some savings, such as ending underpayments and on tax credit administration. However, our measures, particularly the increase in the couple element of Working Tax Credit, would require additional spending. Given that public finances are tight and reducing child poverty is the priority, £1.2 billion could be saved by removing Child Tax Credit from the 2.1 million families on middle and higher incomes who receive only the Family element or less. Just 3,000 of these families had an income of under £20,000, while over 60 per cent had an income of over £30,000. This would also reduce the scale of the tax credit system by around a third.

Reflecting on the child poverty strategy, there is no question that increasing financial support to low-income families and boosting parental employment are both absolutely central. However, they will not be enough on their own. Indeed, over-reliance on the first is expensive and risks undermining work incentives, while a narrow interpretation of the second risks substituting workless poverty for working poverty. Our proposals for reforming Working Tax Credit would respond to the specific issues facing couple families. However, the importance of what happens to people once they are in work becomes especially significant when we look beyond the next few years to the 2020 target for abolishing child poverty (where a strategy based entirely on remedial redistribution is unlikely to be a viable option).

## Conclusion: a progressive agenda for work

The analysis in this report shows that poverty among those at work is a significant and growing problem, which government policy is not currently addressing. Our vision is a full-employment economy that is not based on working families being poor. The goal is fewer families in poverty and the task is to try to ensure that work is an effective means to achieve that end. 'Making work pay' – relative to out-of-work benefits – does not necessarily equate to work being a certain route out of poverty. Society rightly expects those who are able to work to do so, but the existence of such high levels of working poverty suggests society is not meeting its responsibility to keep its side of a fair deal.

Tackling worklessness remains a primary challenge, not least because getting into the labour market is often a stepping stone to a better, higher paid job. But as our analysis has shown, the number of hours worked and the presence of a second earner in couples families are crucial factors affecting the risk of working poverty. However, even then, a number of crucial questions for policymakers remain, beyond someone's entry into a job: Is it sustainable? Does it pay an adequate wage? Can they progress and advance, either where they work or by moving jobs? Does their job allow them and their family to avoid an invidious choice between 'income poverty' and 'time poverty'?

Beyond the minimum wage and Working Tax Credit, working poverty is caused by a range of factors related to policy on skills, welfare, families, industry and the labour market. An effective response involves helping people to improve their earnings potential on the one hand and promoting the availability of adequately paid jobs with progression prospects on the other. This is not a simple agenda but is firmly rooted in the values of fairness, responsibility and social mobility – with real challenges to current policy orthodoxy and the platforms of all the main political parties. Building on the analysis and recommendations presented in this report, ippr will be following up these issues in future work in its *Working out of Poverty* series.

# 1. Introduction

The right to work and to earn a decent living are timeless demands of the labour movement and basic characteristics of a fair society. The notion of the 'working poor' first came to public attention at the start of the last century, through 'new' social science like Seerbohm Rowntree's landmark book *Poverty: A Study of Town Life* (1901) and classic literature like Robert Tressell's portrayal of working-class England in *The Ragged Trousered Philanthropists* (1914). Some hundred years on and nearly six in ten (57 per cent) poor households have someone at work, while half of all poor children live in a working household.

The Labour government has implemented measures such as the minimum wage and tax credits to increase employment and 'make work pay'. This has contributed to more than a decade of economic growth, rising average earnings and high employment. However, a significant number of working people and their families are not sharing in the benefits of this rising prosperity, despite meeting their responsibility to contribute to society (White and Cooke 2007).

Work is demonstrably the surest route out of poverty: 67 per cent of workless households suffer poverty compared with 15 per cent of working households. However, too often having a job does not equate to enjoying a decent standard of living. The reasons for this disjuncture are complex – not least because of the differences between individuals, families and households as units of analysis (Gardiner and Miller 2006). But this should not obscure the simple message that working poverty constitutes both a drag on economic performance and a scar of continuing social injustice.

This paper analyses the extent and nature of working poverty in the UK, investigating what kinds of people are low paid and which working households are poor. We then assess how far these groups overlap and try to account for why this is (or is not) the case. We also investigate the role of the statutory wage floor – the National Minimum Wage – in delivering fairness at work, and wage subsidies – principally the Working Tax Credit – in helping working households to avoid poverty.

Low pay and working poverty are, of course, driven by a range of wider factors related to skills, welfare, regional, industrial, family, employment and labour market policies. There is only so far direct wage regulation and wage subsidies can go in reducing working poverty. These broader policy issues will be addressed in depth in further research from ippr's *Working out of Poverty* series.

# 2. Low pay


## Summary

Note: all figures for low pay are for April 2006.

More than one fifth of all UK workers – 5.3 million people – were paid less than £6.67 an hour in April 2006. This is equivalent to 60 per cent of median full-time pay and equates to just over £12,000 a year for someone working 35 hours a week.

- 64 per cent of low-paid workers were women while 41 per cent were women working part time.
- Almost half (46 per cent) of part-time employees were low paid compared with around one in seven (14 per cent) of those working full time.
- The gap between average part-time and full-time pay was 37 per cent, compared with the 22 per cent gender pay gap.
- Among full-time workers the gender pay gap was 13 per cent, while over four-fifths (81 per cent) of all part-time jobs were done by women.

The proportion of workers who are low paid has declined slightly over the last decade – reversing two decades of rising wage inequality and a growing proportion of the workforce being low paid. Wages have grown fastest for the lowest paid over the last 10 years, thanks to a series of rises in the minimum wage above the rate of average earnings growth. This has slightly squeezed the gap between the bottom and the middle of the wage distribution.

An employee's occupation and the industry in which they work had a major impact on their risk of being low paid:

- More than six in ten of those working in *elementary* and *sales and customer service* occupations were low paid, accounting for over half of all low-paid workers.
- Almost seven in ten (69 per cent) of those working in the *hotel and restaurant* industry were low paid, while just under one third (29 per cent) of all low-paid employees worked in *wholesale and retail* industries.
- Women were more likely to be low paid than men in virtually all occupational and industrial groups. Segregation in relation to gender and working patterns was also significant.
- Workers in the private sector were more than twice as likely to be low paid as their public-sector counterparts (27 per cent versus 12 per cent), while more than eight in ten low-paid workers were in the private sector.

Low-paid workers were spread fairly evenly across UK regions and nations:

- In all but one of the regions and nations of the UK between 20 and 27 per cent of the workforce was low paid. The exception was London, where 11 per cent of workers were low paid. But London was still home to one in ten low-paid employees.
- The average London worker earned 36 per cent more than the average employee in the North East (£13.71 versus £8.81). London also had the widest gap between average full-time and part-time pay (43 per cent). The East Midlands was the region with the widest gender pay gap (25 per cent).
- 45 per cent of employees in Halesowen and Rowley Regis constituency, in the West Midlands, were low paid – the highest proportion of any parliamentary constituency.
- There was a 63 per cent gap between the median pay of Britain's highest and lowest paid constituencies, Poplar and Canning Town (London) and Carmarthen East and Dinefwr (Wales).

Younger workers face the greatest risk of low pay:

- Two in ten low-paid workers were aged between 18 and 21. Just 15 per cent of those working in their thirties and forties were low paid.
- The gender pay gap was relatively narrow among younger workers, rising rapidly with age, reaching over 30 per cent among those in their forties.

More than a fifth (22.5 per cent) of the UK workforce was low paid in April 2006, equating to some 5.3 million employees. Based on analysis of the *Annual Survey of Hours and Earnings* (ASHE), this section sets out who these people are, where they work and what jobs they do (see Annex 2 for more details on the ASHE dataset).

There is no standard national or international definition of low pay, though nearly all use an hourly rate to factor out the impact of variable working hours on weekly or annual pay. Academics and agencies have used a number of definitions, usually based on one of the following benchmarks (reviewed in more detail in Stewart and Swaffield 1997):

- A percentage of median earnings – giving a relative low pay level and a variable number of low-paid people (see, for example, Millar and Gardiner 2004);
- A proportion of the overall earnings distribution – giving a fixed number of low-paid people but a variable low pay level; or
- An alternative calculation based on what an 'average' family or household might need to earn to avoid poverty (see, for example, Kenway and Winkler 2006).

The definition of low pay we use is: *60 per cent of full-time, median hourly pay, excluding overtime*.

We adopt a percentage-of-the-median rather than a fixed-proportion measure to recognise that being low paid takes on real meaning in the context of the earnings of the labour force as a whole. A relative measure also allows scope for the number and proportion of low-paid people to rise or fall over time. We relate low pay to full-time earnings to recognise the significance of the 'full/part-time pay gap' and use a median[1] measure so that extreme values do not overly skew the overall earnings distribution. Finally, we set the level at 60 per cent of median earnings to correspond with the internationally recognised relative poverty line.

In April 2006 median gross pay, excluding overtime, for all employees was £9.88 an hour. Median gross weekly pay was £364.10 or £19,496 a year[2]. Among men, median hourly pay was £11.19, equating to average annual pay of £24,401. Median female pay was £8.69 per hour, or £14,562 for the year. Median full-time pay, excluding overtime, was £11.12 an hour – giving a low pay level of £6.67. For someone working full-time, this equates to £233.45 a week or £12,139 a year.

This measure of relative low pay is distinct from the minimum wage – the legal wage floor – which stood at £5.05 for adults aged over 22 in April 2006 (equivalent to £9,191 for a full-time worker). Table 2.1 gives a full breakdown of employee numbers, median pay rates and both totals and proportions of low-paid workers.

## Low pay, gender and working patterns

As Table 2.1 and Figure 2.1 show, there was a strong gender dimension to low pay in 2006, underpinned by the gender pay gap in average hourly earnings, which stood at 22 per cent:

- 29 per cent of female employees were low paid, compared with 16.1 per cent of men.
- 3.4 million women and 1.9 million men were in low paid jobs, despite roughly similar numbers of men and women being in work overall.
- 64 per cent of all low-paid workers in the UK were women and 36 per cent were men.

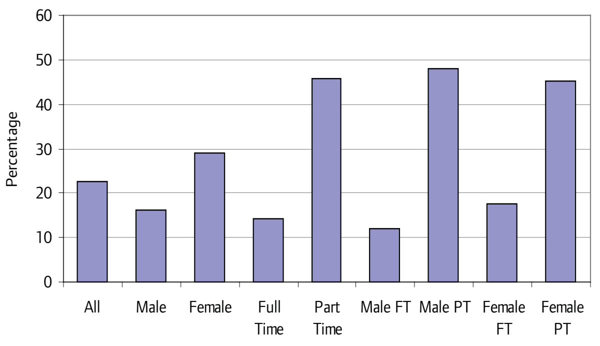
Table 2.1: Summary of average pay and low pay rates

| | Percentage of workers low-paid | Median gross hourly pay (£) | Median gross annual pay (£) | Total workers (thousands) | No. of low -paid workers (thousands) | Pay ratio* (90%: 10%) |
|---|---|---|---|---|---|---|
| All employees | 22.5% | 9.88 | 19,496 | 23,700 | 5,336 | 4.03 |
| Male | 16.1% | 11.19 | 24,401 | 12,000 | 1,925 | 4.28 |
| Female | 29.0% | 8.69 | 14,562 | 11,700 | 3,409 | 3.59 |
| Full time | 14.2% | 11.12 | 23,580 | 17,500 | 2,482 | 3.83 |
| Part time | 45.7% | 6.99 | 7,507 | 6,200 | 2,850 | 3.40 |
| Male full time | 12.1% | 11.71 | 25,769 | 10,600 | 1,284 | 4.04 |
| Male part rime | 48.1% | 6.85 | 7,534 | 1,300 | 648 | 4.37 |
| Female full time | 17.6% | 10.24 | 20,131 | 6,900 | 1,208 | 3.46 |
| Female part time | 45.1% | 7.00 | 7,502 | 4,900 | 2,205 | 3.18 |

*Note: Pay ratios are calculated by dividing the hourly pay rate, excluding overtime, at the 90th percentile by the equivalent figure at the 10th percentile. This tells us how many times greater pay is for higher earners relative to lower earners in any given category. By factoring out percentiles 1-9 and 91-100, these ratios do not compare the very highest and very lowest paid.
Source: Annual Survey of Hours and Earnings 2006

1. If the hourly pay, excluding overtime, of all 23.7 million employees sampled in the Office for National Statistics' Annual Survey of Hours and Earnings (ASHE) were divided into 100 equal parts, or percentiles, and lined up from the lowest to the highest, the median would be the figure at the 50th percentile.
2. £24,301 is often quoted as average annual gross pay for 2006. However, this relates to a mean rather than a median measure.

**Figure 2.1: Low pay risk, by gender and working patterns**




Source: Annual Survey of Hours and Earnings 2006

Dramatically different levels of low pay among full-time and part-time workers, irrespective of gender, were also a significant feature of low pay in 2006:

- 46 per cent of part-time workers were low paid, compared with 14 per cent of full-time employees.
- 2.5 million full-time workers and 2.9 million part-time workers were low paid, despite only around a quarter of all employees being part-timers.
- 53 per cent of all low-paid workers in the UK were part-time and 47 per cent were full-time (despite just 26 per cent of all employees working part-time).

Breaking down the composition of all low-paid workers in the UK in 2006:

- 41 per cent were women working part time
- 25 per cent were men working full-time
- 23 per cent were women working full-time
- 11 per cent were men working part-time.

Probing deeper, it is clear that the 'full-/part-time pay gap' and the gender divide in working patterns are key factors underpinning the gendered experience of low pay (explored further in Manning and Petrongolo 2005):

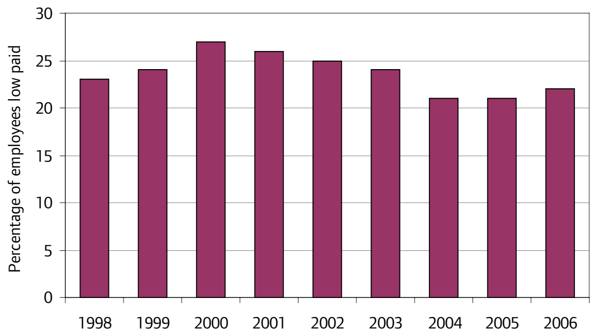
- The difference between the average pay of men and women who worked full time was 13 per cent. While still significant, this is nine percentage points lower than the overall gender pay gap.
- Women working part-time actually earned more on average than part-time working men. However, the gap between average full-time pay and average part-time pay – irrespective of gender – was 37 per cent: higher than the gender pay gap itself.
- Just 11 per cent of employed men had a part-time job compared with 42 per cent of employed women. Put another way, nearly five million of the 6.2 million people working part-time were women.

## Low pay in historical and international contexts

The analysis in this paper sets out the nature and extent of low pay in the UK at April 2006. However it is important to set these figures in both historical and international context.

Using a slightly different methodology – defining the low pay rate at £6.50 per hour, deflated annually in line with average earnings growth, among employees aged 18 and over – analysis by the New Policy Institute (NPI 2007) suggests that rates of low pay rose between 1998 and 2000 before declining by about 18 per cent between 2000 and 2006 (see Figure 2.2). These calculations combine data from ASHE and the Labour Force Survey to account for the under-representation of low-paid workers prior to 2004 in the New Earnings Survey (the precursor to ASHE). Palmer and colleagues also estimate that low pay levels have fallen from 37 per cent to 29 per cent among women and from 17 per cent to 14 per cent among men (Palmer *et al* 2006).

**Figure 2.2: Trends in adult low pay rates, 1998-2006**

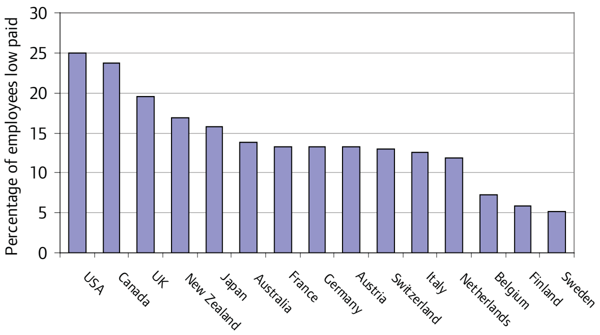



Source: New Policy Institute 2007

Looking back over a slightly longer period reveals that low pay rates increased substantially between the late 1970s and the late 1990s. Analysis of the New Earnings Survey shows that in 1977, 12 per cent of employees earned less than two-thirds of median pay, rising to 21 per cent in 1998. During the same period, the proportion of workers earning below half the median doubled, from three to six per cent (McKnight 2002). Based on similar data, Coats argues that a spike in low-paid workers is evident in the mid-1990s, after the abolition of wage councils in 1993, followed by a clear drop in rates of low pay after the introduction of the minimum wage in 1998 (Coats 2007).

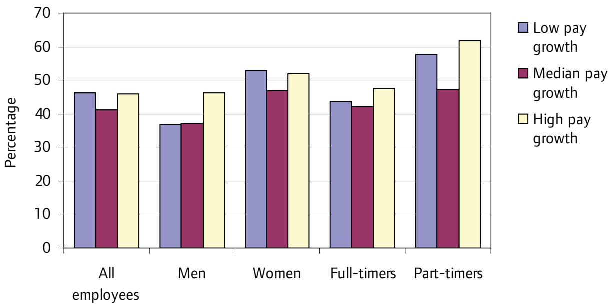
Both the International Labour Organization and the Organisation for Economic Cooperation and Development (OECD) collect data on average wages in different countries. However, the absence of a standard international definition or measure of low pay has hampered cross-national comparisons. Back in 1996 the OECD conducted an assessment of low pay for its annual *Employment Outlook* report (OECD 1996). This was based on specific analysis of national wage surveys, using a standard low pay rate of two-thirds of median full-time earnings. The findings of that analysis are presented in Figure 2.3 (based on full-time employees only).

**Figure 2.3: Cross-national low pay rates in 1996**




Note: Low pay refers to full-time employment only and is defined as less than two-thirds of median earnings.
Source: OECD 1996

**Figure 2.4: Growth in pay at the 10th, 50th and 90th percentiles, 1997-2006**




Source: Annual Survey of Hours and Earnings 2006

While the data is now somewhat dated, the level of cross-national variation in low pay rates remains striking. One quarter of full-time workers in the USA were low paid, compared with fewer than six per cent in Finland and Sweden. At just under 20 per cent, the rate of low pay in the UK was lower than in the USA or Canada but higher than every other European country. The OECD also found that rates of low pay correlated positively with levels of earnings inequality, measured as the ratio of earnings at the 50th to the 10th percentiles. In other words, high levels of wage inequality and high rates of low pay went hand in hand (OECD 1996).

Cross-national variation is especially significant given that across virtually all the nations studied, low pay tended to be concentrated among the same workers in similar jobs. Those most at risk were consistently the low-skilled, young workers, women, and those employed in sales and personal services and elementary occupations. In attempting to account for differences in low pay rates, the OECD suggested that different institutional settings, especially the role of minimum wages and collective wage bargaining, were significant.

Interestingly, researchers did not find that the prevalence of low pay was significantly related to variable skills distribution. Workers with similar levels of qualifications in different countries faced strikingly different risks of low pay. For example, fewer than 10 per cent of workers in France with an upper secondary education were low paid, compared with over 32 per cent in the USA. Also, there was no evidence that countries with smaller rates of low pay achieved this at the cost of higher unemployment rates, even among groups more vulnerable in the labour market (OECD 1996).

## Trends in wage inequality

Between 1997 and 2006 wage growth was faster among workers at the bottom of the earnings distribution than both average and high earners: 46.2 per cent compared with 41.1 per cent and 46.0 per cent respectively. As Figure 2.4 shows, there was higher pay growth at the 10th percentile compared with the median, across both genders and working patterns. There can be little doubt that the minimum wage has been instrumental in affecting these trends, pushing up wages from the bottom. This hypothesis is further supported by looking at pay growth at the 25th percentile, which was 42 per cent over the last decade: a lower rise than for the lowest earners.

Low pay and wage inequality are closely related. A striking aspect of the figures presented in Table 2.1 is the strong relationship between *average* pay on the one hand and the distribution of earnings (expressed as 'pay ratios') on the other. Across virtually all categories, where median pay is *lower*, the gap between the earnings of the lowest and highest paid workers is *narrower*. Conversely, earnings distributions tend to be *wider* where median pay is *higher*. For example, in 2006, full-time employed men combined the highest average pay (£11.71 per hour) with the widest ratio of lowest to highest paid (1:4.04).

To put this wage inequality in individuals' earnings in context, data from the Expenditure and Food Survey shows a ratio of 22:1 between the pay of the top and bottom deciles among working-age households (Jones 2007). This data compares *households*, which could have zero, one, two or even more earners combining their wages[3]. By contrast, ASHE only compares the pay of those *individuals* in paid work. Therefore it is unsurprising that a comparison that includes workless households with no earned income at the bottom, and multi-earner households at the top, produces a much wider pay ratio (especially given the polarisation between zero-earner and two-earner households over the last three decades [Berthoud 2007]).

Looking a little further back, it is clear that variable growth in pay rates across the earnings distribution played a very significant role in the growth of both income inequality and relative poverty during the 1980s and 1990s. Reviewing the data, Dickens and Ellwood (2001) find that while mean and median pay rose steadily between 1979 and 1998, wages for the lowest paid (those at the 10th percentile) actually stagnated among men and rose only slightly among women. Conversely, wages for the highest paid women doubled and rose by more than half for men (those at the 90th percentile).

Assessing changes in 'real' wages, with inflation stripped out to allow for direct comparability across years, underlines the growth in

3. Households with more than one 'benefit unit' could have more than two adults working.

earnings inequality during the last quarter of the 20th century. In the UK between 1975 and 1999:

- Pay for the lowest earners, at the 10th percentile, grew by 24 per cent (from £3.03 to £3.75 per hour, in 1996 prices).
- Median pay grew by 36 per cent (from £4.95 to £6.71).
- Pay among the highest earners, at the 90th percentile, rose by 68 per cent (from £8.77 to £14.72) (McKnight 2002).

The causes of rising wage inequality since the late 1970s – first very rapidly during the 1980s and then at a slower rate in the 1990s – is the subject of considerable debate. Certainly the growing gap between the wages of high- and low-skilled employees was a significant contributory factor, alongside industrial shifts, technological change and the decline of trade union coverage and collective bargaining arrangements. Cross-national research suggests that union density and the coverage of wage bargaining institutions have had a significant impact on trends in wage inequality over recent years (OECD 2004, Lucifora 1999). In the UK, increasing economic returns to skills coincided with an increased supply of highly educated workers (to degree level or above), suggesting that demand for high-skilled workers increased at the same time (Machin 2003).

## Low pay, occupation, industry and sector

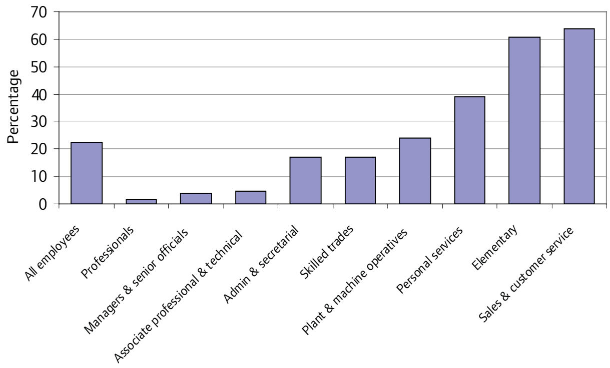
Our analysis shows that in 2006, the type of job people had and the industry or sector they worked in were significant factors affecting whether or not they were low paid. The largest group of low-paid employees worked in elementary and sales and customer service occupations, hotels and restaurants, wholesale and retail and agricultural industries, and were disproportionately employed in the private sector. Conversely, those least likely to be low paid were people working as managers and senior officials or in professional, associate professional and technical occupations, or financial intermediation, real estate, renting and business and public administration industries and were more likely to be working in the public sector.

### Occupation

As Table 2.2 and Figure 2.5 show, patterns of low pay by occupation break down into three distinct sub-groups.

Less than five per cent of employees working in senior, managerial, professional and technical occupations were low paid – accounting for just seven per cent of all low-paid workers. Employees in these 'top' three occupation groups comprised over two-fifths (43 per

**Figure 2.5: Low pay risks by occupation**




Source: Annual Survey of Hours and Earnings (ASHE) 2006

Table 2.2: Average pay and low pay rates, by occupational group, 2006

| | Percentage of workers low-paid | Median hourly pay (£) | Total no. of workers (thousands) | No. of low-paid workers (thousands) | Pay ratio 90:10% |
|---|---|---|---|---|---|
| All employees | 22.5% | 9.88 | 23,715 | 5,336 | 4.03 |
| Professional occupations | 1.6% | 18.48 | 3,192 | 51 | 2.68 |
| Managers and senior officials | 4.0% | 16.82 | 3,580 | 143 | 4.43 |
| Associate professional and technical occupations | 4.8% | 12.99 | 3,510 | 168 | 2.53 |
| Administrative and secretarial occupations | 17.2% | 8.60 | 3,213 | 553 | 2.19 |
| Skilled trades occupations | 17.2% | 9.59 | 1,829 | 315 | 2.49 |
| Process, plant and machine operatives | 24.0% | 8.32 | 1,695 | 407 | 2.29 |
| Personal service occupations | 38.9% | 7.23 | 1,924 | 748 | 2.01 |
| Elementary occupations | 60.7% | 6.11 | 2,925 | 1,775 | 1.81 |
| Sales and customer service occupations | 63.7% | 6.03 | 1,847 | 1,177 | 1.85 |

Notes: A full breakdown of low pay rates by all occupational groups within these main categories is set out in the Annex. There was relatively little variation in low pay rates within the nine main occupational groupings.
Source: Annual Survey of Hours and Earnings 2006

cent) of the entire workforce – over 10 million people – just 362,000 of whom were paid at or under £6.67 an hour.

At the other end of the labour market, sales and customer service and elementary occupations accounted for over half (55 per cent) of all low-paid employees. Fewer than five million people worked in these occupations, 20 per cent of the workforce. However, more than three-fifths (62 per cent) of them were low paid.

Finally, there were 8.6 million people, or 37 per cent of all employees, working in the other four 'middle' occupation groups. Low pay rates in these skilled, administrative, personal and technical jobs ranged from 17 to 39 per cent, equating to slightly over two million low-paid people (38 per cent of the total).

Overall, women and part-time workers faced a greater risk of being low paid than their male and full-time equivalents working in the same occupation. These different rates were compounded because women were more likely to be employed part-time than men. For example:

- Men accounted for well over half (56 per cent) of employees in the three highest paid occupation groups and even then enjoyed higher average pay and lower rates of low pay than their female counterparts.
- Just 15 per cent of employees in these occupation groups were part time, compared with a quarter for all workers.
- Seven out of ten employees in sales and customer service occupations were female. 67 per cent of women working in this occupation group were low paid; 55 per cent of men were.
- In elementary occupations more than three-quarters (76 per cent) of women were low paid compared with just under half (47 per cent) of men.
- 56 per cent of employees in the 'bottom' two occupation groups were women; 44 per cent were men.
- Numbers of full-time and part-time employees in the 'bottom' two occupation groups were similar to one another. However, they did not split equally by gender. For example, there were 1.8 million females working part-time in these occupations, but just 611,000 males.

Analysing the pay gaps *within* occupation groups – between men and women on the one hand and full-time and part-time workers on the other – reveals a slightly more complex picture.

The most immediately striking aspect of Table 2.3 is that the occupation group with the highest average pay – professionals – had the narrowest gender pay gap (3.5 per cent) and full-/part-time pay gap (-4.9 per cent). There were similar numbers of men and women employees in this group, but more than four in five worked full-time. The higher average part-time pay here is largely explained by a relatively small number of very highly paid part-time health, teaching and research professionals.

While there was a strong positive association between median wages and rates of low pay, there was often little correlation between levels of average pay and the size of pay gaps within occupation groups. In many cases occupational segregation – both between men and women and between full-time and part-time work – lay at the heart of these outcomes:

- The second highest paid occupation group – managers and senior officials – had the second widest gender (22.8 per cent) and full-/part-time (23.0 per cent) pay gaps. 65 per cent of employees in this group were male and 92 per cent were full time.
- In personal service occupations low median pay (£7.23) was combined with relatively narrow gender (7.0 per cent) and part-time (7.8 per cent) pay gaps. 83 per cent of these

**Table 2.3: Gender and full-/part-time pay gaps, by occupation, 2006**

| | Median Pay (£) | Gender gap (%) | | Median pay (£) | FT/PT gap (%) |
|---|---|---|---|---|---|
| All occupations | 9.88 | 22.3 | All occupations | 9.88 | 37.1 |
| Skilled trades occupations | 9.59 | 31.9 | Skilled trades occupations | 9.59 | 31.2 |
| Managers and senior officials | 16.82 | 22.8 | Managers and senior officials | 16.82 | 23.0 |
| Process, plant and machine operatives | 8.32 | 21.6 | Process, plant and machine operatives | 8.32 | 21.9 |
| Elementary occupations | 6.11 | 16.3 | Elementary occupations | 6.11 | 20.1 |
| Sales and customer service | 6.03 | 7.8 | Sales and customer service | 6.03 | 17.9 |
| Associate professional and technical | 12.99 | 7.7 | Administrative and secretarial | 8.60 | 13.2 |
| Administrative and secretarial | 8.60 | 7.4 | Personal service | 7.23 | 7.8 |
| Personal service | 7.23 | 7.0 | Associate professional and technical | 12.99 | 7.3 |
| Professional occupations | 18.48 | 3.5 | Professional occupations | 18.48 | -4.9 |

Note: All pay gaps in this section compare gross median hourly pay, excluding overtime.
Source: Annual Survey of Hours and Earnings 2006

employees were women and 50 per cent were part-time.

- Conversely, in skilled trade occupations a median pay rate of £9.59 an hour (just below the national average) was accompanied by the widest gender (31.9 per cent) and part-time (31.2 per cent) pay gaps. 91 per cent of these workers were men and 92 per cent were full-time.

This suggests that, right across the labour market, male and full-time worker domination of an occupational group acts to expand pay gaps (partly through placing upward pressure on wages). In contrast, a more even balance of genders and working patterns tends to contract pay gaps (dragged down by lower female and part-time pay). Overall, there was a 67 per cent pay gap between the median pay of the highest paid occupation group (professionals) and the lowest (sales and customer service).

It is important to place this snapshot of low pay in 2006 in the context of significant shifts that have taken place in the occupational structure of the UK labour market over the past three decades (see Goos and Manning 2003, Brinkley *et al* 2007 and Kaplanis 2007), as well as further change projected for the coming years (see Wilson *et al* 2006). These changes also set the backdrop to low pay rates in 2006 as influenced by the industry in which people work, to which we now turn.

**Industry**

The industry in which people work has a significant bearing on their risks of being low paid. Whereas around one in twenty of those employed in the financial intermediation sector were low paid in 2006, a staggering seven in ten of those working in hotels and restaurants earned £6.67 an hour or less. Table 2.4 gives a full breakdown of the numbers and proportions of low-paid workers for each of the main industrial groupings. Figure 2.6 shows the risks of low pay for those working in different industrial sectors.

As Table 2.4 highlights, there were five industrial sectors which accounted for 70 per cent of all employees in 2006. These were manufacturing, education, health and social work, business and retail. Aside from the retail sector, proportions of low-paid workers in each of these large industries were clustered between 10 and 20 per cent – below the overall low pay rate.

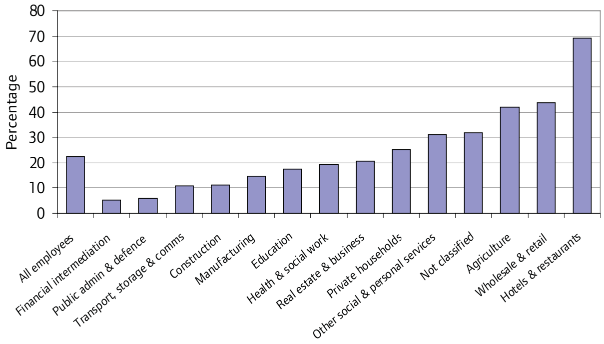
However, there were significant variations within some of these industrial categories, for instance manufacturing. In higher-value manufacturing – electricals and optics, publishing and printing, metals and transport equipment – the rates of low-paid employees were all under 15 per cent. In contrast, in lower-value manufacturing – food, beverages and tobacco, wood, textiles, and rubber and plastics – the incidence of low-paid employees was between 22 and 34 per cent.

Table 2.4: Average pay and low pay rates by industry, 2006

| | Percentage of workers low paid | Median hourly pay (£) | Total no. of workers (thousands) | No. of low-paid workers (thousands) | Pay ratio 90:10% |
|---|---|---|---|---|---|
| All employees | 22.5% | 9.88 | 23,715 | 5,336 | 4.03 |
| Financial intermediation | 5.4% | 13.41 | 1,138 | 61 | 4.99 |
| Public administration & defence | 5.8% | 12.12 | 1,370 | 79 | 2.86 |
| Transport, storage & communication | 10.8% | 10.09 | 1,401 | 151 | 3.13 |
| Construction | 11.3% | 10.87 | 907 | 102 | 3.16 |
| Manufacturing | 14.6% | 10.48 | 3,025 | 442 | 3.48 |
| Education | 17.4% | 11.62 | 3,782 | 658 | 3.97 |
| Health & social work | 19.2% | 10.08 | 2,982 | 573 | 3.29 |
| Real Estate, renting & business activities | 20.6% | 10.92 | 3,280 | 676 | 4.85 |
| Private households | 25.0% | 7.70 | 19 | 5 | - |
| Other community, social & personal service activities | 31.1% | 8.58 | 956 | 297 | 3.89 |
| Agriculture, hunting & forestry | 42.0% | 7.04 | 128 | 54 | 2.41 |
| Wholesale & retail trade | 43.6% | 7.15 | 3,556 | 1,550 | 3.18 |
| Hotels & restaurants | 69.2% | 5.57 | 983 | 680 | 2.18 |
| Not classified | 31.8% | 7.87 | 20 | 6 | - |

Note: 'Fishing, mining and quarrying', 'Electricity, gas and water supply' and 'Extra-territorial organisations and bodies' are not included in this table as there were not sufficient cases in the ASHE dataset to give reliable findings.
Source: Annual Survey of Hours and Earnings 2006

**Figure 2.6: Risks of low pay, by industry**




Source: Annual Survey of Hours and Earnings 2006

Significantly, in their analysis of low pay, Palmer and colleagues note that only around a quarter of low-paid jobs fall in sectors that face international competition – in 'low value' manufacturing, some parts of banking, finance and communications – and therefore face the risk that they could be outsourced abroad. The majority of low-paid jobs are therefore very likely to be low paid for domestic reasons, rather than due to downward external pressure on wages (Palmer *et al* 2006).

Taking an industrial perspective also draws out important differences in levels and risks of low pay related to gender and working patterns, right across the labour market:

- In 2006 there were similar numbers of men and women working in wholesale and retail, but 57 per cent of those women were low paid, compared with 30 per cent of the men.
- 73 per cent of part-time workers in wholesale and retail were low paid, a figure that was 27 per cent for full-time employees.
- Despite dominating the two main public sector categories, females working in education or health and social work were still more than twice as likely to be low paid as their male counterparts. In health and social work, 12 per cent of men and 21 per cent of women were low paid, while in education the equivalent figures were 8 per cent versus 22 per cent.
- 35 per cent of part-time employees in education were low paid, compared with just seven per cent for full-time employees, while 85 per cent of part-time education workers were women.
- In health and social work, 27 per cent of part-time workers were low paid, compared with 14 per cent of full-timers.
- In manufacturing, 37 per cent of part-time employees were low paid, compared with 13 per cent for full-time workers. However, just eight per cent of people working in manufacturing worked part time.
- A similar pattern is found in real estate, renting and business, where part-time workers were three times more likely to be low paid than their full-time equivalents (43 per cent versus 14 per cent), but there was a low proportion of part-time employees in this sector overall (just 22 per cent).

The significance of gender and working patterns also comes through strongly in Table 2.5, which analyses the gaps between average male and female pay, and average full-time and part-time

Table 2.5: Gender and full-/part-time pay gaps, by industry

| | Median pay (£) | Gender gap (%) | | Median pay (£) | FT/PT gap (%) |
|---|---|---|---|---|---|
| All industries | 9.88 | 22.3 | All industries | 9.88 | 37.1 |
| Financial intermediation | 13.41 | 44.3 | Education | 11.62 | 43.8 |
| Education | 11.62 | 28.2 | Real estate, renting & business | 10.92 | 42.4 |
| Wholesale & retail trade | 7.15 | 26.4 | Finance | 13.41 | 38.8 |
| Health & social work | 10.08 | 25.9 | Other comm, social & personal services | 8.58 | 37.3 |
| Real estate, renting & business | 10.92 | 25.8 | Wholesale & retail | 7.15 | 33.4 |
| Public admin & defence | 12.12 | 23.4 | Public admin & defence | 12.12 | 28.0 |
| Manufacturing | 10.48 | 23.3 | Manufacturing | 10.48 | 27.1 |
| Construction | 10.87 | 19.5 | Health & social work | 10.08 | 26.1 |
| Other community, social & personal services | 8.58 | 18.9 | Construction | 10.87 | 22.7 |
| Agriculture, hunting & forestry | 7.04 | 11.1 | Hotels & restaurants | 5.57 | 21.7 |
| Transport, storage & communication | 10.09 | 9.6 | Transport, storage & communication | 10.09 | 21.6 |
| Hotels & restaurants | 5.57 | 7.7 | Agriculture, hunting and forestry | 7.04 | 14.2 |

Note: Two industrial categories included in Table 2.4 – 'Private Households' and 'Not Classified' – are not included here due to insufficiently reliable data.
Source: Annual Survey of Hours and Earnings 2006

pay, within each of the main industrial categories.

High median pay tended to be associated with wider gender and full-/part-time pay gaps, but not in every case:

- By far the largest gender pay gap – 44.3 per cent – was in financial intermediation. However, there were actually slightly more women than men working in this sector.
- Seven in ten education employees were female and this sector had the second widest gender pay gap, at 28.2 per cent. Education also had the widest full-/part-time pay gap (43.8 per cent) – partly due to a large number of part-time female workers facing high levels of low pay.
- The sector with the lowest average pay – hotels and restaurants – had the narrowest gender pay gap (7.7 per cent).

Overall, there was a 58 per cent pay gap between the average highest-paid industrial grouping (financial intermediation) and the lowest (hotels and restaurants).

ASHE does not include data on pay rates according to the size of firms. However, in its most recent report, the Low Pay Commission estimates that the coverage of the minimum wage declines as the size of firms increases. Just over ten per cent of jobs in micro-firms (firms with under ten employees) and seven per cent of jobs in other small firms (with 11 to 50 employees), are thought to be paid at minimum wage level. By contrast only four per cent of jobs in larger firms are estimated as being paid at minimum wage rate (Low Pay Commission 2007).

**Public and private sectors**

In 2006 workers in the private sector were more than twice as likely to be low paid as their public sector counterparts (27.4 per cent versus 12.1 per cent). Coupled with the much higher proportion of employees in the private sector overall, this meant that 80 per cent of all low-paid workers were in the private sector, compared with 14 per cent in the public sector (the remaining six per cent of employees worked in non-classified sectors). ASHE records individuals' direct employment status and does not, therefore, distinguish those working for a private company on a public sector contract.

Over the last decade the evidence suggests that the incidence of low pay in the public sector has declined significantly faster than it has in the private sector (Kenway and Winkler 2006). Over the last decade, average wages have risen by 45 per cent in the public sector and 40 per cent in the private sector, following much faster growth in private sector pay during the preceding ten years. However, the most recent figures appear to show that pay is now growing more slowly in the public than in the private sector (Taylor 2007).

Analysing this comparison between public and private sector employees in more depth, we find that:

- Levels of low pay were higher among female than male employees in both the public and private sectors. In the private sector, 39 per cent of women were low paid compared with 19 per cent for men. In the public sector the equivalent figures were 15 per cent and 6 per cent.
- The gender pay gap was significantly higher in the private sector: 28 per cent, compared with 20 per cent in the public sector.
- In both public and private sectors, part-time employees were significantly more likely to be low paid than full-time workers.
- 27 per cent of part-time public sector workers were low paid, compared with just five per cent of those working full time. In the private sector almost six in ten part-time workers (58 per cent) were low paid – a rate three times higher than for full-time employees (18 per cent).
- The full-/part-time pay gap was 35 per cent in the public sector and 40 per cent in the private sector.
- The overall pay gap between average pay in the public and private sector was 21.2 per cent.

Following a significant decline in trade union membership during the 1980s and 1990s, members are now most likely to be working in the public sector (Metcalf 2003). However, researchers continue to find that employees who are members of a trade union earn around a third more than non-unionised workers, when comparing pay within a range of sub-groups according to gender, ethnicity, health status and manual versus non-manual work (Metcalf *et al* 2001). Pay distributions are also found to be narrower among unionised workers in each of these various sub-groups – a finding that is not explained by trade unionists doing more similar jobs to one another than non trade-unionists. The evidence suggests union activity has a statistically significant and independent impact in raising pay rates and squeezing pay differentials across the labour market (ibid).

Table 2.6: Average pay and incidence of low pay in the public and private sectors, 2006

| | Percentage of workers low-paid | Median hourly pay (£) | Total no. of workers (thousands) | No. of low-paid workers (thousands) | Pay ratio 90:10% |
|---|---|---|---|---|---|
| All employees | 22.5% | 9.88 | 23,715 | 5,336 | 4.03 |
| Public sector | 12.1% | 11.59 | 6,361 | 770 | 3.54 |
| Private sector | 27.4% | 9.13 | 15,562 | 4,264 | 4.16 |
| Not classified | 16.9% | 11.07 | 1,792 | 303 | 3.70 |

Source: Annual Survey of Hours and Earnings 2006

Table 2.7: Average pay and rates of low pay, by nation and region, 2006

| | Percentage of workers low paid | Median hourly pay (£) | Total no. of workers (thousands) | No. of low-paid workers (thousands) | Pay ratio 90:10% |
|---|---|---|---|---|---|
| All UK employees | 22.5% | 9.88 | 23,715 | 5,336 | 4.03 |
| Great Britain | 22.4% | 9.90 | 23,014 | 5,155 | 4.03 |
| England | 22.0% | 10.00 | 19,885 | 4,375 | 4.09 |
| London | 11.1% | 13.71 | 3,254 | 361 | 4.81 |
| South East | 19.6% | 10.39 | 3,239 | 635 | 4.13 |
| East of England | 23.0% | 9.63 | 2,164 | 498 | 3.91 |
| Scotland | 23.7% | 9.53 | 2,113 | 501 | 3.73 |
| South West | 24.4% | 9.27 | 1,967 | 480 | 3.72 |
| West Midlands | 25.6% | 9.24 | 2,125 | 544 | 3.71 |
| North West | 25.6% | 9.32 | 2,591 | 663 | 3.78 |
| East Midlands | 25.7% | 9.11 | 1,665 | 428 | 3.64 |
| Wales | 26.2% | 9.03 | 1,015 | 266 | 3.58 |
| Yorkshire and the Humber | 26.5% | 9.02 | 1,960 | 519 | 3.59 |
| Northern Ireland | 26.9% | 9.07 | 702 | 188 | 3.80 |
| North East | 27.4% | 8.81 | 921 | 252 | 3.56 |

Source: Annual Survey of Hours and Earnings 2006

## Low pay and place

Where people live and where they work are further important factors that influence how likely people are to be low paid. Place is significant at a national, regional and a sub-regional level. Overall, workers in the North East are most likely to be low paid and those in London the least likely. However, there is also significant variation in levels of low pay within regions and nations.

### Regions and nations

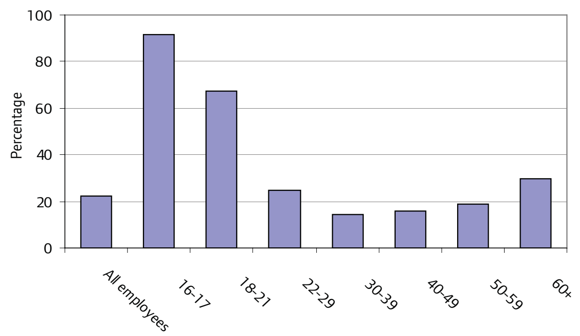
There is a surprisingly even distribution in the rates of low pay across the regions and nations of the UK.

As Table 2.7 and Figure 2.7 show, eleven of the 12 regions and nations of the UK had levels of low pay of between 20 and 27 per cent in 2006. The exception was London, with a low pay rate of 11 per cent.

The spatial distribution of low-paid jobs also reveals a fairly even geographic spread. The North West and the South East were home to the largest proportion of low-paid workers. However, each of these regions still accounted for only 12 per cent of all low-paid employees. Just four per cent of low-paid employees lived and worked in Northern Ireland.

Broad analysis of trends over the last decade suggests that levels of low pay have fallen in seven and risen in five of the regions and nations of the UK (based on a specific low pay calculation used previously in Kenway and Winkler 2006). Northern Ireland, Yorkshire and the Humber, the South West, the North East, Scotland, Wales and the West Midlands have all seen reductions in their levels of low pay. Conversely, the incidence of low pay has risen over the same period in London, the North West, the East of England, the South East and the East Midlands.

**Figure 2.7: Risk of being low paid, according to age**




Source: Annual Survey of Hours and Earnings 2006

London is something of a paradox: its relatively low incidence of low pay in 2006 was combined with by far the highest level of median pay, yet more low-paid jobs than Wales, Northern Ireland and the North East, and the biggest gap between the highest and lowest paid workers of all the regions and nations.

In 2006 the incidence of low pay was significantly higher for women and part-time workers than men and full-time workers in all 12 regions and nations of the UK. These inequities were compounded by the disproportionate number of women employed in part-time jobs. However, it is more revealing to explore the gaps in average pay between and within regions: both between average male and female pay on the one hand and average full-time and part-time pay on the other.

First, there were very substantial gaps in average pay between the regions and nations of the UK in 2006:

- The average London worker was paid 36 per cent more than the average employee in the North East (£13.71 versus £8.81).
- Among men, the biggest pay gap was 36 per cent: between the average male worker in London and his counterpart in Northern Ireland (£15.16 versus £9.74).
- An equally sized regional pay gap existed between the average female London worker and her North East equivalent (£12.34 versus £7.84).
- There was a 33 per cent gap between the pay of an average full-time worker in London and a similar average full-time employee in the North East (£14.82 versus £9.96). However, the biggest pay gap between average part-time workers was a narrower 24 per cent: between London (£8.48) and the North East (£6.41).

As Table 2.8 shows, there was also significant variation in the size of both gender and full-/part-time pay gaps *within* the regions and nations:

- The gender pay gap in the East Midlands (24.8 per cent) was almost twice as large as in Northern Ireland (13.3 per cent).
- The gap between average full-time and average part-time pay ranged from 42.8 per cent in London to 28.8 per cent in Northern Ireland.

It is worth considering in more detail the situation in London, which, while having the highest median pay, had the second narrowest gender pay gap (18.6 per cent) but the widest full-/part-time pay gap (42.8 per cent) in the UK:

- In 2006, the incidence of low pay among full-time workers in the capital, regardless of gender, was very low (six per cent for men and seven per cent for women).
- By contrast the incidence of low pay among part-time workers in London was far higher and much closer to the national average (39 per cent for men and 27 per cent for women).
- Higher incidences of low pay among men working part-time contribute to the comparatively narrow gender pay gap in London. This can also be explained by working patterns in the capital, where only a third of all employees worked part-time, almost three-quarters of whom were female (seven in ten female workers in London were full-timers).

These heterogeneous combinations of incidences of low pay, working patterns and pay gaps across the regions and nations of the UK underline the significance of local labour market circumstances – not least the spatial distribution of different industries and occupations, among which levels of low pay vary substantially. It also points to the value of analysing low pay at the sub-national and sub-regional level, as we do below.

Table 2.8: Gender and full-/part-time pay gaps, by region and nation, 2006

| | Median pay (£) | Gender gap (%) | | Median pay (£) | FT/PT gap (%) |
|---|---|---|---|---|---|
| UK | 9.88 | 22.3 | UK | 9.88 | 37.1 |
| East Midlands | 9.11 | 24.8 | London | 13.71 | 42.8 |
| South East | 10.39 | 24.4 | South East | 10.39 | 37.9 |
| East of England | 9.63 | 24.3 | North West | 9.32 | 36.4 |
| Yorkshire & Humber | 9.02 | 23.5 | West Midlands | 9.24 | 36.1 |
| North East | 8.81 | 22.8 | East of England | 9.63 | 35.7 |
| South West | 9.27 | 22.5 | North East | 8.81 | 35.6 |
| West Midlands | 9.24 | 22.3 | East Midlands | 9.11 | 35.5 |
| North West | 9.32 | 21.7 | Yorkshire & Humber | 9.02 | 34.5 |
| Wales | 9.03 | 20.5 | Scotland | 9.53 | 34.4 |
| Scotland | 9.53 | 19.6 | Wales | 9.03 | 34.3 |
| London | 13.71 | 18.6 | South West | 9.27 | 32.0 |
| Northern Ireland | 9.07 | 13.3 | Northern Ireland | 9.07 | 28.8 |

Source: Annual Survey of Hours and Earnings 2006

4. ASHE does not collect this data for Northern Ireland. Pay ratios are not included because the local data is not sufficiently reliable. Tables 2.9 and 2.10 include analysis of 586 out of 628 parliamentary constituencies, where there was sufficiently reliable data. Figures for the number of low-paid workers in each constituency are approximations, as the total numbers of workers in each constituency are only given to the nearest thousand.

**Sub-regional and sub-national low pay, mapped by parliamentary constituency**

Tables 2.9 and 2.10 set out the ten parliamentary constituencies with the highest and lowest proportions of low-paid workers across Great Britain[4], based on where people *work* (as opposed to live, which we examine below). We use parliamentary constituencies rather than local authority areas (at metropolitan, unitary, country or district level) because of their broadly similar populations.

As Table 2.9 shows, nine of the ten constituencies with the lowest levels of low pay in 2006 were in London, mostly inner London – in line with the regional and national data. However, it is important to note that there were still significant numbers of low-paid employees in some of these areas. In fact, despite having the second lowest proportion of low-paid employees in Great Britain, the Cities of London and Westminster constituency actually had more low-paid workers than any other parliamentary constituency – largely due to its very high number of workers overall. Streatham, in South London, had the fewest absolute number of low-paid employees (3,026).

Table 2.10 shows that the constituencies with the highest proportions of low-paid workers were much more geographically dispersed – with four of the 11 regions and nations of Great Britain represented in the top ten.

We also analysed the relationship between low pay and where people live (as opposed to work). The only significant difference is that those constituencies with the lowest incidences of low pay were dominated by outer London areas and others areas from the

Table 2.9: Parliamentary constituencies with the lowest incidence of low pay, 2006

| | Percentage of workers low-paid | Median hourly pay (£) | Total no. of workers | No. of low-paid workers |
|---|---|---|---|---|
| 1. Poplar and Canning Town | 4.3 | 19.15 | 116,000 | 4,988 |
| 2. Cities of London & Westminster | 5.6 | 17.51 | 716,000 | 40,096 |
| 3. Holborn and St. Pancras | 5.7 | 16.00 | 181,000 | 10,317 |
| 4. Hayes and Harlington | 5.8 | 13.90 | 107,000 | 6,206 |
| 5. North Southwark & Bermondsey | 6.9 | 15.49 | 95,000 | 6,555 |
| 6. Vauxhall | 7.5 | 15.17 | 64,000 | 4,800 |
| 7. Bethnal Green and Bow | 7.9 | 16.34 | 73,000 | 5,767 |
| 8. Bristol North West (South West) | 8.9 | 12.23 | 65,000 | 5,785 |
| 9. Battersea | 9.6 | 12.46 | 38,000 | 3,648 |
| 10. Brentford and Isleworth | 11.1 | 12.83 | 63,000 | 6,993 |

Source: Annual Survey of Hours and Earnings 2006

Table 2.10: Parliamentary constituencies with the highest incidence of low pay, 2006

| | Percentage of workers low-paid | Median hourly pay (£) | Total no. of workers | No. of low-paid workers (thousands) |
|---|---|---|---|---|
| 1. Halesowen and Rowley Regis (West Midlands) | 44.8 | 7.23 | 28,000 | 12,544 |
| 2. Meirionnydd Nant Conwy (Wales) | 44.6 | 7.14 | 7,000 | 3,122 |
| 3. Montgomeryshire (Wales) | 43.8 | 7.44 | 15,000 | 6,570 |
| 4. Carmarthen East and Dinefwr (Wales) | 43.5 | 7.01 | 13,000 | 5,655 |
| 5. Liverpool Garston (North West) | 42.8 | 7.34 | 22,000 | 9,416 |
| 6. South East Cornwall (South West) | 42.5 | 7.49 | 22,000 | 9,350 |
| 7. East Devon (South West) | 42.2 | 7.40 | 19,000 | 8,018 |
| 8. Birmingham Northfield (West Midlands) | 42.2 | 7.68 | 17,000 | 7,174 |
| 9. Wallasey (North West) | 42.1 | 7.50 | 14,000 | 5,894 |
| 10. St. Ives (South West) | 41.8 | 7.55 | 19,000 | 7,942 |

Source: Annual Survey of Hours and Earnings 2006

South East commuter belt. For example, Poplar and Canning Town had the lowest proportion of low-paid people working in a constituency (4.3 per cent) but its proportion of low-paid people living in a constituency was far higher at 13.1 per cent. Hayes and Harlington had the fourth lowest proportion of low-paid people working in a constituency (5.8 per cent) but its proportion of low-paid people living there was 16.7 per cent, the 94th lowest rate in Great Britain.

Taken together, this analysis suggests a complex geographical distribution of low pay in the UK. From a regional and national perspective there appears to be relatively little variation across the UK, with London (and to some extent the South East) an outlier. Sub-regional and sub-national analysis seems to support this judgement, given that the constituencies with the highest levels of low pay were spread across a number of regions and those with the lowest levels were concentrated in London.

But what about the degree of variation in levels of pay within regions and nations? Table 2.11 sheds light on this subject, comparing the pay gap between the constituencies with the highest and lowest median wages in each region and nation.

This analysis reveals a massive 63 per cent gap between the median pay of Britain's highest and lowest paid constituencies: Poplar and Canning Town at the high end versus Carmarthen East and Dinefwr at the low end. However, pay gaps within each of the regions and nations were significant as well. While London was the region with the lowest proportion of low-paid workers, its intra-regional pay gap was by far the widest. By contrast, the region with the highest proportion of low-paid workers (the North East) had the lowest *within*-region variation.

Table 2.11 further confirms the strong relationship between high median pay, low incidence of low pay and wide distribution of earnings.

Previous spatial analysis has found particularly high incidence of low pay in some rural areas: Cornwall, parts of the South West, parts of East Anglia, Lincolnshire, Humberside and parts of the North East (Sunley and Martin 2000). One of the explanations for this appears to be rooted in the types and nature of jobs available in rural areas. For example, low pay is more prevalent in businesses with few employees and those offering seasonal work (Gilbert *et al* 2003). More limited job choice and training opportunities may also restrict wage mobility and depress pay rates in rural areas (Gilbert *et al* 2001). Further analysis of low pay in rural areas will be set out in later work in ippr's *Working out of Poverty* series.

We finish this section with a few observations on Scotland, which combines a number of quite favourable pay outcomes[5]:

- The overall incidence of low pay at 23.7 per cent was only just above the UK average and the fourth lowest after London, the South East and the East of England.
- There were no Scottish constituencies in the constituencies with the top ten highest incidences of low pay, on the measure of either place of work or residence.
- However, unlike the South-Eastern regions of England, Scotland combined this with relatively low levels of inequality in earnings – between high and low earners overall, between men and women and between full-time and part-time workers.
- By contrast, relatively low incidences of low pay in London, the

Table 2.11: Pay gaps between parliamentary constituencies in each region and nation (by place of work), 2006*

| | Pay gap (%) | Highest paid constituency | Median hourly pay (£) | Lowest paid constituency | Median hourly pay (£) |
|---|---|---|---|---|---|
| UK | 63% | Poplar and Canning Town | 19.15 | Carmarthen East and Dinefwr | 7.01 |
| London | 52% | Poplar and Canning Town | 19.15 | Romford | 9.26 |
| South East | 45% | Aldershot | 13.60 | North Thanet | 7.48 |
| North West | 45% | Copeland | 13.53 | Liverpool Garston | 7.34 |
| East Midlands | 43% | Derby South | 12.78 | Boston and Skegness | 7.31 |
| East of England | 42% | South West Hertfordshire | 13.03 | South West Norfolk | 7.53 |
| South West | 40% | Bristol North West | 12.23 | Torridge and West Devon | 7.29 |
| West Midlands | 39% | Coventry North West | 11.78 | Halesowen and Rowley Regis | 7.23 |
| Wales | 39% | Alyn and Deeside | 11.44 | Carmarthen East and Dinefwr | 7.01 |
| Yorkshire & Humber | 38% | Sheffield Hallam | 12.11 | Barnsley East and Mexborough | 7.45 |
| Scotland | 36% | Edinburgh North and Leith | 11.95 | Banff & Buchan | 7.62 |
| North East | 27% | Newcastle upon Tyne Central | 10.38 | Berwick-upon-Tweed | 7.57 |

*Note: Based on median gross hourly pay, excluding overtime.
Source: Annual Survey of Hours and Earnings 2006

5. To place these findings in context, it is worth noting that at 75 per cent, Scotland's employment rate is at the national average – see www.statistics.gov.uk/cci/nugget.asp?id=252

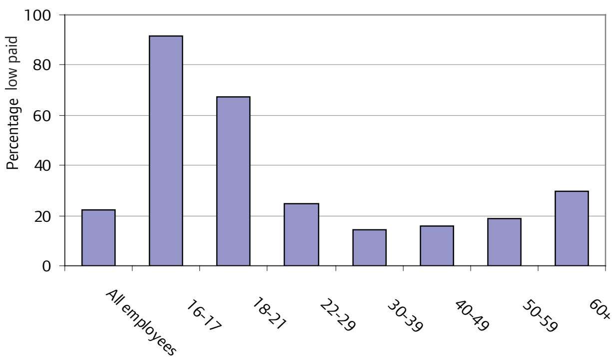
South East and the East of England brought with them some of the biggest pay inequalities – when measured within region, by gender and by patterns of work. (London's relatively lower gender pay gap is the one exception here.)

## Low pay and age

In 2006 people aged under 22 were far more likely to be low paid than those aged between 22 and 29. Those in their thirties and forties were even less likely to be low paid. Incidence of low pay began to rise again for those aged over 50. Table 2.12 sets out proportions and totals of low-paid workers, defined by different age groups.

Figure 2.7 shows the risks of being low paid across different age groups. This confirms that younger workers were far more likely to be low paid than older workers.

**Figure 2.7: Risk of being low paid, according to age**




Source: Annual Survey of Hours and Earnings (ASHE) 2006

However, to fully understand the relationship between age and low pay we also need to look beyond these headline risks, to the distribution of all low-paid workers, mapped by age.

While nine in ten employees aged 16 and 17 earned less than £6.67 an hour in 2006, just five per cent of all low-paid workers fell in this age group. In the same year 85.6 per cent of 16- and 17-year-olds were in education or training of some kind, 6.4 per cent were employed and 8 per cent were not in education, employment or training (figures from the Department for Education and Skills: www.dfes.gov.uk/rsgateway/DB/SFR/s000734/index.shtml). While low pay is an injustice wherever it is found, it is appropriate that policy for 16- and 17-year-olds focuses principally on increasing participation in education and on-going learning – as embodied in proposals to raise the effective school leaving age to 18.

It is more worrying that nearly seven in ten 18- to 21-year-olds were low paid in 2006. This group comprises just 6.8 per cent of all employees but more than one in five (20.4 per cent) of all low-paid workers. This in part reflects the characteristics of those 18- to 21-year-olds who are active in the labour market, rather than being in further or higher education. Somewhat lower rates of pay are to be expected among young people, who have less experience and lower qualifications at the start of their careers.[6] Many of these people will be studying as well as working.

Among employees in their thirties, forties and fifties, incidences of low pay were relatively low and evenly distributed: between 14 and 19 per cent. The slightly higher level among those aged 22 to 29 probably continues to reflect the generally lower skills and experience of people at the start of their careers.

Finally, Table 2.13 (next page) assesses pay gaps by age – between men and women on the one hand and between full-time and part-time employees on the other.

- The highest paid age group (30- to 39-year-olds) had a relatively narrow gender pay gap. This is largely because median female pay peaks at this age, while average male pay peaks in the following decade.
- The narrowest gender pay gap was evident among younger workers. The pay gap between men and women aged 22 to 29 was one quarter the size of the overall gender pay gap, while

**Table 2.12: Percentages of average- and low-paid workers, according to age, 2006**

| | Percentage of workers low paid | Median hourly pay (£) | Total no. of workers (thousands) | No. of low-paid workers (thousands) | Pay ratio 90:10% |
|---|---|---|---|---|---|
| All employees | 22.5% | 9.88 | 23,715 | 5,336 | 4.03 |
| 16-17 | 91.8% | 4.80 | 304 | 279 | 1.85 |
| 18-21 | 67.2% | 5.95 | 1,619 | 1,088 | 1.79 |
| 22-29 | 24.9% | 8.94 | 3,813 | 949 | 3.00 |
| 30-39 | 14.3% | 11.54 | 5,781 | 827 | 3.89 |
| 40-49 | 15.7% | 11.37 | 6,163 | 968 | 4.18 |
| 50-59 | 18.9% | 10.32 | 4,739 | 896 | 4.14 |
| 60+ | 29.8% | 8.46 | 1,378 | 411 | 3.72 |

Source: Annual Survey of Hours and Earnings 2006

6. See Annex 2 for current minimum wage rates for 16/17- and 18- to 21-year-olds.

Table 2.13: Gender and full/part-time pay gaps, assessed by age

| Age group | Median pay (£) | Gender gap (%) | Age group | Median pay (£) | FT/PT gap (%) |
|---|---|---|---|---|---|
| All ages | 9.88 | 22.3 | All ages | 9.88 | 37.1 |
| 40 – 49 | 11.37 | 30.4 | 40 – 49 | 11.37 | 38.7 |
| 50 – 59 | 10.32 | 27.2 | 30 – 39 | 11.54 | 36.2 |
| 60+ | 8.46 | 20.2 | 50 – 59 | 10.32 | 35.1 |
| 30 – 39 | 11.54 | 18.8 | 22 – 29 | 8.94 | 31.9 |
| 22 – 29 | 8.94 | 5.8 | 60+ | 8.46 | 28.6 |
| 18 – 21 | 5.95 | 3.5 | 18 – 21 | 5.95 | 11.9 |
| 16 – 17 | 4.80 | -2.3 | 16 – 17 | 4.80 | -6.1 |

Source: Annual Survey of Hours and Earnings 2006

among 18- and 21-year-olds the gap was six times smaller.

- On average, female 16- and 17-year-olds earn more than their male counterparts. However, given that median pay for both genders was well under £5 an hour this cannot be said to represent a victory for social justice.
- Gaps between average full-time and part-time pay follow a more standard pattern, being larger where median pay is higher. Among 16- and 17-year-olds, part-time workers actually earned over ten per cent more than full-time workers (probably reflecting the higher earnings power of those combining paid work with study relative to those in full-time employment).

This analysis highlights the fact that the gender pay gap is relatively narrow among labour market entrants but grows significantly as age rises. This suggests that what happens once people are in the labour market is more important than the different attitudes or aptitudes that young men and women bring with them to the world of work (Manning 2006).

Analysis by Manning and Swaffield finds that while occupational segregation is evident at labour market entry, it grows very sharply from that point until the age of 35. They suggest that around half of the rise that occurs in the gender pay gap with age is the result of variable receipt of training and differences in labour market attachment – with many women returning from child birth to lower paid, lower status, often part-time, jobs. A smaller number of women progressing to managerial positions is also identified as a key factor explaining the growth of the gender pay gap as the age profile of workers rises (Manning and Swaffield 2005).

## Low pay, disability and ethnicity

The Annual Survey of Hours and Earnings does not include data on the relationship between pay and disability status or ethnicity. However, other research suggests that these are both significantly linked to a person's risk of being low paid. Analysis of the Labour Force Survey for the Poverty Site[7], the New Policy Institute's website for statistics on poverty and social exclusion in the UK, finds that the proportion of employees with a work-limiting disability who earned less than £6.50 in April 2007 was around ten per cent higher than for those without such a condition. This finding held for both full-time and part-time workers, and across a range of skill levels.

Similar analysis also found that the proportion of employees earning less than £6.50 an hour varied considerably according to ethnicity, as follows: Bangladeshi – 50 per cent; Pakistani – 34 per cent; Black African – 25 per cent; White (other) – 22 per cent; Indian – 20 per cent; White British – 19 per cent; and Black Caribbean – 13 per cent. Finally, recent ippr research based on the Labour Force Survey looking at the relative position of different migrant communities in the UK found considerable variation in their average rates of hourly pay. These ranged from American-born workers earning on average £17.10 an hour to Polish-born workers being paid an average of £7.30 an hour (ippr 2007).

7. www.poverty.org.uk/intro/index.htm. All figures relate to employees aged over 25.

# 3. Recommendations for tackling low pay: the minimum wage


**Summary**

The minimum wage has boosted pay at the bottom of the wage ladder and has had no negative impact on jobs. It has helped keep income inequality in check and narrowed the gender pay gap amongst the lowest paid. However, its role in tackling low pay and working poverty could be strengthened through the following steps.

**Increasing the minimum wage for London workers**

The Low Pay Commission should investigate the potential impact of a higher minimum wage for London, where it has been significantly less effective than in every other region in the UK.

- In 1997 London had the largest pay gap between low and median earners of any UK region. Since then this gap has narrowed in every other region except London, where it has widened.
- Since 1997, pay growth at the 10th percentile has been slower in London than in any other region. By contrast, pay growth at the median has been faster in London than in every other region but one.
- Minimum wage workers in London earn just over a third (36 per cent) of median regional pay, compared with an average of over half (54 per cent) in all other regions.

Our analysis shows London to be an exceptional case, requiring an exceptional response. The relatively small proportion of London's jobs that are low-paid indicates that there is room for accommodating a higher minimum-wage floor. We find no case for a wider regionalisation of the minimum wage, less still for a reduction in other UK regions.

We also recommend:

- Maintaining the value of the minimum wage at least in line with average earnings – over the course of an economic cycle to ensure the wages of the lowest paid keep in touch with those of the median earner and to maintain a strong wage floor for the Working Tax Credit to operate upon.
- Tougher enforcement of the minimum wage – including substantially increased fines for non-compliance, expanded enforcement action focusing on repeat offenders, and the 'naming and shaming' of exploitative employers.
- Extending the adult rate to 21-year-olds while maintaining lower rates for younger workers – to protect the employment prospects of those starting out in the job market and to avoid dilution of the main adult rate.

**A cross-government agenda to reduce low pay**

The minimum wage has pushed up wages from the bottom, but in the absence of wider policy action over a fifth of workers still earn less than the equivalent of around £12,000 a year – underpinning Britain's high levels of poverty and inequality. A policy agenda focused solely on getting people into a job is not enough.

Action against low pay could include:

- Cooperation between government and social partners, focused on boosting productivity and performance in low-wage sectors
- Building 'fair wage' commitments into public employment contracts and the £125 billion spent each year by the Government on public procurement
- The development of a 'gold standard' for employers paying decent wages
- Ensuring that the new Local Employment Partnerships deliver sustainable, decently paid jobs, with training prospects
- Engaging civil society actions, like campaigns for a 'living wage' and people's desire to shop and do business with employers paying decent wages.

Action to boost pay and prospects at the bottom of the labour market may be a more politically feasible and sustainable strategy for tackling the gap between rich and poor than higher income taxes and more expansive remedial redistribution.

Low pay is a significant factor contributing to high levels of working poverty. It is also an injustice in itself and its reduction is central to shaping a fairer society. This section considers one major instrument for tackling low pay: direct wage regulation through the minimum wage.

In this paper we have adopted a relative measure of low pay, comparing the wages of the lowest paid with those of the average earner. We use this definition to recognise that the value of someone's pay cheque lies in its size in relation to his or her fellow workers as well as its absolute level. The relationship between wages and living costs, or the household poverty line, is more complex and will be considered later.

Reducing relative low pay (defined as 60 per cent of median full-time earnings) requires action across a very broad policy canvas – far beyond the minimum wage alone. It encompasses both supply- and demand-side strategies, for example, both helping people to improve their skills and earnings potential on the one hand, and promoting the availability of well-paid jobs with progression prospects on the other.

Considering the different nature of low pay in London and the North East, for example, underlines the need for a variety of policy instruments in tackling low pay. Compared with the rest of the UK, London has low incidence of low pay but wide gaps in pay. The minimum wage covers relatively few jobs and its value is weak in relation to median regional earnings. As we go on to suggest, such labour market circumstances suggests there is scope for the minimum wage to do more to reduce low pay in our capital city.

By contrast, compared with the rest of the country, rates of low pay are high in the North East. Coverage of the minimum wage is relatively broad there and its value in relation to median regional pay is relatively high, but gaps in pay are relatively narrow. In such a context it is likely that the role of direct wage regulation is reaching the limits of its capacity to address low pay – without having a negative impact on jobs. Here the priorities must be increasing the supply of well-paid jobs that have prospects for progression, and enhancing the capabilities of people to secure these jobs and thrive in them.

While this paper focuses on the role of the minimum wage, further papers in ippr's *Working out of Poverty* series will address these wider issues and policy solutions.

## Impact and effectiveness of the minimum wage

The introduction of the minimum wage in 1999 marked only the latest chapter in the history of wage regulation in the UK. This began in 1891 when Parliament adopted the Fair Wages Resolution, which committed the Government to only procuring goods and services from suppliers that paid prevailing wage levels for given sectors (often established through collective bargaining agreements). This principle held in one form or another before being rescinded by the Thatcher government in 1983.

During most of the 20th century wage councils operated in a number of industrial sectors across the labour market. These brought together employers, unions and independent representatives to reach agreement about sectoral wage levels. The wide coverage of collective bargaining agreements up until the 1980s played a powerful role in keeping incidence of low pay in check – partly evidenced by the significant increase the number of low-paid workers after their abolition (Coats 2007). Wage councils were abolished in 1993, leading to a brief period when there was no mechanism in place to establish a low pay floor in the UK labour market.

Reflecting on eight years of the minimum wage, it is clear that it has had a major impact on the low pay end of the labour market (see Coats 2007, Metcalf 2006 for a more detailed evaluation).

To summarise, the minimum wage has:

- *Significantly improved the wages of the lowest paid,* especially since 2002 when the 'bite' of the minimum wage has become significantly tougher. The 'bite' of the minimum wage refers to its value in relation to average earnings[9]. Between October 2002 and October 2006 the adult rate of the minimum wage rose by 27.4 per cent, compared with average growth in earnings of 16.7 per cent (Low Pay Commission 2006). The adult rate was worth just over 45 per cent of median earnings in 1999, but this has now risen to over 50 per cent (Low Pay Commission 2007). If the minimum wage had been uprated in line with prices since its introduction it would now be worth just £4.00 an hour, compared to the actual rate of £5.35. The number of workers thought to have seen their pay rise thanks to the introduction of the minimum wage is 1.3 million, with an estimated 1.25 million benefiting from the October 2006 increase (Low Pay Commission 2007). However, as our analysis shows, the minimum wage has not ended relative low pay.
- *Had no discernable negative impact on employment*, either in low-paying sectors or across the labour market as a whole. It may actually have contributed to improved labour market participation rates by improving the financial incentive to work. In line with the so-called 'new economics' of minimum wages in labour markets in which competition is imperfect, rather than perfect (Card and Krueger 1995), a number of rigorous studies have found no evidence that the minimum wage, set at an appropriate level, has cost jobs (Stewart 2003, Dickens and Draca 2005). The residential care sector is the one possible exception, where price elasticity of demand for the service is particularly high and scope for productivity improvements weak (Machin *et al* 2003)[10]. Beyond this one sector, the minimum wage has evolved in parallel with a consistently strong UK labour market, with rising employment, low unemployment, moderate earnings growth and stable prices.
- *Contributed to reducing poverty rates and keeping income inequality in check*, by disproportionately benefiting lower income households and supporting in-work tax credit subsidies. Analysis of minimum wage recipients finds that the majority are concentrated in the bottom three income deciles of working-age households (a relationship that strengthens further when looking at working-age households with at least one worker)[11] (Bryan and

9. The 'bites' of the Youth Development rate and the 16- to 17-year-old rate are significantly tougher than the adult rate, at 75 per cent and just over 65 per cent respectively in 2006.
10. See Coats 2007 for an excellent summary of the 'new economics' of minimum wages.
11. Some minimum-wage recipients are found higher up the income distribution, and will often be second earners, but these are a clear minority.

Taylor 2004). This boost to low-paid workers has contributed to the flattening of income inequality since 2001 (Jones 2007). Research has also highlighted the importance of a robust legal wage floor in maintaining a platform for in-work support, preventing employers from free-riding on wage subsidies (Sutherland 2001). However, as we demonstrate later, the minimum wage is far from a guaranteed poverty protector.

- *Had a major impact on women's pay*, helping to narrow the gender pay gap at the bottom of the earnings distribution. Over two-thirds (66 pr cent) of minimum wage recipients are women, with just under half (47 per cent) of women working part-time (Low Pay Commission 2007). This has contributed to pay rising faster and incidence of low pay falling further among women and part-time workers over the last decade compared with men and full-time employees. Between 1998 and 2006 the overall gender pay gap reduced from 27 to 22 per cent. Over the same period the gap in earnings between low-paid men and low-paid women has narrowed further, from 17 to 10 per cent (comparing male and female pay at the 10th percentile). However, occupational segregation, the gender divide in working patterns and the full-/part-time pay gap still constitute entrenched barriers to closing the gap between male and female earnings.
- *Established the Low Pay Commission (LPC) as a remarkably successful policymaking vehicle*, helping to bring consensus around the minimum wage as an enduring feature of labour market policy. The LPC has demonstrated the potential of effective social partnership in the UK. This has been based on its membership (three trade unionists, three employer representatives, two independent experts and an independent chair), its capacity to gather evidence and commission high-quality research, and its ability to take pay negotiations out of an often polarised public and political arena.

This is an impressive report card – especially given how contentious the debates were about the minimum wage among both politicians and economists prior to its introduction. There is now no serious political agenda to abolish the minimum wage, though there is no way of knowing what impact a change of government would have on its rate of growth. The neo-classical economic theory that minimum wage regulation inevitably costs jobs has been shot down.

Based on its record and impact, below we consider what future role the minimum wage should play in reducing low pay.

## The case for a higher minimum wage for London workers

The minimum wage has been significantly less effective in London than in all other regions and nations in the UK, where its impact has been remarkably even. Since 1997 low-paid Londoners have seen their pay grow more slowly than low-paid workers anywhere else in the UK, while in contrast, average- and higher paid workers in the capital have enjoyed the fastest wage growth. A decade ago the gap between low- and average-paid employees was wider in London than anywhere else. This disparity is now even greater because London is the only region in which this gap has not narrowed but widened.

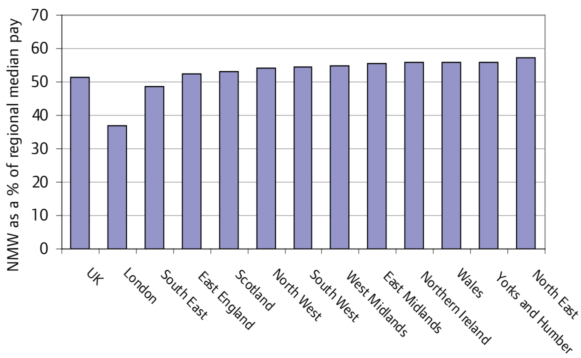
In response to these patterns, and to the particular circumstances facing the low-paid labour market in London, the Low Pay Commission should investigate the potential impact of a higher minimum wage for the cleaners, checkout assistants and waitresses who keep the capital running. Drawing on the evidence and likely impact, it should then recommend an appropriate London rate in its 2008 report. Set at £6.50 an hour, this would benefit somewhere over 300,000 employees.

Below we set out in more detail the reasons for which a higher minimum wage for London workers is necessary.

**a) Minimum wage workers in London are further out of touch with average regional pay than in any other region or nation in the UK**

A minimum-wage worker in London earns far less in relation to the median London wage than the equivalent ratio in any other region. In April 2006, minimum wage workers earned just over a third of average wages in the capital (36.8 per cent). As Figure 3.1 demonstrates, this makes London a significant outlier. Across the rest of the UK employees on the minimum wage earned between 48.6 per cent and 57.3 per cent of average regional pay (in the South East and the North East respectively). This places the value of the minimum wage in all the regions outside London far closer to the UK average of 51.1 per cent. The average regional 'bite' in the 11 regions outside London is even higher, at 54.3 per cent. Also, as earlier analysis showed, London was home to the widest pay gaps in 2006 – both measured as the ratio of earnings at the 90th and 10th percentiles and between the constituencies with the highest and lowest average pay.

**Fig 3.1: 'Bite' of the national minimum wage (NMW) in relation to median regional pay**




Source: Annual Survey of Hours and Earnings 2006

**b) Unlike every other region, London has seen a widening gap between the wages of low and average earners**

If we consider what has happened to pay growth and the value of the minimum wage at the regional level over the last decade we find further evidence that the minimum wage has served low-paid Londoners significantly less effectively than low-paid employees elsewhere in the UK (see Table 3.1, next page).

- Between 1997 and 2006 the gap between the low paid and the average earner narrowed in every region of the UK except London, where it grew by 2.4 per cent.
- Across the UK as a whole the gap between lower and middle earners narrowed by 1.9 per cent, driven in large part by above

Table 3.1: Pay growth and pay gaps by region, 1997-2006

| | UK | London | South East | East of England | North West | East Midlands | West Midlands | Scotland | North East | Yorks & Humber | South West | Wales | N. Ireland |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Pay growth at low pay (%) | 46.2 | 37.1 | 43.8 | 44.0 | 46.1 | 47.3 | 47.6 | 48.0 | 48.5 | 49.6 | 50.7 | 50.8 | 52.3 |
| Pay growth at average pay (%) | 41.1 | 44.2 | 42.7 | 37.6 | 38.7 | 40.4 | 38.7 | 44.4 | 36.2 | 44.1 | 41.5 | 38.1 | 42.8 |
| Pay growth at high pay (%) | 46.0 | 54.3 | 48.9 | 42.7 | 41.3 | 48.5 | 46.7 | 42.3 | 41.7 | 43.3 | 40.4 | 45.5 | 49.2 |
| Gap betw. low & av. pay, 1997 (%) | 45.9 | 50.2 | 45.1 | 44.9 | 44.8 | 43.0 | 44.4 | 43.8 | 44.8 | 42.0 | 44.3 | 44.3 | 44.9 |
| Gap betw. low & av. pay, 2006 (%) | 43.9 | 52.6 | 44.7 | 42.3 | 41.8 | 40.2 | 40.9 | 42.4 | 39.8 | 39.8 | 40.7 | 39.2 | 41.2 |
| Change in % gap betw. '97 and 2006 | -1.9 | 2.4 | -0.4 | -2.6 | -2.9 | -2.8 | -3.5 | -1.4 | -5.0 | -2.2 | -3.6 | -5.1 | -3.6 |

Note: Here and elsewhere, low pay refers to pay at the 10th percentile, medium pay refers to pay at the median and high pay refers to pay at the 90th percentile.
Source: Annual Survey of Hours and Earnings, 2006

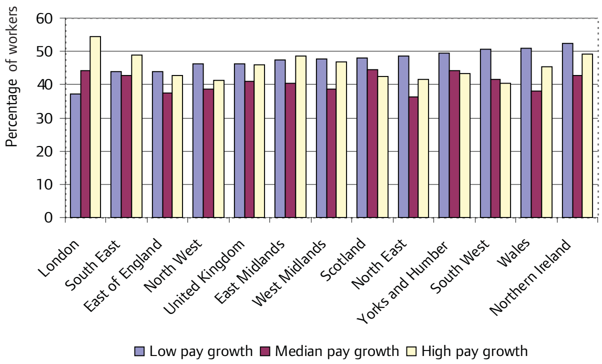
average earnings rises in the minimum wage. In Wales and the North East this gap decreased by 5 per cent.

- London already had the biggest gap between the pay of lower and middle earners in 1997 – 50 per cent compared to the national average of 45.9 per cent. While nationally this gap has narrowed to 43.9 per cent, in London it has grown to 52.6 per cent.
- London also had the biggest gap between lower and higher paid workers in 1997, a gap that has grown by 2.6 per cent in the last decade. By contrast the equivalent gap has remained stable across the country as a whole. Only two other regions (the South East and East Midlands) have seen any rise in the gap between the earnings of lower and higher paid workers, both by less than 1 per cent.

**c) London has seen the slowest growth in pay for low earners**

The rising gap between the earnings of the low-paid and average earners in London has resulted in rising pay inequality in the capital over the last decade. This contrasts with other UK regions, where the minimum wage has more effectively helped the earnings of the low paid to keep up with (and in many cases exceed) average wage growth.

**Fig 3.2: Growth in pay at 10th, 50th and 90th percentiles, by regions, 1997–2006**




Source: Annual Survey of Hours and Earnings 2006

- As Table 3.1 and Figure 3.2 demonstrate, the wages of low-paid Londoners have risen slower than for low-paid workers in every other region (37.1 per cent) and ten per cent slower than wage growth among low-paid workers across the UK as a whole (46.2 per cent).

- By contrast the pay of the average London worker has gone up faster than any other region (44.2 per cent), bar Scotland, and well above the national average (41.4 per cent).
- London has also seen by far the fastest growth in pay among high earners (54.3 per cent), well above the national average growth (46.0 per cent).

As Figure 3.2 shows, the last decade has seen a pattern of stronger growth in wages at the bottom of the earnings distribution compared with the middle – in every region except London. This is in large part due to above-average earnings rises in the minimum wage since 2002. In the capital, wages are pulling apart as low-paid workers fall further behind the average worker, while those at the middle and top of the earnings distribution continue to pull away.

Wage inequality is a significant factor influencing income inequality. If the Government is serious about tackling the gap between rich and poor, but is reluctant to curb spiralling boardroom pay in the City (with figures suggesting that the CEOs of the UK's leading companies are now earning 100 times as much as their average employees [Finch 2007]), tougher action to boost pay at the bottom of the labour market will be essential.

**d) The value of the minimum wage in relation to average regional pay has strengthened the least in London**

Table 3.2 shows that while the minimum wage has done a reasonably effective job of boosting the pay of low earners and keeping their wages in touch with those of the average employee across the rest of the country, it has failed in this task in London.

- Since its introduction the 'bite' of the minimum wage has risen from 46 per cent to 51 per cent of national median earnings – a five per cent strengthening.
- In London the regional 'bite' of the minimum wage has risen by just two per cent, from 34 per cent of the median London wages in 2000 to 36 per cent in 2007.
- In every other region the regional 'bite' of the minimum wage has strengthened by more than four per cent (and by nearly seven per cent in the North East).

**e) Living costs and poverty rates are highest in London**

Beyond the core arguments above, high living costs and high poverty rates in London further strengthen the case for increasing the minimum wage in the capital.

As later analysis in this paper shows, London has the highest rate of poverty among working households in the UK (17 per cent compared with the national average of 14 per cent). London is also home to the highest number of working-poor households of any region. This contributes to London having the highest rates of child poverty in the country. More than four in ten children in the capital (41 per cent, or around 650,000 in total) live in poverty compared with a national average of just under three in ten (29 per cent). In Inner London the child poverty rate rises to over half (51 per cent) (DMAG 2007). Figures from the Greater London Assembly estimate that only 20 per cent of working households in the capital earning the current minimum wage rate – and claiming all eligible tax credits and benefits – can escape poverty (based on a range of family types and working patterns). The GLA suggests that this figure would rise to 75 per cent if the minimum wage in London were £6.35 (GLA 2007).

As later sections of this paper explore further, the relationship between low pay and household poverty is not straightforward, but neither are they unrelated phenomena. While the level of the minimum wage is not set in relation to individuals' income needs, which will vary for different household types, the reality is that living costs and expenditure on housing are significantly above the national average in London (Wingfield *et al* 2005, Dunn and Gibbons 2006).

**f) London has exceptional labour market circumstances**

There has been some recent discussion about fully regionalising the minimum wage (Hennessey 2007). However, we firmly reject this policy avenue. The case for a London-specific premium to the minimum wage rests on the exceptional labour market circumstances in the capital.

**Table 3.2: Change in the regional 'bite' of the minimum wage (MW), 2000-2006**

| | UK | London | East Midlands | Scotland | N. Ireland | South West | South East | Wales | North West | Yorks & Humber | East of England | West Midlands | North East |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 'Bite' of MW in 2000 (%) | 46.2 | **33.7** | 51.4 | 48.6 | 50.9 | 50.0 | 43.2 | 50.4 | 48.5 | 50.3 | 46.5 | 48.5 | 50.5 |
| 'Bite' of MW in 2006 (%) | 51.1 | **36.8** | 55.4 | 53.0 | 55.7 | 54.5 | 48.6 | 55.9 | 54.2 | 56.0 | 52.4 | 54.7 | 57.3 |
| Growth in 'bite' of MW (%) | 5.0 | **3.2** | 4.1 | 4.3 | 4.8 | 4.9 | 5.4 | 5.5 | 5.7 | 5.7 | 6.0 | 6.1 | 6.8 |

Source: Annual Survey of Hours and Earnings, 2006

The minimal deviation in average pay growth and regional minimum wage 'bites' across the rest of the UK do not justify fully variable minimum wage rates. Wholly dismantling the principle of a national minimum wage would also run the risk of areas seeking to attain a competitive advantage based on low wages in a 'race to the bottom'[12]. While the 'bite' of the minimum wage is highest in the North East, this is also the region with the highest proportion of relatively low-paid workers. Given that there is no evidence that the minimum wage has damaged employment in any particular location, there are no grounds for an *a priori* lowering, or holding back, of a minimum wage rate that is currently benefiting thousands of low-paid people.

There is, however, a precedent for establishing variations in the main minimum wage rate in response to particular exceptions in the labour market, as is the case for the Youth and 16- to 17-year-olds rates.

**What would be the effect on jobs of a higher minimum wage for London?**

The Low Pay Commission (LPC) has so far effectively marshalled increases in the minimum wage while assessing its impact on employment across the labour market, with a series of rigorous evaluations finding no negative impacts (Metcalf 2006). Our recommendation is that the LPC investigates what would be the impact of a higher London minimum wage, including its impact on jobs.

However, there are some important factors that suggest a higher rate need not damage employment. First, fewer than five per cent of London workers are currently covered by the minimum wage, below the national average and a lower proportion than for all but two other UK regions (Low Pay Commission 2007). As we have shown, London also has the lowest proportion of relatively low-paid workers of any region, suggesting that there is some room for accommodating a higher minimum.

Second, while its employment rate still lags behind the national average, largely due to rapid rises in its working-age population, London has seen the fastest job growth of any region since 1997, with 700,000 new jobs created. This includes employment growth in low-paid sectors, which has been reasonably strong in London over the last decade and a half, following a sharp decline in the 1980s (Kaplanis 2007, HMT 2007a). One explanation for slower pay growth at the 10th percentile in the capital over the last decade could be the particularly intense competition for low-skilled jobs in London, which has acted to hold down wages (HMT 2007a). A higher minimum wage would help to counter the potential for employers to use a high supply of workers seeking low-wage employment to hold down pay[13]. Continued job growth at the bottom of the labour market, combined with the particularly weak bargaining power of low-paid workers in the capital, suggest that a minimum wage premium for London is both necessary and viable.

Finally, a higher minimum wage would increase the financial incentive to work for unemployed and economically inactive people, an incentive that can be weaker in London than elsewhere given its higher living and housing costs. Alongside more personalised and flexible employment services (Harker and Oppenheim 2007), this could help boost employment. To the extent that a higher minimum wage had an impact on wider pay settlements around the edges of the administrative boundary of London we might expect this to push up the wages of the low-paid in these areas.

## Three further steps towards a more effective minimum wage

**1) Sustain the value of the minimum wage at least in line with average earnings growth**

Earning the minimum wage is very far from a guarantee for avoiding household poverty. For example, in April 2006, a family consisting of a couple with three children and including one full-time earner would have needed the minimum wage to be £14.43 for them to escape poverty through wages alone (see section 5 for more details). This leads some to argue – not without reason – that the minimum wage is simply too low.

However, it is undoubtedly the case that there is some upper limit at which point a minimum wage would begin to have a harmful effect on jobs. Given that median pay is below £10 an hour, a rate of over £14 an hour would be way beyond that limit. Balancing these trade-offs in light of the evidence and prevailing labour market circumstances – and achieving a degree of consensus among the employers and trade unions – is precisely the job of the Low Pay Commission. There is an open debate about the current level of the minimum wage, but we do not propose to make specific recommendations about its current rate (other than to note that it is palpably not a protection against poverty).

Since the introduction of the minimum wage, the LPC has presided over a series of increases that have outstripped the rate of average earnings growth. This has brought the 'bite' of the minimum wage to over 50 per cent of median earnings, towards the upper range in comparison with the rest of the OECD. However, France, New Zealand and Australia all have minimum wages worth between 60 and 70 per cent of median earnings, with no evidence of negative impact on jobs. The rise in the minimum wage in 2007 from £5.35 to £5.52 is above inflation but below average earnings growth, which the LPC justified partly in order to allow more time to assess the impact of previous rises.

It is important for the minimum wage to play its proper role as a strong wage floor in a broader policy agenda to tackle low pay. Therefore it is reasonable to expect that the minimum wage should rise at least in line with average earnings growth – measured over an economic cycle to allow for flexibility in light of particular labour market circumstances – to ensure that the wages of the lowest paid keep in touch with average earners.

**2) Tougher enforcement of the minimum wage**

The success of the minimum wage depends on its enforcement, especially for the most vulnerable workers. Estimates from the Annual Survey of Hours and Earnings suggest that around 336,000 workers are paid below the minimum wage (ONS 2006). This figure does not necessarily represent the level of non-compliance, as there

12. Either if the Low Pay Commission recommended a national 'baseline' above which regions could rise, or if decision making was devolved entirely to a regional level.
13. Investigating trends in London's the low-wage labour market should be a key aspect of the Low Pay Commission's examination of the impact of a higher minimum wage in the capital.

are some legal exemptions for training or accommodation costs. There are no official figures on non-compliance, but it is likely to be high in the informal economy (Katungi *et al* 2006).

The Government increased the budget for minimum wage enforcement to £9m a year in the 2006 Pre-Budget Report and the speech by John Hutton MP, Secretary of State for Business, Enterprise and Regulatory Reform, at the Trades Union Congress in 2007 gave welcome prominence to the need for stronger minimum wage enforcement. The Government has consulted on increasing the financial penalty for non-compliance and ensuring exploited employees receive fair wage arrears (Department of Trade and Industry 2007), with an Employment Bill promised in the 2007 Queen's Speech. However, there is still little deterrent for employers, who, if they are found to have paid workers below the legal minimum, are currently only required to make up wage arrears. An additional financial penalty can only be applied if an employer fails to comply with an enforcement notice following exposure of underpayment. One study calculated that a typical employer will only get inspected once every 330 years (Metcalf 2006). Substantially increased fines for non-compliance, expanded and more coordinated enforcement action[14], and 'naming and shaming' of underpaying employers should all be part of a robust enforcement agenda.

**3) Extend the adult rate to 21-year-olds, but maintain lower rates for younger workers**

For those concerned with fairness, the idea of different rates of pay based on age is instinctively uncomfortable. If people are doing the same job why should they not get the same pay? However, there is a powerful case for lower minimum wage rates for younger workers.

- Median pay is considerably lower among young workers: £4.80 per hour for 16- to 17-year-olds, £5.95 for 18- to 21-year-olds but well over £8.00 for all older age groups.
- Even taking account of the existing youth rates, the 'bite' of the minimum wage is already far tougher for younger workers: 62.5 per cent for 16- to 17-year-olds, 71.4 per cent for 18- to 21-year-olds compared with 51.4 per cent for all employees. For workers aged between 30 and 60 the minimum wage is actually worth under 50 per cent of median pay for their age group.
- The proportions of low-paid workers are far higher among younger age-groups: 92 per cent among 16- to 17-year-olds, 71.4 per cent among 18- to 21-year-olds but less than 25 per cent for all age groups above 22 years.

It is hard to conclude that applying the current adult rate minimum wage to younger workers would not damage their employment prospects, and probably do so quite drastically. Younger workers starting out in their career generally command lower wages, often due to having less experience and fewer qualifications, and the scarring effects of youth unemployment can be deep and lasting. An alternative route to pay parity would be to set the minimum wage at a (much lower) rate such that it did not precipitously damage the employment prospects of young people. The effect of this would be to drag the current adult rate down, significantly diluting its coverage and impact on the vast majority of the low-paid workforce.

The best (if imperfect) policy mix seems to be a strong adult rate for the other 92 per cent of the workforce, combined with baseline wage protection for younger workers. Ultimately, improving the skills and promoting the labour market prospects of young people will serve their interests far better than a narrow debate about minimum wage levels.

However, the Government should heed the consistent recommendation of the Low Pay Commission to extend the adult rate of the minimum wage to 21-year-olds, many of whom will have attained degree-level qualifications. In its latest report the LPC noted that nine in ten 21-year-olds are already paid at least the adult rate of the minimum wage (LPC 2007).

## A cross-government agenda to reduce low pay

Despite the heated arguments about globalisation, outsourcing and a 'race to the bottom', by far the majority of low-paid jobs – such as cleaner, security guard and waiter and waitress – are low paid for domestic, not international, reasons. However, beyond maintaining a legal wage floor, the Government currently has no official view on the extent of low pay in the UK. It has no targets, no official measurements or any explicit policies – in marked contrast to its stance on household poverty, of which low pay is a crucial part.

The minimum wage has pushed up pay from the bottom, but with little further action on low pay, the result is greater wage compression in the lower half of the earnings distribution. We now have a labour market in which over a fifth of employees earn between the equivalent full-time wage of around £9,000 and £12,000 a year, while wages at the very top continue to spiral upwards. This is a very significant factor underpinning Britain's high levels of inequality; putting a break on the Government's employment, skills and child poverty ambitions.

A cross-government agenda to reduce low pay[15] is now needed (see also Howarth and Kenway 2004), and the Office for National Statistics should be asked to report annually on progress. Using a measure related to full-time pay would focus attention on the importance of reducing levels of low pay among part-time workers, not least in making further progress towards closing the gender pay gap.

An agenda to reduce the level of low pay would complement the Government's long-term targets to achieve an 80 per cent employment rate, significantly boost the UK's skills base and halve, then abolish, child poverty (Department of Work and Pensions 2007b and Department for Innovation, Universities and Skills 2007). It should go well beyond the minimum wage, to address the drivers underpinning low pay, such as measures to:

- Enhance the skills and capabilities of individuals to command higher wages

14. For example, by bringing together the work of the Health and Safety Executive and Acas (Advisory, Conciliation and Arbitration Service), as suggested in the Labour Party's 2005 general election manifesto.
15. Measured at 60 per cent of median full-time earnings. The 'bite' of the minimum wage is currently 45.5 per cent in relation to this measure.

- Improve the pay and prospects for progression for those working at the bottom of the wage ladder
- Develop a range of legislative, voluntary and institutional routes to a labour market that competes on high-value skills and productivity, rather than on low wages.

Such an agenda should consider what government and the social partners – employers and trade unions – in particular sectors can do to improve the productivity and performance of low-wage businesses, for instance through investment in skills, technology, product development, market analysis, management and human resources. This would involve taking steps to support companies currently operating in a low-pay/low-skill equilibrium to reshape their business models, helping them shift up the value chain. Consideration should be given to place-based strategies to reduce the incidence of low pay, through supply- and demand-side action, in light of local or regional economies. This could potentially be achieved through greater use of devolutionary vehicles such as the existing Cities Strategies and initiatives to address the particular needs of rural economies.

Government itself could take the lead in addressing low pay, as a major employer in its own right. An anti-low-pay agenda could underpin the contracting arrangements for the £125 billion spent each year on public procurement (reviving the spirit of the Fair Wages Resolution). Building in the requirement to pay decent wages and to train the workforce could increase costs for the state as a purchaser of services. However, higher quality employment is likely to lead to improved productivity and reduced reliance on tax credit supplements to wages.

An agenda to reduce low pay could also involve the development of a 'gold standard' for employers paying decent wages, potentially building on the Government's 'Skills Pledge' (indeed, a similar measure was proposed in the Labour Party's 2005 election manifesto but has yet to be developed). The commitment to supporting the creation of more high-quality part-time jobs, in response to the Women and Work Commission's report (CLG 2007), is a step in the right direction. This year's Budget announced innovative plans to make 250,000 new jobs available for those out of work through Local Employment Partnerships between Jobcentre Plus and major employers. This is a very welcome demand-side intervention. However, if those moving into these jobs are also to move out of poverty, the Government and local Jobcentre brokers must do all they can to ensure that these are well-enough paid, sustainable jobs, with at least some prospects for training and progression. Job sustainability must be a particular priority given the likely focus on the current Incapacity Benefit caseload and the poor retention rates of disabled workers.

Finally, a campaign for fairness at work could also tap into wider civil society campaigns, like ethical consumerism and the work of community organisations, such as London Citizens, who campaign for a 'living wage'. Tougher action to boost pay and prospects at the bottom of the labour market may also be a more politically feasible and sustainable strategy for reducing poverty and tackling the gap between rich and poor than either higher taxes on the rich or more expansive remedial redistribution.

These issues and policy options will be investigated and analysed in greater depth through later research in ippr's *Working out of Poverty* series, with a particular focus on promoting progression in the labour market from low-paid employment.

# 4. Poverty in working households

**Summary**

Moving into work does not necessarily mean moving out of poverty:

- Almost six in ten poor households (57 per cent) now have someone at work – a rise of ten percentage points on a decade ago.
- There are half a million more working-poor households than there were a decade ago (2.5 million compared with 2 million), while the proportion of working households that are poor has also risen.
- Record employment levels have seen the number and proportion of workless households fall, from 3.1 million in 1996/7 to 2.7 million in 2005/6 (and from 18 to 15 per cent of all households).
- Over the same period the number of poor workless households fell, from 2.2 million to 1.8 million, while the *proportion* of such households also dropped.

Half of all poor children now live in a working household:

- The number of poor children living in a working household is at the same level as it was a decade ago, while the number of poor children in workless households has fallen by 600,000. In 1997, just over four in ten poor children lived in a working household; in 2007 the figure is a half.
- The number of poor, workless households with children has fallen by 300,000 over the last ten years, but the number of poor working households with children has risen by 200,000 (measured after housing costs).

A large majority of working-poor families contain a couple:

- Almost eight in ten working-poor families with children are headed by couples, but families with couples are almost twice as likely to have someone in work as lone parents.
- The risk of working poverty is almost twice as high for families with children as for those without.
- The risk of working poverty is very low among couples with either two or 1.5 earners, but rises substantially where there is just one earner.
- Among lone parents, the risk of working poverty is twice as high for those working part-time as for those working full-time.
- However, lone parents working full-time face three times the risk of poverty as two-earner couple households.

Single people make up a large majority of the working poor that do not have children – and they also face higher risks of working poverty than similar couple families:

- More than four in ten of all working-poor family units are those without children, with over seven in ten being single people, of whom about half work part time and half full time.
- A full-time working single person is five times as likely to be poor as someone in a couple in which both work full time. A single person working part time faces almost twice the risk of working poverty as someone in a couple in which there is one full-time earner.
- Couples where only part-time work is being done (by either one or both parties) face a 30 per cent risk of poverty.

Age, disability and ethnicity are also important factors:

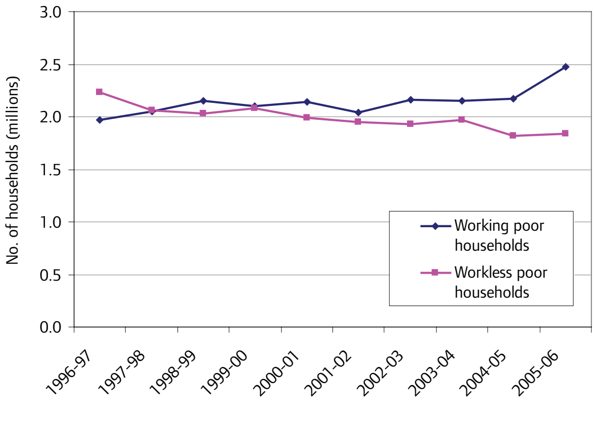
- 35 per cent of working households headed by someone aged between 18 and 21 are poor.
- A quarter of all working-poor households have at least one disabled adult.
- Ethnic-minority-headed households face around twice the risk of working poverty as households headed by a white person.

There is much truth in the Government's claim that work is the best route out of poverty. 62 per cent of movements out of poverty are caused by someone getting a job, while 44 per cent of entries into poverty are rooted in loss of employment (Jenkins and Rigg 2001). However, the relationship between being in work and not being in poverty is neither certain nor straightforward. As Section 5 explores, not all low-paid people are poor and some workers who are not low paid still end up poor. This is partly because different family types need different amounts of income to avoid poverty (see Gardiner and Miller 2006) and also because households draw on a range of income sources to avoid poverty, beyond wages.

This section analyses poverty among working households: defined as households with at least one person at work and that are below the poverty line. Poverty occurs where total household income is less than 60 per of median equivalised household income[16]. After setting out the headline rates and trends, we explore the characteristics of working-poor households in more depth. Our analysis looks at trends in working poverty between 1996/7 and 2005/6 to give a sense of the changes that have taken place over the last decade – which also corresponds with the period that Labour has been in government.

It is worth noting that working poverty is not just a UK problem. A recent study found that 1.5 million people in Canada faced working poverty there and that 40 per cent of those living on low resources were in work (Fleury and Fortin 2006). Also, McKnight (2002) finds considerable cross-national variation in the overlap between low pay and poverty – with 25 per cent of low-paid workers in the USA living in poverty, compared with less than four per cent in Sweden.

**Figure 4.1: Trends in poverty levels, by household working status, 1996/97–2005/06 (AHC*)**




*After housing costs
Source: Households Below Average Income, 2005/06

## Incidence of and trends in working poverty

In 2006 almost six in ten poor households (57 per cent) had someone at work – a rise of ten percentage points and half a million more working-poor households than a decade ago. The proportion of working households that are poor has also risen. Over the same period the number of poor workless households fell, from 2.2 million to 1.8 million, while the rate of poverty among such households also dropped. Figure 4.1 illustrates the trends in poverty according to working status, with a fall in workless poverty accompanied by a rise in working poverty.

Significant increases in benefits targeted at families with children, regardless of work status, may partly explain this pattern. The rising employment rate and decline in the proportion of working-age households that are workless are also significant. Policies such as the New Deal, tax credits and the minimum wage have contributed to record employment levels. This has led to a decline in the number of workless households over the last decade (from 3.1 million to 2.7 million) and a fall in the proportion of households in which no one works (from 18 to 15 per cent). Rising employment alongside the growth in both the absolute number and proportion of those in working poverty suggests that a sizable number of households have moved to having someone in work but have not moved out of poverty.

The following figures, combined with Table 4.1, outline the headline

Table 4.1: Breakdown of households by working and poverty status

| *2005/6* | *Poor* | *Not poor* | *Total* |
|---|---|---|---|
| Working | 2.5m | 13.8m | 16.3m |
| Workless | 1.8m | 0.9m | 2.7m |
| Total | 4.3m | 14.7m | 19.0m |
| *1996/7* | *Poor* | *Not poor* | *Total* |
| Working | 2.0m | 12.1m | 14.1m |
| Workless | 2.2m | 0.9m | 3.1m |
| Total | 4.3m | 13.0m | 17.2m |

Note: Figures do not necessary add up across columns and rows due to rounding.
Source: Households Below Average Income, 2005/06.

16. Unless otherwise stated, we are referring to income measured after housing costs. See appendix for a description of housing costs.

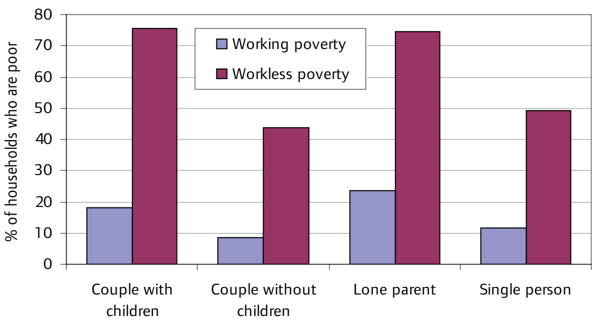
changes over the last ten years:

- In 2006, 14.5 per cent of all households (or 2.8 million) were workless; down from 18.1 per cent (or 3.1 million) in 1996/97.
- 22.7 per cent of all households (or 4.3 million) were poor; down from 24.4 per cent (4.3 million households) in 1996/97.
- 15.2 per cent of all working households were poor; up from 13.9 per cent in 1996/97. This includes a significant jump from 13.6 per cent in 2004/05.
- 57.4 per cent of all poor households contained at least one person doing some paid work; up from 46.8 per cent in 1996/97.

**Working poverty among families**[17]

Almost half (48 per cent) of all working-poor family units in 2006 were couples with children, while just under a third (28 per cent) were single, childless people. Couples without children (14 per cent) and lone parents (10 per cent) accounted for the remaining working-poor families. Figure 4.2 sets out the risks of both working – and workless – poverty for different family types. This shows that in 2006 lone parents faced the greatest risk of working poverty and a similarly high risk of workless poverty to couples with children. The overall risk of being in poverty – both workless and working – was significantly lower among couples and single people without children.

**Figure 4.2: Risk of poverty for different family types, by work status**




Source: Households Below Average Income, 2005/06

We have excluded families defined as being self-employed from this part of the analysis because the incomes of self-employed people reported in the Family Resources Survey are thought to be unreliable, either due to underreporting or volatility. However, if we take the data at face value and include all families, we find that those in which one or more person is self-employed made up a substantial proportion of all working-poor families in 2006: 21.2 per cent, or 615,000 families. The vast majority (86 per cent) of these were couple families. Over a quarter (26 per cent) of all self-employed families were poor. This suggests that families for whom self-employment is the main source of income may well have faced a relatively high risk of working poverty; however, more reliable, time-series data would be needed for this to be fully understood.

In the remainder of this section we exclude the self-employed, but consider working poverty by family type, working patterns, gender, age, disability, ethnicity and geography.

## Characteristics of the working poor

**Families with children**

Between 1996/97 and 2005/06 the number of poor children fell from 3.4 million to 2.8 million (DWP 2007a)[18]. During this time the number of poor children in workless households fell from 2 million to 1.4 million. However, over the same period, the number of poor children in working households fluctuated at around 1.4 million – and is now at the same level as it was in 1996/97 (see Figure 4.3).

Table 4.2 sets out the changes in the number of poor children by work status and family types between 1996/97 and 2005/06 – the

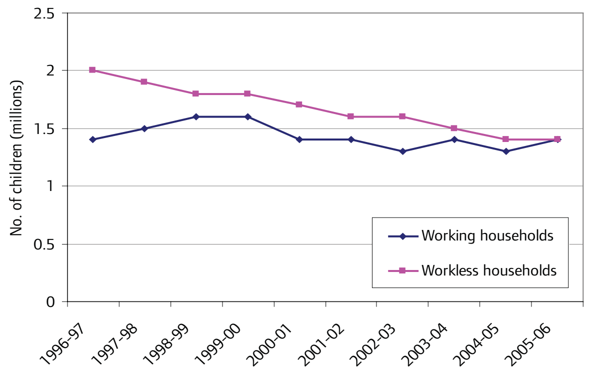
Table 4.2: Changes in child poverty by work status and family type (1997 to 2006)

| 2005/06 | Working families | | Workless families | | Total | |
|---|---|---|---|---|---|---|
| | % | Millions | % | Millions | % | Millions |
| Couples | 43 | 1.2 | 17 | 0.5 | 60 | 1.7 |
| Lone parents | 7 | 0.2 | 33 | 0.9 | 40 | 1.1 |
| Total | 50 | 1.4 | 50 | 1.4 | 100 | 2.8 |
| **1996/97** | **Working families** | | **Workless families** | | **Total** | |
| | % | Millions | % | Millions | % | Millions |
| Couples | 36 | 1.2 | 24 | 0.8 | 61 | 2.0 |
| Lone parents | 5 | 0.2 | 34 | 1.2 | 39 | 1.4 |
| Total | 41 | 1.4 | 59 | 2.0 | 100 | 3.4 |

Note: figures do not necessary add up across columns and rows due to rounding.
Source: Households Below Average Income, 2005/06.

17. There are more 'families' than 'households' in the Households Below Average Income dataset. This is because some 'households' contain more than one 'family'. For instance, a couple living in the same house as another single adult would count as a multiple-family, or multiple-benefit unit, household. The data assumes that in such cases income is shared equally across the household, with all individuals having the same poverty status.
18. Figures on numbers of children, rather than numbers of households, are given Before Housing Costs, the Government's preferred measure for the headline child poverty rate.

**Figure 4.3: Trends in child poverty, by household working status**




Source: Child Poverty Strategy & Analysis team, Department for Work and Pensions. Derived from Households Below Average Income. Figures are before housing costs.

period of time during which the Government made its pledge to halve, then abolish, child poverty.

The trends are even starker if we analyse child poverty at the household level, measured after housing costs. This reveals three significant trends (see Table 4.3):

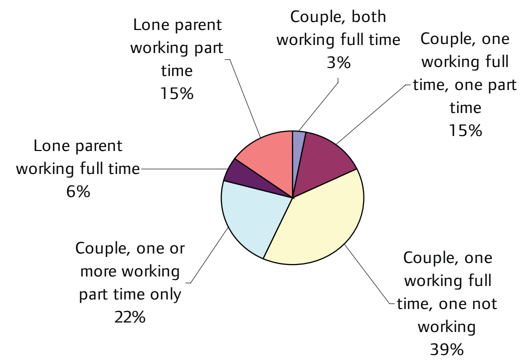
- The proportion of households with children, in which someone is at work, has risen, from 82 to almost 86 per cent.
- The poverty rate among all households with children has fallen, from 30 to 27.7 per cent.
- Poverty among workless households with children has fallen both in absolute terms, by 300,000, and as a proportion of all poor households with children, from 52.4 to 40 per cent.
- Poverty among working households with children has risen both in absolute terms, by 200,000, and as a proportion of all poor households with children, from 47.6 to 60 per cent.

So, while a decade ago under half of all poor children lived in a working household, the proportion had risen to six in ten by 2005/06. Given the drop in the number and proportion of households with children that are workless, from 19.9 per cent to 15.8 per cent (see also ONS 2007), this suggests that increased parental employment rates have resulted in a sizable number of children moving from workless poverty to working poverty. The Harker Review into the Government's child poverty strategy identified rising child poverty rates among working households as a key barrier to further progress (Harker 2006).

In addition to the headline trends overtime, it is important to consider the contrasting extent and risks of poverty by work status and working patterns for different family types (and different family sizes, which are investigated separately below).

Figure 4.4 breaks down the population of working-poor families with children. Unsurprisingly, families in which all adults work full time made up a very small proportion of all working-poor families with children, whether they were families headed by a couple or a lone parent (9per cent in total). However, it is striking that almost 80 per cent of working-poor families with children were couple

**Figure 4.4: Composition of working-poor families with children**




Note: Figures exclude the self-employed and families that contain a pensioner.
Source: Households Below Average Income, 2005/06

**Table 4.3: Breakdown of households with children, by work and poverty status, 2005/06 and 1996/97**

| 2005/6 | Working | | Workless | | Total | |
|---|---|---|---|---|---|---|
| | % | Millions | % | Millions | % | Millions |
| Poor | 16.6 | 1.2 | 11.1 | 0.8 | 27.7 | 2.0 |
| Not poor | 69.3 | 5.0 | 3.0 | 0.2 | 72.3 | 5.2 |
| Total | 85.9 | 6.2 | 14.1 | 1.0 | 100 | 7.2 |
| 1996/7 | Working | | Workless | | Total | |
| | % | Millions | % | Millions | % | Millions |
| Poor | 14.7 | 1.0 | 15.3 | 1.1 | 30 | 2.1 |
| Not poor | 67.3 | 4.7 | 2.7 | 0.2 | 70 | 4.9 |
| Total | 82 | 5.7 | 18 | 1.3 | 100 | 7 |

Notes: Figures in this table refer to income after housing costs. Figures do not necessary add up to 100 per cent across columns and rows due to rounding.
Source: Households Below Average Income, 2005/06.

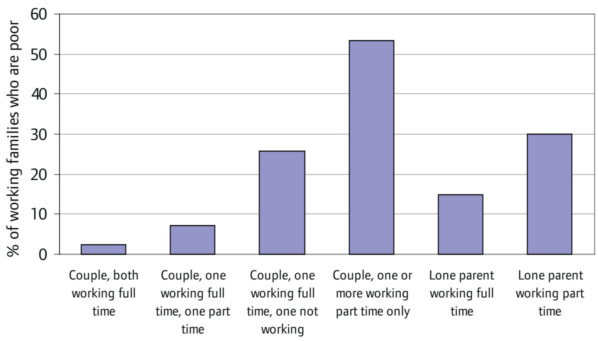
families (79 per cent). Of these, nearly half were couples with one full-time earner, while a further significant proportion were couples, one or both of which were working only part time.

'Couples with one or more part-time workers' are a standard family group in the Households Below Average Income (HBAI) dataset. Our analysis indicates that the vast majority – maybe as many as nine in ten – of these part-time working families had only one earner (based on Family Resources Survey, 2004/05). This suggests that nearly 60 per cent of working-poor households with children comprised single-earner couples.

Similar differences between couple and lone-parent families are evident when we look at their comparative risks of experiencing working poverty in 2006 (see Figure 4.5):

- Among couples with either two or one-and-a-half earners (one working full- and one working part-time) the risks of poverty were very low (2 per cent and 6 per cent respectively).
- The risk of working poverty was far higher where one adult in a couple did not work. A quarter (25 per cent) of couples where only one person was in full-time work were poor, rising to over half (51 per cent) among couples where one or more worked part time (the vast majority of whom had only one earner).
- Among lone parents, the risk of working poverty was far lower for those working full time (15 per cent) compared with those working part time (30 per cent).

**Figure 4.5: Risks of working poverty among families with children**




Note: Figures exclude self-employed and families containing a pensioner.
Source: Households Below Average Income, 2005/06

Table 4.4 confirms that the vast majority of working-poor families with children are headed by couples, but places this in the context of patterns of working rates and worklessness in different family types.

- There are more than 3.5 times as many couple families with children than lone-parent families overall.
- The risk of workless poverty is similar among both lone-parent families and couple families with children: 76 and 74 per cent respectively.
- But lone parents make up two thirds of all workless families with children.
- This is largely because 49 per cent of lone-parent families are workless, compared with just 7.5 per cent of couple families with children.
- Lone parents make up 37 per cent and couples 63 per cent of all poor families with children.
- However, the overall risk of poverty is 49 per cent among lone-parent families, compared with 22 per cent for couple families with children.

In other words, the majority of poor children live in couple families but the risk of poverty is higher for children in lone-parent families. And while worklessness is a more significant factor underpinning child poverty in lone-parent families, working poverty is the key factor underpinning child poverty in couple families.

Finally, the risk of working poverty rose with the number of children in a household. 37 per cent of working households with four or more children were poor, compared with 17 per cent of working households with one child. However, a large majority (73 per cent) of the working-poor population are households with one or two children.

### Families without children

The current system of wage subsidies through the tax credit system is skewed towards families with children. While a parent working at least 16 hours a week is eligible for the Working Tax Credit, support for couples and single people without children is restricted to those aged over 25 and working more than 30 hours a week.

Table 4.4: Work and poverty rates among families with children

| 2005/06 | Working families | | | | Workless families | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Poor | | Not poor | | Poor | | Not poor | | | |
| | % | Millions | % | Millions | % | Millions | % | Millions | % | Millions |
| Couple with children | 13.1 | 1.4 | 58.9 | 6.3 | 4.7 | 0.5 | 1.9 | 0.2 | 78.5 | 8.4 |
| Lone parent | 2.8 | 0.3 | 8.4 | 0.9 | 7.5 | 0.8 | 2.8 | 0.3 | 21.5 | 2.3 |
| TOTAL | 15.9 | 1.7 | 67.3 | 7.2 | 12.2 | 1.3 | 4.7 | 0.5 | 100 | 10.7 |

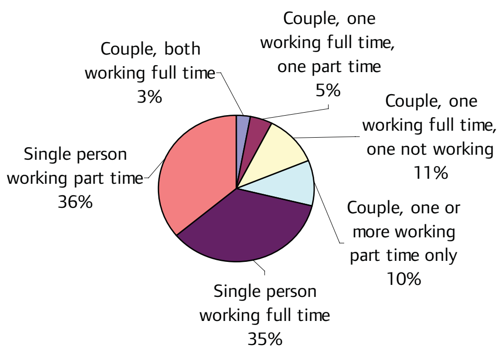
Note: Figures do not necessary add up to 100 per cent across columns and rows due to rounding. Source: Households Below Average Income, 2005/06.

This policy reflects both the Government's commitment to reducing child poverty and the reality that both the levels and risks of poverty are higher among families with children. In 2006, the risk of working poverty for families without children was 10 per cent, and 19 per cent for those with children. Among workless families, 75 per cent of those with children were poor, compared with just under 50 per cent for couples and single people without children.

However, working poverty remained a real problem among families without children in 2006:

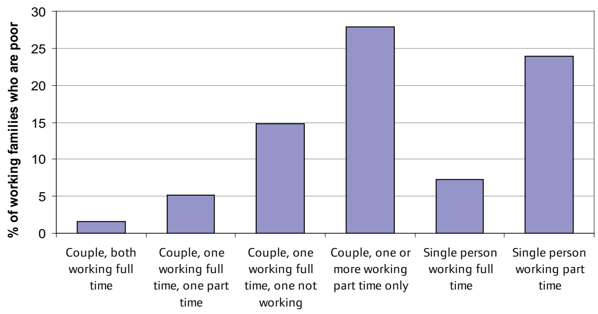
- 41 per cent of all working-poor families (or 1.2 million) were those without children.
- Single people accounted for over 70 per cent of working-poor families without children (as Figure 4.6 shows) – in contrast to working-poor families with children, where couple families predominate.
- Working poverty among single people without children was divided equally between full-time and part-time workers.
- Of the 29 per cent of working-poor families without children that are couples, very few had either two or one and a half earners (eight per cent in total).

**Figure 4.6: Composition of working-poor families without children**




Note: Figures exclude the self-employed and families which contain a pensioner.
Source: Households Below Average Income, 2005/06

**Figure 4.7: Risks of working poverty among families without children**




Source: Households Below Average Income, 2005/06

Figure 4.7 sets out the risks of working poverty among families without children:

- Unsurprisingly, families without children, in which all adults worked had the lowest risk of working poverty.
- A full-time working single person was five times as likely to face working poverty as a couple in which both were working full time (7.3 per cent versus 1.5 per cent).
- Couples families in which only part time work was being done faced a 30 per cent risk of poverty. Again, the vast majority of these were couples in which only one partner was earning.

Finally, Table 4.5 reaffirms that single people made up by far the largest proportion of working-poor families without children.

- There were almost twice as many single people without children as couples without children overall.
- The risk of workless poverty was 50 per cent for both single people and couples without children.
- But while just 8 per cent of couples without children were workless, the equivalent rate for single people without children is 33 per cent.
- Nine out of 10 workless poor families without children (89 per cent) were single people.

This demonstrates that single people made up the greatest

Table 4.5: Work and poverty rates among families without children

| 2005/06 | Working families | | | | Workless families | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Poor | | Not poor | | Poor | | Not poor | | | |
| | % | Millions | % | Millions | % | Millions | % | Millions | % | Millions |
| Couple, no children | 2.5 | 0.4 | 28.7 | 4.5 | 1.3 | 0.2 | 1.3 | 0.2 | 33.8 | 5.3 |
| Single, no children | 5.1 | 0.8 | 39.5 | 6.2 | 10.8 | 1.7 | 10.8 | 1.7 | 66.2 | 10.4 |
| Total | 7.6 | 1.2 | 68.2 | 10.7 | 12.1 | 1.9 | 12.1 | 1.9 | 100 | 15.7 |

Source: Households Below Average Income, 2005/06. Figures do not always add up to 100 per cent due to rounding.

proportion of both working and workless families without children – as well as facing greater risks of both working and workless poverty.

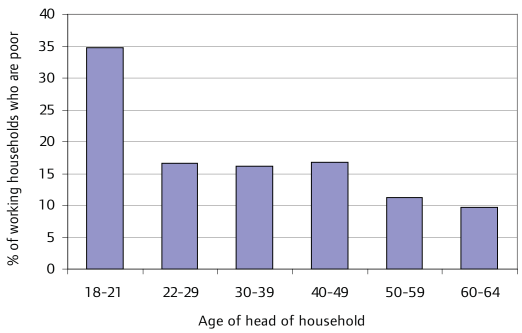
**Working poverty and age**

Looking again at all households, irrespective of whether or not they have children, Figure 4.8 shows that those headed by younger people faced by far the greatest risk of working poverty in 2006 (see glossary for explanation of what defines the head of a household).

- Over one third of working households headed by someone aged between 18 and 21 (35 per cent) were poor.
- The risk of working poverty among households headed by someone aged 22 to 49 was far lower, at around 16 per cent.
- Households headed by someone over 50 faced an 11 per cent risk of working poverty, lower than the overall average.
- However, less than three per cent of all working households were headed by those aged under 22.
- Households headed by someone aged 22 to 49 accounted for nearly 80 per cent of all working-poor households.

There are two main factors that are likely to account for the high risks but low numbers of working-poor households headed by young people. First, many young people will still be living with their parents or other older family or friends. Some of those who are living independently at this age will not be working because they are studying or training. However, those who are heading their own household – and also working – may be at a relative disadvantage as a result of the low youth rates of the minimum wage, and because Working Tax Credit is not available to childless people under the age of 25.

**Figure 4.8: Risks of working poverty, by age**




Source: Households Below Average Income, 2005/06

**Working poverty and disability**

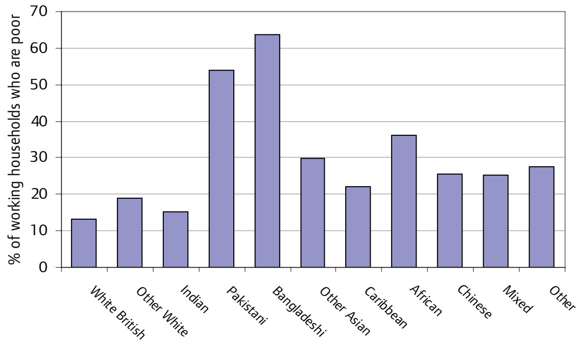
In 2006, the risk of being in working poverty was higher for households with a disabled adult (18 per cent) than for those without (14 per cent). Just over 70 per cent of households with a disabled adult have someone working, compared with 90 per cent for those without a disabled adult. Overall, a quarter of all working-age households have at least one adult with a disability, and 30 per cent of these households are poor – compared with 20 per cent of those with no disabled adult.

The HBAI dataset does not include data on households with a disabled child. However, analysis of the Family Resources Survey for 2004/05, shows that the risk of poverty among working households with a disabled child was 18.8 per cent, higher than for working households overall (15.2 per cent). These figures do not take into consideration the additional costs that disabled people might face on account of their impairment. Overall, 6.8 per cent of working-age households included one or more disabled children.

**Working poverty and ethnicity**

Ethnic-minority-headed households faced around twice the risk of working poverty as households headed by a white person, in 2006. Figure 4.9 sets out the working poverty risks by ethnicity of the head of household. Pakistani and Bangladeshi households faced by far the highest risks, 54 and 64 per cent respectively. Indians were the only ethnic minority group that experienced a risk of working poverty that was comparable to white households, at 15 per cent.

**Figure 4.9: Risks of working poverty, by ethnicity**

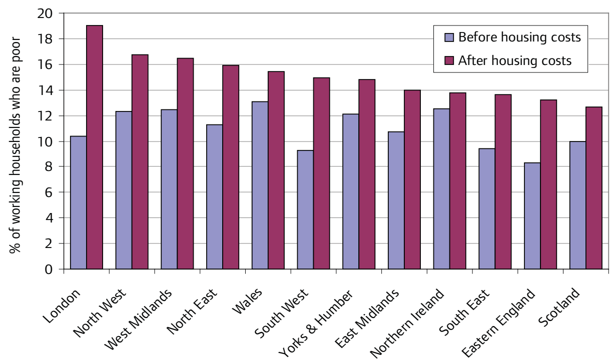



Source: Households Below Average Income, 2005/06

**Working poverty and place**

In 2006 both the highest risk of working poverty and the largest number of working-poor households were found in London. Figure 4.10 shows the proportion of working households that were poor according to region. Table 4.6 on the next page sets these headline

**Figure 4.10: Risks of working poverty, by region**




Source: Households Below Average Income, 2005/06 rates in the context of wider data about rates of poverty, work and worklessness across the UK.

Housing costs are clearly a significant factor in influencing whether or not a working household faces poverty. For example, London had rates of working poverty around the national average on a before housing costs measure, which rose substantially once housing costs were taken into account. The impact of relative housing costs appears to be variable across the UK, with certain regions and the nations of Wales, Scotland and Northern Ireland displaying a far smaller gap between working poverty rates before and after housing costs.

It is also worth noting that some regions and nations – for example the North East and Wales – had relatively high rates of working poverty, but a relatively small proportion of the total working-poor population. Finally, there is very little association between working and workless poverty rates across the different regions and nations of the UK.

Table 4.6: Breakdown of working poverty rates by region

| | Working poverty rate (AHC) | Working poverty rate (BHC) | Percentage of all working-poor households | Overall household poverty rate | Workless poverty rate | Working households as % of all households |
|---|---|---|---|---|---|---|
| UK | 15.2 | 10.7 | 100 | 22.7 | 66.5 | 85.5 |
| London | 19.1 | 10.4 | 16.2 | 28.1 | 76.8 | 84.3 |
| North West | 16.7 | 12.3 | 12.2 | 25.2 | 67.4 | 83.3 |
| West Midlands | 16.4 | 12.5 | 9.4 | 25.6 | 72.2 | 83.6 |
| North East | 15.9 | 11.3 | 4.2 | 25.0 | 66.6 | 82.2 |
| Wales | 15.4 | 13.1 | 4.7 | 22.5 | 56.2 | 82.6 |
| South West | 14.9 | 9.3 | 8.2 | 20.3 | 61.2 | 88.5 |
| Yorkshire & Humber | 14.8 | 12.1 | 8.0 | 22.7 | 65.1 | 84.4 |
| East Midlands | 13.9 | 10.7 | 6.5 | 22.5 | 70.6 | 84.9 |
| N. Ireland | 13.8 | 12.5 | 2.6 | 22.3 | 60.3 | 81.7 |
| South East | 13.6 | 9.4 | 12.7 | 18.4 | 60.7 | 89.9 |
| East of England | 13.2 | 8.3 | 8.2 | 18.7 | 63.5 | 88.9 |
| Scotland | 12.7 | 9.9 | 7.0 | 20.4 | 62.5 | 84.6 |

Note: AHC=after housing costs; BHC=before housing costs
Source: Households Below Average Income, 2005/06.

# 5. The overlap between low pay and poverty

**Summary**

There is not a straightforward relationship between earning a low wage and living in poverty. This is because different family types need different amounts of money to enjoy a similar standard of living and because an individual's own wages are only one source of income on which a household can draw to avoid poverty.

In 2004/05:

- 7.2 per cent of low-paid adults were poor, taking into account all sources of household income.
- By contrast, just 0.4 per cent of non-low-paid workers were poor – their poverty risk was 18 times lower.
- Overall, 14 per cent of working-age – but not necessarily working – adults were poor.

Having a low wage significantly increased an individual's exposure to poverty:

- Less than a fifth of low-paid adults (19 per cent) earned enough to lift their household out of poverty through their own wages alone, compared to more than three-quarters of non-low-paid workers.
- However, a further 74 per cent of low-paid people avoided poverty thanks to the wages of others in the household and (though to a far lesser extent) benefits and tax credits.

Low-paid workers' exposure to poverty – and the ways in which they avoid it – varied considerably by different family types:

- Low-paid single adults were over three times more likely to end up poor as those living as part of a couple, but were eight times more likely to be able to avoid poverty directly through their own earnings.
- 15 per cent of low-paid lone parents ended up poor compared with just five per cent of low-paid parents living as part of a couple. Fewer than one in ten low-paid lone parents avoided poverty just through their own wages, but benefits and especially tax credits lifted a significant further proportion above the poverty line.
- Just two per cent of low-paid adults in couples with children escaped poverty through their wages alone, compared with nearly six in ten similar non-low-paid adults.
- However, once the wages of their partner were taken into account, over six in ten low-paid adults in couples with children escaped poverty.

Working patterns had a significant impact on whether low-paid workers ended up poor, as did other sources of earned income:

- Nearly a third of low-paid full-time workers (32 per cent) earned enough to take their household above the poverty line through their wages, compared with just two per cent of low-paid part-time workers.
- As for many groups of workers, partners' earnings and the wages of other adults in the household enabled a significant additional proportion of those working part time to escape poverty.
- In the case of wages from other (non-partner) adults, this rests on the assumption that all earned income is shared equally across households, which will not necessarily be the case in practice.
- To raise awareness of the potential for 'hidden' poverty to exist within non-poor households, the Government should consider also tracking poverty at the family (or benefit unit) level.

A single earner in a couple family with two children would have to work almost 80 hours a week at the minimum wage in order to avoid poverty through their wages alone. The current architecture of in-work support does not guarantee that work is a route out of poverty, but it does provide more reliable protection for lone parents than for couple families.

There is not a straightforward relationship between being low paid and living in poverty. This is both because different family types need different amounts of money to enjoy a similar standard of living and because an individual's pay is only one source of income on which households can draw to avoid poverty. For instance someone could be low paid and rich or high paid and poor. Unemployed or economically inactive people are not necessarily poor, as other working adults in their household may protect them from poverty[19].

In this section we analyse the extent to which low-paid workers are able to escape poverty through their own earnings and the other sources of household income that are significant. The annex gives an explanation of the low pay rate use for this section. We also consider the proportion of low-paid workers that remain poor, despite all other sources of household income. (The analysis does not look at the marginal impact on household poverty rates of working extra hours.)

To briefly explain our methodology: using the Department for Work and Pensions' Family Resources Survey (FRS), we break down all sources of household income for individual workers, adding them up cumulatively, considering at each stage whether their total household income is enough to take them out of poverty. The ordering in which income sources are considered is based on what previous research suggests is their relative value to individuals, as well as how income is shared by members of a household (derived from Millar and Gardiner 2004). That ordering is as follows: an individual's own earnings from employment and self-employment; their partner's earnings; non-means-tested benefits; tax credits (including benefits such as Child Benefit and Child Tax Credit paid to adults for dependent children); means-tested benefits; earned income of other adults in the household; and finally other household income (such as from capital or investments).

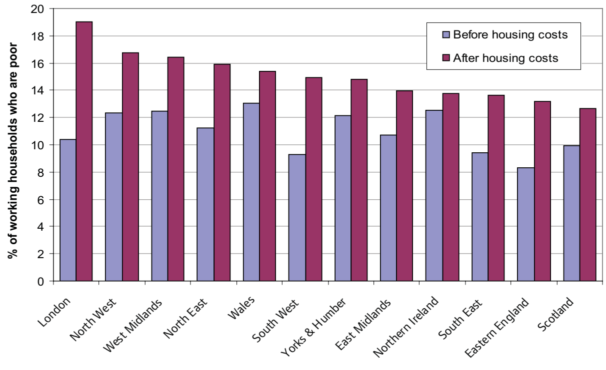
This section considers poverty on a before housing costs measure, because the FRS does not include data on people's housing expenditure (or other expenditure needs such as childcare, utilities, food and transport). However, a previous study looking at the relationship between low pay and household poverty identified variable housing costs as a significant issue. Kenway and Winkler (2006) found that some low-paid people avoided poverty by spending a very low proportion of their income on housing, while some non-low-paid people ended up poor because of very high housing costs.

## Routes out of poverty for low-paid workers

Our analysis finds that 1.9 per cent of all working adults lived in poor households in 2004/05. However, as Figure 5.1 shows, the risk of poverty is significantly higher for low-paid adults (7.2 per cent) than for non-low-paid adults (0.4 per cent). By way of comparison, 14 per cent of all working-age – but not necessarily working – adults were poor in 2004/05 (DWP 2005).

Using a similar methodology, Millar and Gardiner (2004) find that 14 per cent of low-paid individuals and 5 per cent of all employees lived in poor households. That study used the Family Expenditure Survey (FES) rather than the Family Resources Survey (FRS), with some differences in the data and definitions: the sample size of FRS is more than four times as large. Also, Millar and Gardiner use the 2000/01 FES dataset, and there have been a number of policy changes since then, such as increases in the minimum wage and tax credits.

**Figure 5.1: Sources of income that workers draw on to escape poverty**




Source: Family Resources Survey 2004/05

On ippr's analysis, low-paid adults were much less capable than other workers of avoiding poverty just with their own earnings. Less than a fifth of low-paid adults (19 per cent) could lift their household out of poverty through their own wages alone. The equivalent proportions for non-low-paid adults and all workers were more than three quarters (76 per cent) and more than three-fifths (64 per cent) respectively. Irrespective of other sources of household income, this underlines the significantly higher risk of being exposed to poverty for low-paid workers.

Figure 5.1 shows that for a large majority (74 per cent) of low-paid workers, it was forms of household income other than wages that enabled them to avoid poverty. Over half (55 per cent) of low-paid workers avoided poverty through their own and their partner's income combined. Even after benefits and tax credits had been taken into account, other adults' earnings helped a further 22 per cent of low-paid households to escape poverty. Other sources of income also enabled a further third (34 per cent) of all working adults and nearly an additional quarter (23 per cent) of non-low-paid adults to avoid household poverty.

It is important to remember that the graphs in this section do not show the total amount of household income from the various sources. Rather they indicate which source of income it was that took the household over the poverty line, based on the ordering outlined earlier. For instance, it is not necessarily the case that the households of non-low-paid workers received less income from partners' earnings than low-paid adults. It is more likely that a greater proportion of non-low-paid adults did not need their partner's income to move above the poverty line (because they had already done so through their own earnings).

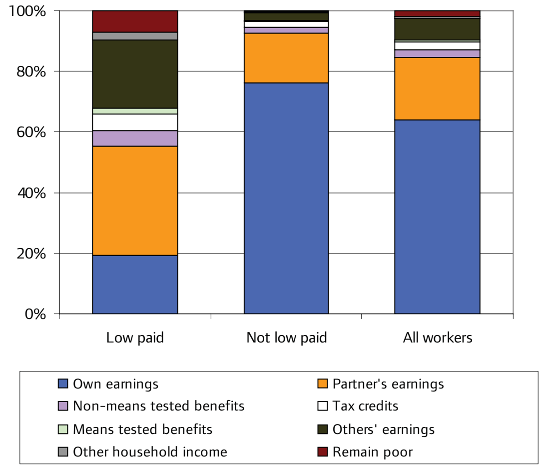
19. For a discussion of the overlap between being low paid and living in poverty that draws on slightly earlier data, see McKnight 2002. She argues that employment provides a less certain protection from household poverty than was the case in the late 1960s. Between 1968 and 1996 the share of households with a single low-paid employee rose and the proportion of those households in poverty doubled.

### Low-paid workers escaping poverty: men and women

Figure 5.2 shows that the overall risk of household poverty for the low-paid was very similar across the genders: 8 per cent for men and 7 per cent for women. However, low-paid men were more than twice as likely as low-paid women to earn enough to lift their household out of poverty through their own wages alone: 11 per cent compared with 29 per cent. This difference is likely to be explained by women having shorter working hours and higher rates of part-time work. Considering the position of all workers, not just the low-paid, reveals a similar gender divide. Fewer than half (49 per cent) of all working women were able to avoid poverty just through their own earnings compared with over three-quarters (76 per cent) of all working men. These findings chime with our earlier analysis of low pay, which found that women were more than twice as likely as men to be low paid and did 80 per cent of all part-time jobs (which are more likely to be low paid).

Given that low-paid women were far less likely to earn enough to lift their household out of poverty through their wages alone, they were much more likely to rely on other sources of household income to avoid poverty: over eight in ten low-paid women (82 per cent) compared to over six in ten low-paid men (63 per cent). Partners' earned income was very significant for helping low-paid women avoid poverty. A greater proportion of low-paid women than men avoided household poverty thanks to their own income being combined with their partner's (58 per cent compared with 51 per cent of men).

**Figure 5.2: Sources of income that male and female workers draw on to escape poverty**

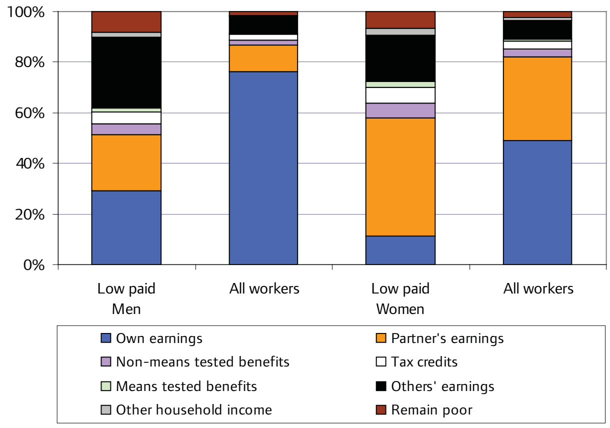



Source: Family Resources Survey 2004/05

### Low-paid workers escaping poverty: couples and single people

Figure 5.3 highlights considerable variation in the risk of poverty for low-paid workers living in different types of families. Low-paid adults who live with a partner are much less likely than single people to end up poor: 4 per cent compared with 13 per cent. Considering all working adults, just 1 per cent of those with a partner were poor, compared with 4 per cent of single people.

**Figure 5.3: Sources of income that couples and single people draw on to escape poverty**



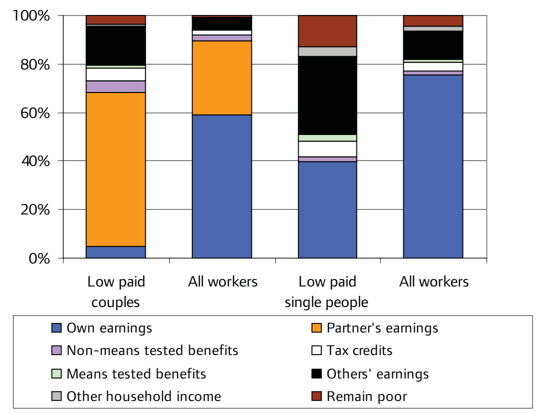

Source: Family Resources Survey 2004/05

Although low-paid single people faced a greater risk of ending up in poverty after all sources of household income had been taken into account, they were much more likely than those with a partner to avoid poverty through their own earnings alone: 40 per cent compared with just five per cent. However, when their partner's income was included, the proportion of low-paid people in couple families avoiding poverty rose to 65 per cent. While low-paid single people obviously did not have a partner to contribute to the household's earnings, it is significant that the wages of additional adults helped a further 32 per cent to breach the poverty line (even after benefits and tax credits were taken into account).

### Low-paid workers escaping poverty: different family types

Figure 5.4 considers the relative position of low-paid workers in couple families and those living alone, according to whether or not they have children. This shows that low-paid lone parents faced the greatest risk of poverty (15 per cent), higher than low-paid single people without children (12 per cent), and low-paid adults in couples both with children (4 per cent) and without (3 per cent).

**Figure 5.4: Sources of income that different family types draw on to escape poverty**




Source: Family Resources Survey 2004/05

Beneath these headline poverty rates, there were some significant differences in how low-paid adults in these different family types avoided poverty:

- Among low-paid workers in couple families with children, just two per cent earned enough to lift their household out of poverty directly through their own wages. Among non-low-paid adults in this family type the equivalent proportion was nearly six in ten (58 per cent). A similar proportion (59 per cent) of low-paid adults in couples with children could avoid poverty with their own and their partner's earnings combined. This underlines the significance we reported earlier of having two earners for couple families with children in order to avoid poverty.
- Among low-paid workers in couple families without children, less than a tenth (8 per cent) were able to escape poverty just through their own earnings. However, almost four in five (78 per cent) moved over the poverty line when theirs and their partner's wages were combined.
- Less than one in ten low-paid lone parents (nine per cent) were able to avoid poverty through their own earnings alone. In the absence of a partner to contribute wages to the household's income, benefits and tax credits emerged as a significant factor: enabling an additional 61 per cent of low-paid lone parents to move above the poverty line. Tax credits appear to be especially significant here.
- A far higher proportion (45 per cent) of low-paid single people without children could avoid poverty just with their own earnings than low-paid lone parents could. This rose to 94 per cent among single people without children who were not low paid. In the absence of a partner and with more limited access to benefits and tax credit support, the earnings of other adults in the household were significant in helping a further 37 per cent of single, childless low-paid people out of poverty. However, this assumes that the earnings of other adults were shared equally across all members of the household, which is not necessarily the case in practice.

**Low-paid workers escaping poverty: partner's work status and earnings**

Given its importance in enabling a significant proportion of low-paid people in couple families to avoid poverty, partners' income should be investigated in more depth. Figure 5.5 considers the position of low-paid people in couple families, broken down by those whose partners are: not working, also low paid, or non-low paid (i.e. earning above the low pay threshold). There was real variation in both the proportions that ended up poor and how those who managed to avoid poverty did so.

- 12 per cent of low-paid people whose partner was not working ended up poor. 83 per cent of this group avoided poverty through a combination of tax credits, benefits and the earnings of other (non-partner) adults in the household.
- 7 per cent of low-paid people whose partner was also low paid ended up poor. Just under half (47 per cent) were able to avoid poverty through their combined earnings (with the earnings of other adults in the household also significant).
- More than nine in ten low-paid people (92 per cent) who had a partner who was working but not low paid avoided poverty through their combined earnings.

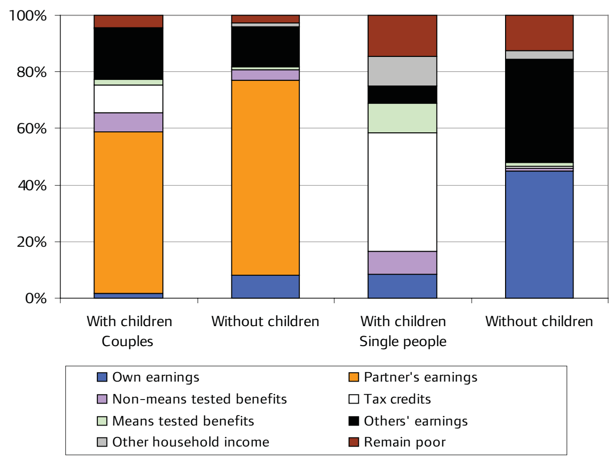
**Low-paid workers escaping poverty: full- and part-time workers**

As Figure 5.6 makes clear, the working patterns of low-paid adults had a major impact on whether they were able to avoid poverty – and especially on whether they were able to do this through their own wages alone.

- Twice as many low-paid part-time workers (10 per cent) ended up poor as low-paid full-time workers (5 per cent).
- Among all workers, only one per cent of full-time workers finished up in household poverty, compared with 5 per cent of part-time workers.

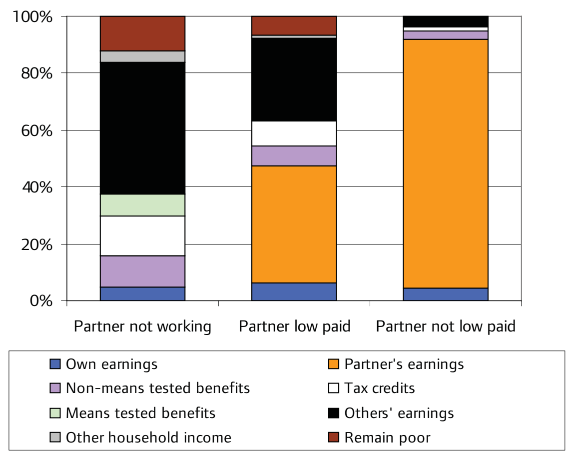
Reflecting our earlier findings about the high rates of low pay among part-time workers, this analysis shows that very few of those

**Figure 5.5: The significance of work status and earnings of the partners of low-paid people for escaping poverty**




Source: Family Resources Survey 2004/05

**Figure 5.6: Sources of income that full- and part-time workers draw on to escape poverty**




Source: Family Resources Survey 2004/05

working part-time were able to escape poverty just through their own earnings:

- Just 2 per cent of low-paid part-time workers earned enough to move above the poverty line through their wages alone. Among all part-time workers the proportion was less than two in ten. However, a further 88 per cent of low-paid part-time workers were able to avoid poverty thanks to other sources of household income. Again, partners' income and the earnings of other adults in the household were particularly significant.
- By contrast, nearly a third (32 per cent) of low-paid adults working full time were able to avoid poverty just with their own earnings. Partners' earnings took a further 33 per cent of these households above the poverty line. Among non-low-paid full-time workers nearly nine in ten earned enough to directly lift their household out of poverty.
- Overall, almost eight in ten full-time workers (78 per cent) were able to avoid poverty through their own wages alone, compared with less than two in ten (17 per cent) of those working part-time.

As for many groups of workers, partners' earnings and the wages of other adults in the household enabled a significant additional proportion of those working part time to escape poverty. In the case of wages from other (non-partner) adults, this rests on the assumption that all earned income is shared equally across households, which will not necessarily be the case in practice (explored further in Gardiner and Miller 2006 and Bailey 2006). Therefore:

*We recommend that to raise awareness of the potential for 'hidden' poverty to exist within non-poor households, the Government should consider tracking poverty at the family (or benefit unit) level in its official statistics.*

## The relationship between low pay, in-work support and poverty

Having investigated the overlap between being low paid and ending up poor, we conclude this section by analysing the support available to different low-income working families – and the extent to which it provides a reliable protection from poverty.

Creating a system of in-work support that guarantees a route out of poverty is complex given that different sized families need different amounts of income to enjoy a similar standard of living. Also, as we have shown, household income comes from a wide variety of sources.

To illustrate some of this complexity, Table 5.1 on the next page considers the number of hours work (at a given rate of pay) needed to avoid poverty and the level of in-work support available to different family types. In-work support consists of Working Tax Credit as well as other benefits including Child Tax Credit, Child Benefit, Housing Benefit and Council Tax Benefit. The table considers the position of families in April 2006, earning the minimum wage (£5.05 an hour). The equivalised poverty lines are given for each family type, both before and after housing costs.

For each of the family types and their possible working patterns the table shows the following:

- The hourly pay rate needed to avoid poverty through wages alone – relating net take home pay (after income tax and National Insurance contributions) to the before housing costs measure.
- The number of hours the family would need to work (at minimum wage) to avoid poverty through wages alone – based on the required gross income of each worker to have a net family income over the before housing costs poverty line.
- The net income (both before and after housing costs) that the family would receive if they claimed all the in-work benefits to which they are entitled.

Full-time workers are assumed to be working 35 hours a week and part-time workers 16 hours a week. Figures for take-home pay and the number of working hours needed to avoid poverty for couples are given collectively (with part-time workers assumed to be making half the contribution as full-time workers). The figures in bold indicate when the given family would not escape poverty – either through their earned income alone or after claiming the in-work support to which they are entitled.

It is important to note that the figures in this table should be treated as indicative only and are subject to a number of simplifications and assumptions (see table note). However, with this caveat in mind, the figures indicate that very few family types were able to avoid poverty through their own wages alone (assuming 35-hour full-time and 16-hour part-time working weeks). The only exceptions are single, childless people working full time and smaller couple families in which both adults worked full time. No working lone-parent was able to avoid poverty just through their wages alone. In fact a single earner in a couple family with two children would have had to work almost 80 hours a week at the minimum wage to lift their family out of poverty just through their own wages. This highlights very starkly the extent to which low-wage families are forced to make an invidious choice between 'income poverty' and 'time poverty'.

Table 5.1 also shows that while in-work support lifted a number of family types out of poverty (assuming all eligible benefits were claimed) it did not provide a guarantee that work is a route out of poverty (especially on an after housing costs measure). However, the current architecture of in-work support does (theoretically) provide more reliable protection from poverty for lone parents. On an after housing costs measure, it is only when couple families have two full-time earners that their net income moves above the poverty line. Significantly, on the Government's preferred before housing costs measure, most 1.5-earner couple families are able to avoid poverty.

Finally, these calculations underline the very weak poverty protection for larger couple families, where the cost of living (approximated by the relative poverty line) rises much further than the additional support available. This reflects the calls, in analysis into what it would take to halve, then abolish, child poverty, for extra measures to support large families (Hirsch 2006).

Table 5.1: Poverty lines, pay and in-work support

| Household type and work status | | Poverty line (BHC) | Poverty line (AHC) | Gross hourly rate to avoid poverty (BHC) | Take-home pay at min. wage | Hours at min. wage to avoid poverty poverty (BHC) | Net income at the min. wage BHC | Net income at the min. wage AHC | Working Tax Credit is tapered away at… |
|---|---|---|---|---|---|---|---|---|---|
| Single, no children | FT | £145.39 | £107.88 | £4.63 | £156 | 32.1 | £172.15 | £110.77 | £221 |
| | PT | £145.39 | £107.88 | £10.13 | **£81** | 32.1 | **£126.61** | **£65.23** | N/A |
| Lone parent, 1 child under 11 | FT | £188.79 | £145.08 | £6.49 | **£156** | 45.0 | £265.48 | £196.96 | £307 |
| | PT | £188.79 | £145.08 | £14.13 | **£81** | 44.8 | £234.87 | £166.25 | £271 |
| Lone parent, 2 children under 11 | FT | £212.66 | £199.02 | £7.51 | **£156** | 52.1 | £311.06 | £234.84 | £307 |
| | PT | £212.66 | £199.02 | £16.44 | **£81** | 52.1 | £288.05 | £211.83 | £271 |
| Lone parent, 3 children under 11 | FT | £303.80 | £260.40 | £8.68 | **£156** | 60.2 | £356.64 | £280.42 | £307 |
| | PT | £303.80 | £260.40 | £18.99 | **£81** | 60.2 | £333.63 | **£257.41** | £271 |
| Couple, no children | Both FT | £217.00 | £186.00 | £3.20 each | £311 | 22.2 each | £311.04 | £244.86 | £305 |
| | FT & PT | £217.00 | £186.00 | £4.52 - £4.60 | £236 | 31.9 + 14.3 | £254.85 | £188.67 | £305 |
| | One FT | £217.00 | £186.00 | £7.69 | **£156** | 53.3 | **£203.82** | **£137.64** | £305 |
| | One PT | £217.00 | £186.00 | £16.88 | **£81** | 53.3 | **£147.18** | **£81.00** | N/A |
| Couple, 1 child under 11 | Both FT | £260.40 | £223.20 | £4.00 each | £311 | 27.7 each | £355.88 | £282.46 | £307 |
| | FT & PT | £260.40 | £223.20 | £5.44 - £5.83 | **£236** | 40.4 + 17.2 | £316.51 | £243.09 | £307 |
| | One FT | £260.40 | £223.20 | £9.54 | **£156** | 66.1 | £267.25 | **£193.83** | £307 |
| | One PT | £260.40 | £223.20 | £20.88 | **£81** | 66.1 | **£254.67** | **£181.25** | £271 |
| Couple, 2 children under 11 | Both FT | £303.80 | £260.40 | £4.91 each | £311 | 34.1 each | £401.09 | £319.17 | £307 |
| | FT & PT | £303.80 | £260.40 | £6.44 - £7.09 | **£236** | 49.1 + 20.4 | £365.46 | £280.54 | £307 |
| | One FT | £303.80 | £260.40 | £11.37 | **£156** | 79.0 | £317.63 | **£235.71** | £307 |
| | One PT | £303.80 | £260.40 | £24.93 | **£81** | 79.0 | £308.75 | **£226.83** | £271 |
| Couple, 3 children, 4, 11 & 14 | Both FT | £375.41 | £338.52 | £6.43 each | **£311** | 44.6 each | £446.63 | £364.71 | £307 |
| | FT & PT | £375.41 | £338.52 | £8.31 - £9.11 | **£236** | 63.2 + 26.3 | £407.15 | **£325.23** | £307 |
| | One FT | £375.41 | £338.52 | £14.46 | **£156** | 100.2 | **£363.21** | **£281.29** | £307 |
| | One PT | £375.41 | £338.52 | £31.63 | **£81** | 100.2 | **£354.33** | **£272.41** | £271 |

Note: Calculations are based on the Department for Work and Pensions' Tax Benefit Model Tables for April 2006 and relate to that month, when the minimum wage was £5.05. All families are assumed to have relatively low weekly housing costs (ranging from £48.28 to £59.72), Council Tax ranging from £13.10 to £22.20 a week, and no childcare costs. Single people and childless couples are assumed to be over 25 and therefore eligible for the Working Tax Credit (if they work over 30 hours a week). None of the families is assumed to have children aged under one, who would be eligible for the additional baby credit in Child Tax Credit.

# 6. Recommendations for tackling working poverty: the Working Tax Credit

**Summary**

Working Tax Credit (WTC) is more generous, more widely available and has significantly higher take-up rates than any previous system of in-work support. But it is clear that it could be more effective at tackling working poverty. Therefore we propose that measures are introduced to:

*Tackle working poverty among couple families by boosting work incentives for second earners through a Personal Tax Credit Allowance (PTCA) and by increased support to low-income working families*

- By effectively individualising the first WTC threshold, a Personal Tax Credit Allowance would allow both adults in eligible families to earn up to £100 a week before their entitlement started to be withdrawn.
- Under the PTCA, a family earning minimum wage would be £36 a week (or £1,872 a year) better off if a second adult moved into part-time work than under the current system – with the balance of financial benefit from getting a job tilted in favour of families.
- 564,300 single-earner couples receiving WTC would benefit if a second earner moved into work. Restricting the PTCA to those working at least 16 hours a week would control costs while promoting the sharing of work and care within households.
- Time-limiting the PTCA or placing an upper family earnings limit on eligibility would focus the new incentive on the lowest-income working couples, while restricting the so-called 'deadweight costs' among existing dual-earner tax-credit recipients.
- In addition, WTC for couples with children should be increased – by one third to £91.31 a week (or £4,748 a year) from April 2008, reflecting the higher poverty line for couples. This would benefit 1.6 million families, lifting 200,000 children out of poverty at a cost of £1.6 billion.

*Renew trust in the tax credit system through a 'no claw-backs' rule and by writing off overpayments to low-income families*

- HM Revenue and Customs should move to a system of fixed but flexible entitlements in which the amount of support families receive can go up but not down between standard assessments. This would be simpler to communicate and understand than the existing £25,000 income disregard.
- This would effectively end overpayments (and underpayments), unless there were fraud or unreasonable error on the part of claimants. If families failed to report changes between standard assessments, back payments would not be made.
- One way to control the costs of this change would be to move to bi-annual rather than annual awards. However, this would be a complex change requiring thorough consultation and investigation.
- Only a third of total tax credit overpayments have been recovered. The financial and political costs of recouping all the remaining money risks fatally undermining the system's efficacy among those who need it most.
- Around half of all outstanding overpayments are due from low-income families earning less than £20,000 a year. These should be immediately written off as part of a tax credit re-launch and take-up campaign.

Our package of reforms would bring some savings, including on the £587 million annual tax credit administration budget and by no longer back-paying underpayments, which ran to £550 million in 2006. However, increasing the WTC for couples would require additional spending. Given that public finances are tight and reducing child poverty is the priority, £1.2 billion could be saved by removing Child Tax Credit from the 2.1 million families on middle and higher incomes who receive only the Family element or less. In 2005/06 just 3,000 of these families had an income of under £20,000, while over 60 per cent had an income of over £30,000. This would reduce the scale of the tax credit system by around a third.

Looking further ahead, the value of WTC should be indexed to average earnings growth – to maintain strong work incentives and ensure low-wage families' share in rising prosperity. It is only rising in line with prices in April 2008, meaning its relative value will fall.

Consideration should be given to opening up entitlement to WTC for 21- to 24-year-olds – investigating its costs and impacts on work incentives and working poverty.

We have shown in this paper that the relationship between low-paid people and poor working households is not straightforward. Higher wages self-evidently offer a higher standard of living and a reduced risk of poverty. However, an individual earning wages above the low-pay threshold is not guaranteed to avoid poverty. This is partly because poverty exists – and is measured – on a household level, reflecting the reality that income and families' responsibilities are often (but not necessarily always) shared – and is also because an individual's earnings are only one contribution to the household's total income.

Therefore, addressing working poverty requires policies focused at the household level, beyond just the wages of those individuals living in it. This must encompass action on wider labour market factors alongside seeking to reduce low pay, such as retention, progression, skills and family-friendly employment. These issues will be explored through later papers in ippr's *Working out of Poverty* series. In this paper we focus on the contribution of one policy vehicle: in-work wages subsidies through the Working Tax Credit.

## The impact and effectiveness of Working Tax Credit

With the introduction of the tax credit system, the Government has significantly restructured financial support for low-income households. Unlike Family Credit, the Working Tax Credit operates like the tax system and is administered by HM Revenue and Customs (HMRC), rather than the Benefits Agency (or its successor, Jobcentre Plus). The explicit aim of this process has been to improve financial incentives to work, by 'making work pay' and reducing poverty, especially among families with children (HM Treasury/Inland Revenue 2002). While they are closely integrated in practice, Child Tax Credit and Working Tax Credit serve different purposes. The aim of the former is to boost the household income of families with children, with entitlement not tied to work status, whereas the objective of the latter is to boost the income of working households.

Working Tax Credit (WTC) is the latest in a series of policy vehicles to subsidise the family income of low-wage workers, dating back to the Family Income Supplement introduced in 1971 (See Timmins 2001 for a useful historical discussion). Since then the terms of the policy debate have revolved around a series of trade-offs between ensuring support gets to those who need it, while trying to avoid unnecessary complexity and protecting financial incentives to work (within the reality of limited resources). It is against this background that we now briefly assess the impact and effectiveness of the Working Tax Credit.

**Take-up of Working Tax Credit is significantly higher than previous wage subsidy systems, but still very low among families without children**

90 per cent of eligible low-income working families with children were in receipt of tax credits in 2004/05. This compares very favourably to both Family Credit, which reached between 60 and 70 per cent of eligible families in the late 1980s and early 1990s, and Family Income Supplement, where take-up rates were around 50 per cent in the 1970s and early 1980s (HMRC 2007b).

However, take-up of Child Tax Credit is significantly higher than for Working Tax Credit: 82 per cent compared with 61 per cent of eligible families. In 2004/05, more than a million working families missed out on an estimated £2 billion to which they were entitled. The vast majority of them – over nine in ten – were working families without children, among whom take-up of Working Tax Credit was just 19 per cent. By contrast, 94 per cent of working families with children entitled to Working Tax Credit – as well as Child Tax Credit – received it in 2004/-5.

**Entitlement to Working Tax Credit is both wider and more generous than previous systems, but still does not cover all working families**

In April 2007, just under two million families were in receipt of Working Tax Credit. Over 1.6 million of these were families with children and over 300,000 were those without them (HMRC 2007a) (expenditure on Working Tax Credit was £5.4 billion in 2005/06 [HMRC 2007c]). By contrast, in the late 1980s, Family Income Supplement reached just under 200,000 families, rising to around three-quarters of a million under Family Credit by the end of the 1990s. Coverage then rose quickly to around 1.5 million under Working Families Tax Credit – and has risen further since. The average award rose steadily from less than £2 a week in the early 1970s to just under £60 a week under Family Credit, to around £125 a week for working families with children in 2005/06 (Child and Working Tax Credits combined) (HMRC 2007c). Of course, many working people – anyone working under 16 hours a week and all childless people under 25 or not working 30 hours a week – remain ineligible for Working Tax Credit.

**Working Tax Credit has contributed to major poverty reductions – especially among households with children – but rates of working poverty are still high**

As Section 4 set out, overall poverty rates have fallen over the last decade, particularly among households with children. Government policy has demonstrably contributed to these trends, especially in the context of high levels of inequality in original incomes (Jones 2007). Analysis by both the Institute for Fiscal Studies and the Treasury shows that reforms to the personal tax and benefit system have been strongly redistributive towards low-income families with children. Households with children in the poorest fifth of families have seen their incomes rise by over 20 per cent and are on average £4,000 a year better off as a result (Brewer and Shepherd 2004, HM Treasury 2007b). However, as our analysis has shown, rates of working poverty are higher now than a decade ago.

**Rising parental employment rates have contributed to falling child poverty, but the impact of tax credits on work incentives is complex**

In addition to the Working Tax Credit, the Government's anti-child-poverty strategy has encompassed large rises in Child Tax Credit and Child Benefit – where entitlement is not linked to work status. While this has targeted resources on the poorest (workless) families, it has acted to weaken financial incentives to work for some families. Beyond this, the impact of tax credits on work incentives is complex (Adam *et al* 2006):

1. Overall, fewer lone parents and first earners in couple families face very weak incentives to work at all, due to very high effective marginal tax rates of over 80 per cent (effective marginal tax rates, 'EMTR', is the percentage of any increase in earnings that is lost through personal taxes or reductions in means-tested benefits).

However, fewer face low EMTR – of around 30 to 40 per cent – and more face withdrawal rates of over 50 per cent. This is largely because the withdrawal rate in Working Tax Credit is far lower then under Family Credit (39 per cent compared with 70 per cent), but it covers more families.

2. Partly due to the effect of the wider coverage of means-tested wage subsidies, the incentive for many lone parents and couple families to increase their earned income has somewhat weakened. For couples, this applies both for single earners increasing their earned income and for second adults moving into work (where this pays more than their personal tax and National Insurance allowances).

3. Work incentives for childless families tend to be stronger, partly because fewer are entitled to (or receive) Working Tax Credit than families with children – and so fewer are subject to its withdrawal rates. Also, lower levels of out-of-work support for childless people tend to increase the financial gain to work. Work incentives are stronger because financial support is weaker – demonstrating that there can be trade-offs for policymakers between preserving strong work incentives and reducing poverty through targeted transfers.

See Brewer and Shepherd (2004) and Adam *et al* (2006) for a more detailed discussion of the impact of Labour's policies on work incentives.

**Significant overpayments (and underpayments) of tax credits have caused real hardship and uncertainty for many families**

Unlike Family Credit, Working Tax Credit awards can alter during the course of a year. This means that tax credits can (at least theoretically) rise quickly either if family income falls or if changes in household circumstances, like the birth of a child, increase needs. However, it can also leave families liable to repaying money at the end of the tax year that had been overpaid because changes that reduced their entitlement were not reported quickly enough, or the system failed to process the change efficiently or accurately. In 2005/6, £1.7 billion was overpaid in tax credits, slightly down on £1.8 billion and £2.2 billion in the previous years (National Audit Office 2007). In addition, HMRC estimates that in 2004/05 claimant error and fraud led to between £1 billion and £1.3 billion being paid out to those not entitled and somewhere between £200 million and £350 million not being paid out to those who were entitled (ibid).

Retrieving these overpayments has caused real financial insecurity for families (CAB 2007 and Parliamentary and Health Service Ombudsman 2007). The danger now is that many families will not want to risk making a claim for support for fear of the problems caused by overpayments, undercutting the efficacy of the entire tax credit project. Up to March 2007, HMRC had collected £2 billion in overpaid tax credits, had written off £700 million and was still attempting to reclaim a further £3.3 billion (NAO 2007). Partly, in response to these problems, the system now permits household income to rise by up to £25,000 without this leading to a reduction in tax credit entitlement for that year (up from £2,500). The impact of this change on overpayment rates and expenditure will not be known until April 2008, when 2006/07 awards are finalised.

**Working Tax Credit does not recognise the higher living costs of couples, but children in lone-parent families still face the greatest risk of poverty**

The maximum Lone Parent element of Working Tax Credit is the same as the Couple element (£3,430 a year – rising to £3,570 from April 2008), despite the costs of living being higher for two people than one. This is reflected in the relative poverty lines, which are around a third higher for an otherwise equivalent couple than for a lone-parent household. Also, as our analysis has shown, there are over four times as many working-poor couple-families with children than working-poor lone-parent families (1.4 million versus 0.3 million). However, overall, children in lone-parent families face around twice the risk of poverty compared with children in couple families. Even among working households, the risks of poverty are higher for lone-parent than for couple households. Nevertheless, levels of working poverty among couple households are high and the so-called 'couple penalty' has received a considerable amount of policy focus (Harker 2006, Brewer 2007, Callan 2007, Field and Cackett 2007).

## Making sure the Working Tax Credit works

Given the intensity of political debate about tax credits, it is important to begin by setting out the general principles that, we argue, should underpin the role of the state in directly addressing working poverty through subsiding low-wage households.

1. It is not the state's job to subsidise employers by allowing them to pay very low wages in the knowledge that the Government will make up the difference. Therefore a robust minimum wage is an essential accompaniment to any system of wage subsidies (see Sutherland 2001).

2. Given that poverty is experienced and measured – albeit imperfectly – on a household basis, it is sensible for wage subsidies to take into account family circumstances and the income of other adults. A fully individualised approach would create a slightly simpler but far less well targeted system of support.

3. A targeted approach is essential to effectively narrowing the gap between rich and poor in a society such as the UK that has high levels of poverty and inequality. There is no prospect of adopting a universal strategy – such as big rises in Child Benefit or a Citizen's Income scheme – that continued to benefit households at the bottom of the income distribution to the extent that is currently the case.

Building on these principles, our earlier analysis of low pay and poverty, and our assessment of its impact and effectiveness, we argue that reform of the Working Tax Credit is needed in three key areas to help address working poverty:

1. Improving work incentives

2. Renewing trust in the tax credit system

3. Increasing support for working families.

We conclude this section by assessing the potential costs and savings of the measures we propose, and considering from where additional resources might be found.

## 1. Reforming the Working Tax Credit: improving work incentives

### a) A Personal Tax Credit Allowance

To improve the financial incentive to work for second earners in low-income couple families – helping to reduce the high rates of poverty among this group and to support families to share working and caring responsibilities – we recommend the introduction of a *Personal Tax Credit Allowance* (PTCA). Before we discuss this in detail, we set out the background to the recommendation.

Our analysis has shown that around 60 per cent of all working-poor households with children are those headed by a couple in which only one adult works. Such households face a 25 per cent risk of being poor, rising to over 50 per cent where the earner is only working part-time. These poverty risks fall drastically – to six and two per cent – where couples with children have one-and-a-half or two full-time earners respectively. While research has pointed to a polarisation between two- and zero-earner households as a driver of increasing inequality ('work rich' vs 'work poor'), this has largely been due to a growth in two-earner-professional and higher-skilled households (Berthoud 2007).

The current structure of Working Tax Credit creates much weaker incentives for second adults in couple families to move into work, relative to first earners. This is because the system treats families as having a single source of earned income (or, more precisely, 'taxable income', which for example includes interest from savings ), whether or not this is actually the case.

The amount of Working Tax Credit a family receives is calculated in two stages. First, the maximum amount to which they are entitled is worked out by adding up the value of all the components to which they are eligible (see Annex 2 for a full breakdown of tax credit thresholds, rates and disregards). For a couple with children, working less than 30 hours a week and with no childcare costs, this would currently be £65.66 a week or £3,430 a year (the Basic element plus the Couple element).

Second, the proportion of this entitlement that the family actually receives is dependent on its total gross family income. Family income – regardless of how many earners there are – below £99.84 a week (or £5,220 a year) is disregarded (this allowance is rising to £6,420 a year or £123.46 a week from April 2008). This means that the couple family described above can earn up to almost £100 a week before that figure of £66.65 begins to be reduced. As income rises above this level, the maximum Working Tax Credit entitlement is reduced by 37p for every extra pound earned (this taper is rising to 39 per cent from April 2008). By the time this couple family's gross income reaches £277.30 a week (or £14,419 a year), their Working Tax Credit entitlement is reduced to nil. However they would continue to be entitled to Child Tax Credit.

Because family income is treated as coming from one source (whether or not this is actually the case), the effect of a second adult getting a job is that all their additional contribution to the family's earnings counts towards a reduction in their Working Tax Credit entitlement by the 37 per cent taper (assuming the first adult is earning more than £99.84 a week). This means that the significant gain to work for first earners – through being able to earn almost £100 a week 'means-test free' – is virtually always unavailable for second earners (the only exceptions being where the first worker earned under £99.84 a week).

The recently introduced £25,000 disregard of income changes within a tax year means that many families in this situation will be shielded from immediate reductions in their Working Tax Credit award. However, the impact would be felt fully when their entitlement was recalculated at the start of the following tax year, and the additional earnings taken into account.

In response to this situation, we recommend the introduction of a Personal Tax Credit Allowance (PTCA). A PTCA would give all individuals in eligible families their own personal allowance – allowing them each to earn up to £99.84 a week (or £5,220 a year) before their families' Working Tax Credit entitlement started to be withdrawn. For a dual-earner family this would mean a combined allowance of almost £200 a week. Working Tax Credit would still be calculated on the basis of gross family income. Where families responded to this improved incentive, and a second adult moved into work, it would bring savings to the state in virtually all cases.

#### Benefits and costs of the Personal Tax Credit Allowance

To demonstrate the impact of a Personal Tax Credit Allowance we have modelled the difference it would make in financial gains to work for two different low-income couple families with children. These are summarised in Table 6.1and set out in full in Annex [21].

**Couple A** earns £6.67 an hour, which we classify as 'low pay', and **Couple B** earns the minimum wage of £5.52 an hour. In each case we first show the Working Tax Credit entitlement and net household income for these families based on a single adult working 35 hours a week. We then model the impact of these families increasing their gross incomes by the same amount (£110 for Couple A and £90 a week for Couple B) in three alternative ways:

I. The single earner increases their gross income (by working longer hours or increasing hourly pay)

II. The second adult moves into work under the existing Working Tax Credit rules

III. The second adult moves into work with the Personal Tax Credit Allowance.

We then highlight how much better off these families would be under each of these three scenarios, and what would be the savings to the state.

In each scenario the families would be financially better off, but there is considerable variance in the gain to the families from increasing their gross income.

The state gains most and the families least where a single earner simply increases their gross income. This is because the family would

21. Note that our calculations are based on the Department for Work and Pensions' Tax Benefit Model Tables, April 2007. Limitations on this data mean that the figures here do not model the impact on net family income of families becoming entitled to the childcare element of the Working Tax Credit once both adults in couple families work over 16 hours a week. We have also not been able to model the impact of couple families becoming entitled to the 30 hour credit in Working Tax Credit when their combined weekly working hours reach this amount.

**Table 6.1: The impact of the Personal Tax Credit Allowance on the financial gain to work for low-income couple families with children**

Couple A has a single earner working 35 hours a week at £6.67 an hour. This family receives £17.50 a week in Working Tax Credit and has net family income of £243.32. The following table shows the gain to the family and the savings to the state that would arise if the family increased its gross income by £110 a week (the equivalent of 16 hours at £6.67 an hour) in three alternative ways:

| | Net income | Working Tax Credit | Family better off by… | Government savings (DWP/HMRC) |
|---|---|---|---|---|
| i) Single earner increases earnings | £266.31 | £0 | £22.99 a week (£1,195.48 a year) | £87.01 a week (£4,524.52 a year) |
| ii) 2nd earner, 16 hrs @ £6.67 (current system) | £300.56 | £0 | £57.24 a week (2,976.48 a year) | £52.76 a week (£2,743.52 a year) |
| iii) 2nd earner, 16 hrs @ £6.67 (under PTCA) | £314.36 | £13.80 | £71.04 a week (£3,694.08 a year) | £42.66 a week (£2,218.32 a year) |

*If the second adult in this family moved into work, they would be £13.80 a week, or £717.60 a year, better off with the PTCA than if they made the same move into work under the current system.*

Couple B has a single earner working 35 hours a week at £5.52 an hour. The family receives £32.20 a week in Working Tax Credit and has net family income of £241.52. The following table shows the gain to families and the savings to the state that would be gained if the family increased its gross income by £90 a week (the equivalent of 16 hours at £5.52 an hour) in three alternative ways:

| | Net income | Working Tax Credit | Family better off by… | Government savings (DWP/HMRC) |
|---|---|---|---|---|
| i) Single full-time earner increases earnings | £251.91 | £0 | £10.39 a week (£540.28 a year) | £79.61 a week (£4,139.72 a year) |
| ii) 2nd earner, 16 hrs @ £5.52 (current system) | £281.61 | £0 | £40.09 a week (£2,084.68 a year) | £49.91 a week (£2,595.32 a year) |
| iii) 2nd earner, 16 hrs @ £5.52 (under PTCA) | £317.61 | £36.00 | £76.09 a week (£3,956.68 a year) | £13.91 a week (£723.32 a year) |

*If the second adult in this family moved into work, they would be £36.00 a week, or £1,872 a year, better off with the PTCA than if they made the same move into work under the current system.*

pay a marginal tax rate of 33 per cent on every extra pound earned (in income tax and National Insurance contributions [NICs]), while seeing their means-tested benefits fall. When a second adult moves into work the families gain more. This is because they benefit from the second adult's personal income tax and National Insurance allowance, also worth about £100 a week in total. However, the financial gain is greatest under the Personal Tax Credit Allowance.

### Gain for families

If we compare the impact of a second adult moving into work, the minimum-wage-earning family are £36.00 a week (or £1,872 a year) better off under the PTCA than with the existing Working Tax Credit rules. For the family earning £6.67 an hour the equivalent gains are £13.80 a week, or £717.60 a year. Compared to the single earner increasing their own gross income, the gains are £65.70 a week (or £3,416.40 a year) and £48.05 a week (or £2,498.60 a year) respectively.

The PTCA would send a clear message to low-income couples: both adults – not just one – in eligible families can earn up to £100 a week before their Working Tax Credit entitlement is reduced.

Given the drastically lower poverty risks among dual- and one-and-a-half earner couples, there is a high chance that a second adult getting a job would move a family out of poverty. In her report for the Department for Work and Pensions, Lisa Harker estimated that if 20 per cent of poor single-earner families were to become dual-earner families – representing just a two per cent increase in the number of dual-earner couple households – around 80,000 children could be lifted out of poverty (Harker 2006).

### Costs and potential savings for the state

In each of the scenarios outlined in Table 6.1 the state makes net savings from the family increasing their gross income, through a combination of reductions in means-tested benefits and increases in income tax and NIC payments. The difference is that under the PTCA these state savings are not as great, with the balance of benefits titled towards the family. It is important to emphasise that this is not a general increase in the earnings disregard: it is only activated if and when a second adult moves into work.

There are currently 871,000 couple families in receipt of Working Tax Credit, 769,000 of whom are couples with children. Of these, 564,300 are single earners who would be entitled to a PTCA if the second adult moved into work. The only circumstance where there would be additional costs for the state from a second adult moving into work would be if that person earned less than the PTCA level of £99.84 a week. This would apply, for example, if someone worked at minimum wage for less than 18 hours a week. In this situation the gross household income would rise by less than the additional disregard. This would increase the families' Working Tax Credit entitlement by more than the amount that would be offset by additional income tax and NIC liability. In all other scenarios of second earners moving into work, Working Tax Credit entitlement would fall, but not by as much as it would under the current rules.

These financial costs could be controlled by restricting the PTCA to second earners working a minimum of 16 hours a week. Couples with children are entitled to Working Tax Credit if at least one adult works at least 16 hours a week. Therefore applying a similar threshold for the PTCA for second earners would be consistent with supporting couples to share both work and caring responsibilities, expanding their choices about how they do this. The current structure of Working Tax Credit incentivises couples to have one full-time earner, helping to entrench traditional (gendered) patterns of work and care. Couples who would make maximum marginal gain from the introduction of the PTCA would be those in which both adults worked part time.

However, there are also 205,100 couples with children in receipt of the Working Tax Credit that are already dual earners. These families would be very likely to see an immediate rise in their entitlement under the PTCA, because it would effectively double the families' Working Tax Credit first threshold. Dual-earner couples only comprise around a quarter of existing couple-with-children recipients of Working Tax Credit – making the new incentive well targeted in terms of current recipients. However, the effect of the PTCA would also be to draw into Working Tax Credit eligibility additional dual earners who are currently only in receipt of Child Tax Credit (because they earn too much to receive Working Tax Credit).

The extra costs to the state for these families would depend on their individual circumstances, making it difficult to calculate the precise impacts. Improving work incentives always includes some 'deadweight costs' where people are already doing what the incentive is trying to promote. However, the introduction of the PTCA would see some additional resources directed to families who are not at the very bottom of the income distribution (among tax credit recipients). Given the current tight spending climate the Government may wish to restrict some of these gains by focusing the improved incentive on the lowest-income working families.

There are two potential ways this could be achieved. One option would be to make the PTCA available only to new second earners on a time-limited basis, perhaps for 12 or 24 months – along similar lines as the in-work credit for lone parents. This would tightly focus the improved incentive on new second earners. A second option would be to place an upper earnings limit on the PTCA so that only the lowest dual-income (or potential dual-income) families would benefit. The current upper Working Tax Credit threshold would seem a sensible option. This would focus the benefit on those moving into low-paid jobs who are currently seeing the least financial gain from work. Both options would create some new distortions in the system, and these would have to be traded off against the desire to improve second-earner incentives and target scarce resources.

The final 102,000 couples receiving Working Tax Credit are those without children. Of these, 73,100 are single-earner couples and 28,700 are dual-earner couples. Childless couples are not entitled to Working Tax Credit unless one adult works at least 30 hours a week. Potential second earners in couple families without children face similarly weak work incentives, which the PTCA would improve. Again, similar restriction on eligibility, including the minimum 16 hours qualifying rule and an upper earnings limit, could be put in place to control additional spending.

### Would the PTCA lead to more second adults working?

People's work capabilities and choices rest on a complex range of factors, of which financial incentives are just one[22]. Evidence suggests that potential second-earners in poor families face a range of barriers to work, such as caring responsibilities or health problems (Lyon *et al* 2006). However, one in five workless partners in poor single-earner couples say they are looking for work and half intend to work in the future (ibid). There is no doubt that work incentives for this group are very weak and research indicates that the current structure of the Working Tax Credit has reduced labour supply among females in couples, who are invariably the second earners (Brewer *et al* 2005)[23]. While the actual impact of work incentives on work outcomes are complex, OECD modelling has found that reducing marginal tax rates – which is what the PTCA would effectively do for potential second earners – does have a statistically significant impact on labour supply. The strongest effect is on unemployed people that have a working partner (OECD 2005).

The effectiveness of the PTCA would therefore rest on people's awareness and understanding of its benefits – alongside wider action to promote work for second earners such as more affordable childcare and flexibility at work as well as measures to address low skills, job readiness and work-limiting health conditions or disabilities.

Non-working partners of working people will very often not be in contact with Jobcentre Plus, removing one avenue for helping people to understand the financial costs and benefits of work. The Government has acknowledged this problem, establishing Partners Outreach pilots for second earners in six cities (DWP 2007b). The Harker Report called for a 'whole family' focus to employment services so that they consider clients' wider household situation (Harker 2006). In addition, Jobcentre Plus could use links with local employers, learning providers, childcare settings and health services to disseminate information about the benefits of the PTCA: both directly to potential second earners and to low-wage workers whose partners could benefit. The Government should also investigate making the refreshed 'better-off calculator', due to be operational in

22. The Department for Work and Pensions is currently undertaking research into the level of financial gain people say they need in order to move into work – both the stated amount and the underlying reasons (House of Commons 2007).

23. 90 per cent of potential second earners in couples where the sole earner works full time are women. That said, just over three-quarters (76 per cent) of potential second earners where the sole worker is part-time are men (Harker 2006).

November 2007, available online as well as through Jobcentre Plus.

Finally, the PTCA is consistent with a 'worker-carer' paradigm of paid work and care relations within families (Moullin 2007). It would rebalance incentives for couples away from having a single full-time earner and towards having two part-time workers (or a one-and-a-half earner family). Of course this reform would not in itself reshape patterns of paid work and care within families, but it would remove one of the barriers to more equitable sharing of these responsibilities.

**b) Boosting incentives for single people and lone parents**

In addition to the Personal Tax Credit Allowance, further steps could be taken to improve the effectiveness of Working Tax Credit in reducing working poverty among single people (especially those working part time, where rates of working poverty are high). Almost half of all Working Tax Credit recipients are single people: 242,000 are single people without children and 876,000 are lone parents.

Single people without children

More than seven in ten working-poor families without children are single people. Half of working-poor single people without children work less than 30 hours a week – making them ineligible for Working Tax Credit which could be worth up to £24.18 a week, or £1,257.36 a year[24]. Almost a quarter of single childless people working part time (less than 31 hours per week, as defined by HBAI) are poor, compared with just seven per cent of those working full time.

One way of trying to reduce working poverty among this group would be to increase the incentive for single people without children to work 30 hours or more a week. This could be done by boosting the value of the '30 hour credit', which goes to those eligible for Working Tax Credit and working at least 30 hours a week and is currently worth up to £13.51 a week. This would increase upfront costs to the state but could bring savings through increased income tax and NICs, if people responded to the improved incentive by working longer hours. However, it is not clear where the 'tipping point' of this incentive effect lies – that is, how far the value of the 30 hour credit would have to be increased to have a demonstrable impact on individuals' working hours. An immediate priority is improving awareness and understanding of the significance of the 30 hour mark among low-paid workers (without children), employers and welfare-to-work providers – to boost working hours and rewards to work where this is possible.

Lone parents

Our analysis has shown that only around 20 per cent of all working-poor families with children contain a lone parent. However, lone parents working part-time still face a 30 per cent risk of poverty. As with single childless people, an enhanced 30 hours credit would also improve the incentive for lone parents to work longer hours, boosting their weekly income. But this will often not be a practical or attractive option as lone parents are balancing employment with bringing up their children. However, almost three in ten part-time working-poor lone parents work for less than 16 hours a week and are therefore ineligible for Working Tax Credit (significantly reducing their gain from work).

For many lone parents working for less than 16 hours a week may be an informed choice – perhaps because of caring responsibilities or as a first step into the labour market[25]. However, this may not always be the case. The Government, Jobcentre Plus and Children's Centres should improve understanding about the significance of the 16-hour rule. Crucially, this should involve raising awareness among employers and trade unions, as in some cases it may be possible to extend working time by just a few hours but in the process significantly increase lone parents' take-home pay. Promoting the availability of part-time jobs of at least 16 hours a week is the kind of practical issue that cooperation about local labour market needs between employers, trade unions, Jobcentre Plus and Regional Development Agencies should deliver.

## 2. Reforming the Working Tax Credit: renewing trust in the tax credit system

The problems that have led to tax credit overpayments and their recovery are complex in their explanation but have been devastating in their effect.

Overpayments were made in one third of all awards in each of the three years in which the current tax credit system has been in operation up to 2006 (HMRC 2007d). Thousands of families have faced real financial uncertainty, severely damaging their trust in the system and casting wider public and political doubt over the efficacy of tax credits. A recent survey of tax credit recipients found that almost half (49 per cent) were either less likely or definitely not going to make a claim in the future due to their experience of overpayments (CAB 2007). The Government has only retrieved a third of all overpaid money, with nearly £4 billion still outstanding; £700 million of overpayments have already been written off because the Government deems them unrecoverable.

Further overpayments are likely to be far lower in the future following the introduction of a £25,000 disregard of increases in household income within a tax year. We will not know the impact of this change until later in 2008, but not all overpayments arise because of income changes. However, there remains a public perception that tax credits 'do not work' and in some cases cause more poverty than they relieve. This leaves political support for the principle of tax credits precariously balanced and, more importantly, there is a risk that many low-income families will want nothing further to do with a system they fear will do more harm than good.

There is an urgent need for the Government to draw a line under previous tax credit problems, reassuring people of the system's accuracy and reliability. Reforming the tax credit system requires a

24. The maximum Working Tax Credit entitlement for a single person with no children is £46.83 a week (the Basic element plus the 30 hour credit). However, the withdrawal rate means that £24.18 is the maximum they could receive, given that they would have to work 30 hours a week, at least at the minimum wage, to be eligible. Working Tax Credit for single childless people is tapered away to zero once gross weekly earnings reach £224.49 (or £11,673.48 a year).

25. The incentive for lone parents to work in jobs of less than 16 hours a week is very weak. A recent study suggested increasing the earnings disregard in Income Support, Housing Benefit and Council Tax Benefit so that 16 hours' work a week, at the minimum wage, led to no reduction in these means-tested benefits. The researchers suggest this would cost £790 a year and boost the lone-parent employment rate by 5.4 percentage points (Bell *et al* 2007). Such an approach would compliment maintaining the 16-hour passport into Working Tax Credit.

careful balance between flexibility of the award and certainty for the claimant. We argue that this requires a clear break in the operation of the system, which can be communicated simply. Specifically, we recommend:

**Move to a system of fixed but flexible tax credit assessments and payments, creating a clear and transparent 'no claw-backs' rule**

Moving to a system in which tax credit entitlements could rise but not fall between standard assessment periods would give families the assurance that no money they had been (legitimately) awarded would subsequently be reclaimed.

Once a new or renewed claim had been processed the award would be fixed, unless families reported drops in income or changes in household circumstance that increased (but did not reduce) their award on a rolling basis. If families failed to report changes in between standard reassessments, back payments would no longer be made. Removing the possibility of tax credit awards falling in between assessments would effectively end overpayments, except in cases of misrepresentation or unreasonable error on the part of claimants. For example, claimants could still be liable for overpayments if they failed to promptly report family changes that required a new award to be started, such as a couple forming or breaking up. Overpayments might also still accrue if a family had overestimated a fall in income that they reported between standard reassessments. Errors or unreasonable delays on the part of HMRC which led to overpayments would not subsequently be reclaimed.

Such a fixed but flexible system would be likely to increase expenditure. However, this would be partly offset by administrative savings from not reclaiming overpayments on a very large scale, no longer back-paying underpayments (which ran to £550 million in 2005/06) and reducing the number of 'changes of circumstance' that had to be processed. Moving to bi-annual assessments would be one way to control these costs, by limiting the amount of time a family received more money than they officially should following a rise in income (or a change in household circumstances).

Given that tax credit assessments are currently based on annual taxable income, this would not be a straightforward change. There are a range of potential options that could be considered. Annual assessments based on taxable income in the previous year could be supplemented with a requirement on claimants to declare income and household circumstances at the six-month point (potentially verified by PAYE information). This would mean two assessments a year rather than the current one. Alternatively, a fixed but flexible system and a 'no clawbacks' rule could be introduced while retaining an annual system based on taxable income, with the autumn 2005 reforms to the tax credit system moving the system in this direction.

These issues raise a number of important implementation questions that would need to be consulted upon and investigated further as part of this reform. Any change would need to take seriously the potential for manipulation or fraud, which can be high in a means-tested system. Also, particular attention would need to be given to the rules around the childcare element of the Working Tax Credit, given that families' childcare needs are often volatile and poorly served by an annualised system of financial support (which is already a problem under the current system; claimants are required to report changes to HMRC if their childcare costs are reduced by more than £10 a week for four consecutive weeks).

Partly to control the level of overpayments, the Government has progressively reduced the amount of time that claimants have to report changes of circumstances (to one month) and return end-of-year information (to three months). Delays and errors in processing claims and payments have also been caused by technical and administrative problems at HMRC (CAB 2007, NAO 2007, Parliamentary and Health Service Ombudsman 2007). To clarify the responsibilities on both sides, claimants should be expected to return information about claims and changes of circumstances within a month and HMRC should be required to process awards and put them into payment also within one month (except in demonstrably exceptional circumstances). This would apply, for example, in cases where a couple got together or separated, triggering a new tax credit claim[26].

The introduction of the £25,000 disregard goes a long way towards creating such a fixed but flexible system for income changes within a tax year. However, there is no evidence that awareness of this disregard is high and it is far from clear that this change is capable of shifting people's attitudes towards tax credits (despite its high potential costs). The simpler, less technical, message of a 'no clawbacks' rule would be easier to communicate and understand (with the caveat that retaining some flexibility so that awards could increase between standard assessments would mean that overpayments could still arise).

The only way to completely eliminate overpayments would be to move to a system of fully fixed entitlements. However, it is important that tax credit awards can rise quickly in response to increasing needs – which happened for 720,000 households last year.

**Write off existing tax credit overpayments for low-income families**

Despite all the controversies and hardships already caused, HMRC has only recouped a third of total tax credit overpayments. The Government must question whether it is capable of recovering the £3.3 billion it is still chasing and the political and financial costs this would involve. HMRC does not publish data on the income profile of those who currently have outstanding overpayments. However, over the three years of the current system, £2.1 billion has been overpaid to families earning less than £20,000 (a little under half of total overpayments where data is available in this form). A one-off overpayments write-off for such low-income families, combined with a move to fixed but flexible awards and the 'no claw-backs' rule, offers a potential route to getting the tax credit system back on track.

There would inevitably be short-term political costs from a one-off overpayments write-off. That said, continuing along the current

26. The Government is currently working on steps to improve coordination for those people who use both HMRC and DWP services, such as joint debt recovery and implementing a Government-wide change of circumstance service ('Tell Us Once'), as recommended by David Varney (House of Commons 2007).

course entails major political costs. Over and above the negative public or media discourse, recovering all of the outstanding overpayments would result in 'death by a thousand cuts' – as every personal experience further tainted the efficacy and trust of tax credits. This measure would help HMRC to concentrate on reclaiming money from better-off families, while focusing on efficiently processing claims and getting money into the pockets of eligible families. Finally, while HMRC does not publish unit costs for tax credit recovery, a significant write-off would bring administrative savings that would partially offset the loss of any recovered revenue.

**Mount a tax credit re-launch and take-up campaign**

These measures would provide the platform for a re-launch of tax credits, with clear messages about the support that is available and the changes in the system – which are simpler and clearer than the incremental reforms the Government has introduced over recent months and years.

A tax credit re-launch could also provide the focus for a major awareness and take-up campaign, through national and local media, Jobcentre Plus, training providers, employers, trade unions, Children's Centres and extended schools. This should not neglect childless families, where take-up rates of Working Tax Credit are woefully low (including single working people who make up a large proportion of the childless working poor) – or rural areas, for which there is evidence that take-up of benefits is lower (Commission for Rural Communities 2006). The re-launch should also include efforts to increase the awareness of Housing Benefit and Council Tax Benefit as in-work benefits – increased take-up of which would have a significant impact on working poverty (Turley and Thomas 2006).

## 3. Reforming the Working Tax Credit: increasing support for low-income working couple families

As section 5 explored, the existing system of in-work support (of which Working Tax Credit is a key part) does not provide a guarantee that work is a route out of poverty – even if all benefits and tax credits are claimed. Protection is particularly weak for low-income working couple-families. Among those earning minimum wage, only where couple families have two full-time workers are they able to escape poverty, through a combination of pay and in-work support. Indeed, for larger couple-families with three or more children, even having two full-time earning adults is not enough to raise the family's income above the poverty line.

Therefore, alongside the Personal Tax Credit Allowance, which would boost work incentives, we recommend further action to increase support for low-income couple-families to reduce their high rates of working poverty:

**Increase the Working Tax Credit for couples with children**

Couple and lone-parent families are entitled to the same maximum amount of Working Tax Credit, £3,430 a year or £65.66 a week. However, given the additional adult in the family, couple families will often need a higher level of income to achieve the same standard of living. This is reflected in the equivalised poverty lines, which are higher for otherwise similar couple and lone-parent families.

The so-called 'couple penalty' has attracted considerable recent policy attention from across the political spectrum (Brewer 2007, Harker 2006, Callan 2007, Field and Cackett 2007). Some of these reports have suggested that the structure of the tax credit system is 'incentivising' couples to separate – because people would be entitled to receive more money as single people, with the report by Field and Cackett 2007 in particular presenting inaccurate and misleading figures. There is no evidence that people actually are responding to the system in this way. Also, given that the majority of tax credit support is channelled through Child Tax Credit, it is far from clear that both people would be better off from living separately. However, given that figures suggest there are 200,000 more people claiming support as lone parents than the official estimate of lone-parent numbers (Brewer and Shaw 2006), there is evidence that the system is affecting the way people report their living circumstances.

It is important to make clear that our case for a higher couple element in Working Tax Credit is rooted in reducing the high levels of working poverty among couple families with children – contributing to the Government's child poverty target.

A number of different options have been discussed for increasing couple support in Working Tax Credit. The Conservatives' Social Justice Commission recommended raising the couple element to 1.6 times the current rate, equivalent to the ratio of singles to couples in Income Support. They estimated that this would cost £3 billion a year, benefiting 1.8 million couples, who would gain on average £32.05 a week. Estimates suggest this could take 300,000 children out of poverty (Callan 2007). However, spending the same amount of money on increasing the child element of the Child Tax Credit would lift 700,000 children out of poverty, almost reaching the Government's 2010 target. Another approach was set out in last year's Institute for Fiscal Studies' Green Budget, which suggested that for £1 billion the couple rate of Working Tax Credit could be increased by £780 a year or £15 a week (Brewer 2006).

Given our objectives, an alternative approach would be to increase the level of support for couples by a similar factor as the equivalised poverty line. The after-housing-costs poverty line for families with one child is 1.54 times higher for couples than for lone parents. The equivalent factors for families with two and three children are 1.31 and 1.3 respectively. If the level of Working Tax Credit for couples were set a third higher than for lone parents from April 2008, it would be £4,748 rather than £3,570 (or £91.31 a week rather than £68.65). This would be an increase of £22.66 a week. The Institute for Fiscal Studies has calculated that such a rise would benefit 1.6 million families at a cost of an extra £1.6 billion a year, lifting 200,000 children out of poverty (personal communication between the authors and Mike Brewer, IFS). It is important to remember with all these reform options that they are maximum Working Tax Credit entitlement levels: the actual amount couples receive would be based on their family income.

Taken alongside the Personal Tax Credit Allowance, this is a balanced package of measures to improve work incentives, address the higher living costs faced by couples, and reduce high rates of child poverty in couple families. A strategy to reach the Government's 2010 target of halving child poverty purely through increases in the Child element of the Child Tax Credit would risk weakening work incentives while failing to address the particular circumstances facing low-income, working couple-families with children. However, channelling all additional resources into boosting couple support, as the Conservative Party is suggesting, would be a less efficient way of reducing child poverty.

Restricting this increased element to couples with children would control costs and focus resources on the Government's child poverty pledge. Couples without children would be eligible to benefit from the Personal Tax Credit Allowance, which would increase the incentive for such families to have two earners – drastically reducing their working poverty risks.

**Commit to index the value of Working Tax Credit to rises in average earnings**

Given the variety of family circumstances and needs, designing a system of in-work support that provides a clear 'income guarantee' above the poverty line is complex and would be very expensive. In-work wage subsidies, just like direct wage regulation, have an important (but limited) role to play in reducing working poverty. It is therefore important that Working Tax Credit keeps pace with rising average prosperity, by indexing its value to average earnings growth. The level of the Working Tax Credit is due to rise only in line with prices in April 2008, meaning that its relative value will fall.

Looking further ahead, consideration should be given to opening up entitlement to Working Tax Credit to individuals without children aged between 21 and 24 (and not in full-time education or training). Households headed by young people face the highest risk of working poverty. In many cases these young people will be at the start of their careers and will subsequently go on to enjoy higher earnings and a better standard of living. However, there does not seem to be any reasonable justification for them to go without in-work support simply because of their age. There are not, for example, the same labour market factors at play that justify the youth rates of the minimum wage. Aligning entitlement to the Working Tax Credit with the lower age threshold for the minimum wage that we earlier advocated would also considerably improve work incentives for this group.

## Paying for reform

The package of reforms proposed here entails both additional spending and opportunities for resources to be saved. A number of our proposals would contribute to reducing child poverty, a target which by common consensus will require additional resources to reach. The likely costs and savings of our package of reforms are summarised in Table 6.2.

Our tax credit reform package would bring both extra costs: through writing off a sizable proportion of overpayments, introducing a system of fixed but flexible entitlements and a 'no claw-backs' rule, and (over time) indexing the Working Tax Credit to earnings growth. The measures would also bring some administrative savings, by reducing the scale of overpayment recovery by around half, limiting the number of changes of circumstances that had to be processed and ending the process of back-paying underpayments at the end of the tax year. The introduction of the Personal Tax Credit Allowance would bring savings to the state where additional second earners moved into work, but there could be some costs for existing dual earner couples (which could be controlled through targeted implementation).

The one change that would entail immediate and significant extra resources – £1.6 billion – is the increase in Working Tax Credit for low-income couple families. The Conservative Party has claimed that it could fund its more generous increase in the couple element, worth £3 billion, through radical welfare reform (Callan 2007). We are sceptical about whether savings on this scale could be achieved through reductions in the claimant counts of the main out-of-work benefits without a very much more punitive benefits regime, which would be very likely to increase the numbers of working poor. Reducing the numbers in receipt of Incapacity Benefit, Income Support and Jobseeker's Allowance in ways designed to promote sustainable work would actually require upfront investments, significant changes to employer practice and work culture, alongside a more flexible and personalised system of employment support and a simplified benefits system (Bennett and Cooke 2007).

An alternative route to channelling resources to priority areas, in the context of a tight spending climate, would be to remove entitlement to the Child Tax Credit from those on middle and higher incomes. In 2005/06, 2.1 million families received only the Family element of Child Tax Credit or less (£545 a year or around £10 a week), costing just over £1.2 billion. Of these families, just 3,000 had an annual income of under £20,000, while more than 60 per cent had an income of over £30,000.

Reducing support for these families would clearly have political drawbacks. However, focusing tax credits on families in poverty

Table 6.2: Summary of likely costs and savings of proposed reforms

| Potential costs | Potential savings |
|---|---|
| • Increasing the Working Tax Credit for couples by a third to £4,748 a year (£1.6 billion)<br>• Writing off overpayments (reducing potential recovered revenue)<br>• Implementing fixed but flexible awards and a 'no claw-backs' rule<br>• Indexing Working Tax Credit to earnings growth<br><br>Longer term reform:<br>• Extending Working Tax Credit eligibility to those aged 21 to 24. | • Removing Child Tax Credit from those entitled only to the Family element or less (£1.2 billion)<br>• Child Tax Credit reform reduces the scale of tax credit system by a third<br>• Scale of overpayments recovery halved<br>• Fewer changes of circumstances to process and no need to finalise awards at end of the year.<br>• End back paying underpayments at the end of the tax year – which ran to £550 million in 2005/06 |

Note: The net costs or savings from introducing the Personal Tax Credit Allowance would depend on how the system was implemented. Where new second earners moved into work there would be savings to the state (assuming a minimum 16 hours rule applied). Additional costs to the exchequer from existing dual-earner couples could be controlled either by time-limiting the PTCA or placing an upper earnings limit on eligibility, focusing the reform on those second earners with the weakest incentives to work.

would free up resources to increase support for low-income, working, couple-families with children. Given that the Government has frozen the value of the Family element since its inception, this part of Child Tax Credit has already been declining in relative value. This reform would also reduce the scale of the tax credit system by more than a third – from interacting with over six million to something closer to four million families – bringing further administrative savings. In 2005/06 the total administrative costs of the tax credit system were £587 million.

# 7. Conclusion

The analysis in this paper has underlined the extent and nature of both low pay and working poverty in the UK today, the degree to which they overlap, and trends over the recent past. This has revealed that there is no inevitable association between having a job and avoiding poverty. In fact, this association has weakened over the past decade, as declining rates of worklessness have been accompanied by increases in both the number and proportion of working households that are poor.

The Government has partially recognised this, through measures to 'make work pay'. However, an effective anti-poverty strategy cannot rely solely on increasing financial support to poor families and helping more people into any job. Over-reliance on the first weakens work incentives while over-reliance on the second simply moves people from workless to working poverty. Tackling poverty must also address what happens to individuals and their families when they are in work: their wages and the support provided by the state, their ability to sustain their job and progress in their career, and the balance of working and caring across the household (so that families do not face an invidious choice between 'income poverty' and 'time poverty').

The measures we propose are an attempt to begin to fill in the gaps in policy. Changes to the minimum wage would ensure it plays its proper role in reducing working poverty by maintaining a strong wage floor. Reforms to the Working Tax Credit would contribute to addressing the high rates of working poverty among couple-families with children and help recover public trust in the efficacy of the tax credit system.

As we have acknowledged throughout the report, working poverty is caused by many factors relating to a range of policy areas: skills, welfare, family, devolution, industry and the labour market. This requires action across a broad range of policies beyond direct wage regulation and wage subsidies that are discussed in detail here. Principally, addressing working poverty also means helping people to improve their skills and earnings potential on the one hand and promoting the availability of sufficiently-well-paid jobs with prospects for progression on the other. These broader issues will be addressed further in research from ippr's *Working out of Poverty* series.

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# Annex 1: Modelling the impact of a Personal Tax Credit Allowance

**Couple A: A couple, with two children under 11 years, with average local authority housing costs and no childcare costs – earning ippr-defined low pay rate of £6.67 an hour**

Single earner – 35 hours a week @ £6.67 per hour:

- Gross weekly income = £230
- Take-home pay = £192.35
- Working Tax Credit = £17.50
- Child Tax Credit = £81.13
- Child Benefit = £30.20
- Council Tax Benefit/Housing Benefit = £10.09
- Net income before housing costs = £331.17
- Costs: Rent and Council Tax = £87.95
- **Net income after housing costs = £243.32**

*Scenario A: single earner increases his or her personal gross weekly income by £110 a week:*

Single earner – increases gross income to £340 a week:

- Gross weekly income = £340
- Take-home pay = £266.05
- WTC = £0
- CTC = £57.93
- Child Benefit = £30.20
- CTB/HB = £0.08
- Net income before housing costs = £354.26
- Costs: Rent and Council Tax = £87.95
- **Net income after housing costs = £266.31**

**Family better off by £22.99 a week (£1,195.48 a year)**
**State better off by £87.01 a week (£4,524.52 a year)**

**(Saves £17.50 on WTC, £23.20 on CTC, £10.01 on HB/CTB = £50.71 + gains £36.30 in extra tax and NICs)**

*Scenario B: second adult moves into part-time work at a similar level of pay raising gross family income by £110 a week (under the current system):*

Two earners – 35 hours a week + 16 hours a week both @ £6.67 (current system):

- Gross weekly income = £230 + £110 = £340
- Take-home pay = £192.35 + £107.95 = £300.30
- WTC = £0
- CTC = £57.93
- CB = £30.20
- CTB/HB = £0.08
- Net income before housing costs = £388.51
- Costs: Rent and Council Tax = £87.95
- **Net income after housing costs = £300.56**

**Family better off by £57.24 a week (£2,976.48 a year)**
**State better off by £52.76 a week (£2,743.52 a year)**

(Saves £17.50 on WTC, £23.20 on CTC, £10.01 on HB/CTB = £50.71 + gains £2.05 in extra tax and NICs)

*Scenario C: second adult moves into part-time work at a similar level of pay raising gross family income by £110 a week (under the ippr system):*

Two earners – 35 hours a week + 16 hours a week both @ £6.67 (ippr system):

- Gross weekly income = £230 + £110 = £340
- Take-home pay = £192.35 + £107.95 = £300.30
- WTC = £13.80 (doubled allowance of £199.68, WTC withdrawn on the £100.62 earned over that level)
- CTC = £57.93
- CB = £30.20
- CTB/HB = £0.08
- Net income before housing costs = £402.31
- Costs: Rent and Council Tax = £87.95
- **Net income after housing costs = £314.36**

**Family better off by £71.04 a week (£3,694.08 a year)**
**State better off by £42.66 a week (£2,218.32 a year)**

(Saves £3.70 on WTC, £23.20 on CTC, £10.01 on HB/CTB = £40.61 + gains £2.05 in extra tax and NICs)

*Under the ippr system the family would be £13.80 a week, or £717.60 a year, better off than under the current system.*

**Couple B: A couple, with two children under 11 years, with average local authority housing costs and no childcare costs – earning minimum wage of £5.52 an hour**

Single earner – 35 hours a week @ £5.52 per hour:

- Gross weekly income = £190
- Take-home pay = £165.55
- WTC = £32.30
- CTC = £81.13
- CB = £30.20
- CTB/HB = £20.29
- Net income before housing costs = £329.47
- Costs: Rent and Council Tax = £87.95
- Net income after housing costs = £241.52

*Scenario A: single earner increases their personal gross weekly income by £90 a week:*

Single earner – increases gross income to £285 a week:

- Gross weekly income = £280
- Take-home pay = £225.85
- WTC = £0
- CTC = £80.13
- CB = £30.20
- CTB/HB = £3.68
- Net income before housing costs = £339.86
- Costs: Rent and Council Tax = £87.95
- **Net income after housing costs = £251.91**

**Family better off by £10.39 a week (£540.28 a year)**
**State better off by £79.61 a week (£4,139.72 a year)**

(Saves £32.30 WTC, £1 on CTC, £16.61 on HB/CTB = £49.91 + £29.70 in extra tax and NICs)

*Scenario B: second adult moves into part-time work at minimum wage, raising gross family income by £90 a week (under the current system):*

Two earners – 35 hours a week + 16 hours a week both @ £5.52 (current system):

- Gross weekly income = £190 + £90 = £280
- Take-home pay = £165.55 + £90.00 = £255.55
- WTC = £0
- CTC = £80.13
- CB = £30.20
- CTB/HB = £3.68
- Net income before housing costs = £369.56
- Costs: Rent and Council Tax = £87.95
- **Net income after housing costs = £281.61**

**Family better off by £40.09 a week (£2,084.68 a year)**
**State better off by £49.91 a week (£2,595.32 a year)**

(Saves £32.30 on WTC, £1 on CTC, £16.61 on HB/CTB = £49.91 + £0 extra tax and NICs)

*Scenario C: second adult moves into part-time work at minimum wage, raising gross family income by £90 a week (under the ippr system):*

Two earners – 35 hours a week + 16 hours a week both @ £5.52 (ippr system):

- Gross weekly income = £190 + £90 = £280
- Take-home pay = £165.55 + £90.00 = £255.55
- WTC = £36.00 (allowance of £199.68, WTC withdrawn on £80.32 earned over that level)
- CTC = £80.13
- CB = £30.20
- CTB/HB = £3.68
- Net income before housing costs = £405.56
- Costs: Rent and Council Tax = £87.95
- **Net income after housing costs = £317.61**

**Family better off by £76.09 a week (£3,956.68 a year)**
**State better off by £13.91 a week (£723.32 a year) through increased tax and reduced benefits**

(Saves £1 on CTC, £16.61 on HB/CTB = £17.61 + £0 extra tax and NICs and costs £3.70 more on WTC)

*Under the ippr system the family would be £36.00 a week, or £1,872 a year better off than under the current system.*

# Annex 2: Data sources, minimum wage and tax credit rates

## a) Data sources

### Section 2: Low pay

Data in this section is based on analysis of the Annual Survey of Hours and Earnings (ASHE), which is sponsored by the Office of National Statistics. ASHE is based on a 1 per cent sample of employee jobs derived from National Insurance records. The survey covers the whole of the UK. Information on earnings and hours is obtained in confidence from employers. It does not cover the self-employed, employees not paid in the reference period, those not on adult rates of pay or those whose pay during the fieldwork period was affected by absence. Earnings information relates to gross pay before tax, National Insurance or other deductions, and excludes payments in kind. ASHE replaced the New Earnings Survey in 2004, with improved sampling of those on low wages.

Figures for total numbers of employees in ASHE are indicative and not necessarily an accurate estimate of the total employee job count. However, the total number cited in this paper – 23.7 million – is reasonably compatible with the estimated 24.6 million employed people in the Labour Force Survey for the equivalent period (with a further 3.7 million self-employed people). For more information see the ASHE page at www.statistics.gov.uk/STATBASE/Product.asp?vlnk=13101

### Section 3: Poverty in working households

The analysis in this section is based on the Households Below Average Income (HBAI) 2005/06 dataset which is produced by the Department for Work and Pensions using the Family Resources Survey (FRS). The FRS collects data on the incomes and circumstances of private households in the UK. There are 20,385 working-age households in the 2005/06 HBAI dataset. The FRS has covered the whole of the UK since 2002/03. Estimates for Northern Ireland were imputed for the years 1998/99 to 2001/02 and figures for earlier years are for Great Britain only.

All income figures in this chapter have been equivalised using OECD equivalence scales. We assume that household income is shared equally by all members of a household, although this may well not be the case in practice. Figures include the self-employed unless otherwise stated. It should be noted that income data for self-employed individuals is thought to be unreliable, due to under-reporting and volatility of earnings.

### Section 5: The overlap between low pay and poverty

This section uses data from the Family Resources Survey (FRS) 2004/05, produced by the Department for Work and Pensions. The 2005/06 dataset was not publicly available at the time of writing. We have used a section of the FRS which contains only information on adults (individuals aged 16 or over who are not dependent children). There are 38,512 working-age adults in the 2004/05 FRS dataset. As in section 3, all income figures have been equivalised using OECD equivalence scales. Figures in this section include the self-employed.

In this section low pay is defined as hourly wages below 60 per cent of full-time median earnings, as recorded by the FRS in 2004/05. This produces an hourly low-pay rate of £5.45 for that year. This is slightly different from that derived from the Annual Survey of Hours and Earnings for the same year. This is because earnings recorded by FRS are lower than those recorded by ASHE, but the proportion of employees found to be low paid remains comparable: 21.9 per cent using FRS 2004/05 and 22.5 per cent using ASHE in 2004.

## b) Minimum wage and tax credit rates

National Minimum Wage rates (1999-2007)

| Date | Adult rate | Youth rate (18-22) | 16/17 rate |
|---|---|---|---|
| April 1999 | £3.60 | £3.00 | N/A |
| October 2000 | £3.70 | £3.20 | N/A |
| October 2001 | £4.10 | £3.50 | N/A |
| October 2002 | £4.20 | £3.60 | N/A |
| October 2003 | £4.50 | £3.80 | N/A |
| October 2004 | £4.85 | £4.10 | £3.00 |
| October 2005 | £5.05 | £4.25 | £3.00 |
| October 2006 | £5.35 | £4.45 | £3.30 |
| October 2007 | £5.52 | £4.60 | £3.40 |

| National Minimum Wage rates (1999-2007) | | | |
|---|---|---|---|
| Date | Adult rate | Youth rate (18-22) | 16/17 rate |
| April 1999 | £3.60 | £3.00 | N/A |
| October 2000 | £3.70 | £3.20 | N/A |
| October 2001 | £4.10 | £3.50 | N/A |
| October 2002 | £4.20 | £3.60 | N/A |
| October 2003 | £4.50 | £3.80 | N/A |
| October 2004 | £4.85 | £4.10 | £3.00 |
| October 2005 | £5.05 | £4.25 | £3.00 |
| October 2006 | £5.35 | £4.45 | £3.30 |
| October 2007 | £5.52 | £4.60 | £3.40 |

| Tax credit rates and thresholds (from April 2008) | | |
|---|---|---|
| **Working Tax Credit rates** | Per annum | Per week |
| Basic element | £1,800 | £34.62 |
| Additional couple and lone parent element | £1,770 | £34.04 |
| 30-hour element | £735 | £14.13 |
| Disabled worker element | £2,405 | £46.25 |
| Severe disability element | £1,020 | £19.62 |
| 50+ return-to-work payment (16-29 hours) | £1,235 | £23.75 |
| 50+ return-to-work payment (30+ hours) | £1,840 | £35.38 |
| Childcare element (one child) | 80% of up to £175 | |
| Childcare element (two or more children) | 80% of up to £300 | |
| **Child Tax Credit rates** | Per annum | Per week |
| Family element | £545 | £10.43 |
| Baby element (for children under one) | £545 | £10.43 |
| Child element (for each child) | £2,085 | £40.10 |
| Additional disabled child element | £2,540 | £48.85 |
| Additional severely disabled child element | £1,020 | £19.62 |

| Tax credit thresholds | | |
|---|---|---|
| *First income threshold*: gross family earnings below which maximum tax credit entitlement is paid | £6,420 per annum | £123.46 per week |
| *First withdrawal rate*: rate at which tax credit entitlement withdrawn as family income rises above first income threshold | 39% | |
| *Second income threshold*: point at which tax credit entitlement is reduced at the second withdrawal rate | £50,000 per annum | £956.28 per week |
| *Second withdrawal rate*: rate at which tax credit entitlement is withdrawn as family income rises above second income threshold | 1 in 15 | |
| *Alternative first income threshold*: for those entitled to Child Tax Credit only | £14,495 per annum | £277.23 per week |
| *Income disregard*: amount by which family income can rise during the tax year without it affecting the tax credit award | £25,000 per annum | - |
| *Minimum payment if only Working Tax Credit claimed* | £26 per annum | £0.50 per week |
| *Minimum payment if Child Tax Credit also claimed* | £0.50 per annum | £0.01 per week |