Child Poverty Policy: how to tackle the underlying or systemic causes of child poverty

Submission on behalf of the Institute of Economic Affairs

Philip Booth, (Senior Academic Fellow at the Institute of Economic Affairs; Director of Catholic Mission and Professor of Finance, Public Policy and Ethics at St. Mary's University, Twickenham)

March 2021

I am responding on behalf of the Institute of Economic Affairs (IEA) to your letter of 4th February 2021 in relation to strategies for dealing with child poverty. The Institute of Economic Affairs is an education and research charity and, as such, it does not have a corporate view. However, the work of other IEA staff is reflected in this submission.

1. Pre-amble

I would begin by cautioning against the hope expressed in the letter to the Prime Minister of 28th October 2020 in which it is stated: "In the long-term, we need a coherent, cross-government and cross-party strategy to tackle the underlying causes of child poverty, including low pay, educational disadvantage, and the shortage of affordable housing and childcare, as well as measures to promote social mobility and racial justice". The nature of the problem is such that it will almost certainly be the case that there will not be a cross-party strategy. Parties naturally divide on both means and ends in relation to policies in this area.

This submission is informed by Catholic social thought and teaching. Whilst Catholic social teaching in this area does not preclude state-provided welfare, the aim should be to have thriving families, culture, civil society and a policy background such that resorting to welfare is unusual: indeed, this was also Beveridge's aspiration. The particular focus of the proposals in sections 3 and 4 reflects the fiscal constraints discussed in section 2. It also reflects the recent substantial increases in the statutory minimum wages in recent years making it one of the highest minimum wages in the OECD. As such, it is proposed that the focus needs to be on two other areas of policy, often neglected in the discussion of child poverty, which would lead to families being more resilient and self-sufficient. It is not being suggested that these areas are the only policy areas relevant to child poverty. However, they are the chosen focus given the limits of this short submission.

2. Fiscal climate

Most people would accept that there are serious social problems in many parts of the country. These include dire poverty, drug addiction, a strained health service, struggles with adequate long-term care, the failing of white and black boys from poor homes in school, visible homelessness and invisible homelessness, and so on. However, this is in a context in which UK government spending is 44.2 per cent of national income[1] – and the taxation levied to finance spending is more or less at record

[1] Estimates of government spending as a proportion of national income vary and the usual figure given is a little lower than this. Such lower quoted figures are based on national income at market prices, are easier to

levels. In 1960, the beginning of the decade which filmmaker Ken Loach regards as the height of the welfare state, and which he compares favourably with today, that figure was 35.4 per cent. Nearly all of the increase in government spending is explained by increases in welfare spending. How is it that there has been a huge increase in government spending on welfare and yet the problems that welfare spending tries to resolve seem stubborn? There are further explanations in sections 3 and 4. However, a large part of the explanation lies in demography. The ratio of people of working age to those above pension age has decreased from seven to three in this time period. It is difficult to over-stress the extent of the pressure on public finances arising from changing demography. This will worsen.

Comparisons might be made with other European countries where taxes and government spending are higher. Scandinavian countries are often cited. However, such countries levy taxes at higher levels because they have a much broader tax base than the UK, including very heavy taxes on the less-well-off. In Denmark, for example, Value Added Tax is charged at 25 per cent with no exemptions for food, fuel, books, and so on. An individual earning £9,000 would pay 16 per cent of their income in direct tax (and then Value Added Tax at 25 per cent on all spending): in the UK, an individual earning £9,000 would pay no tax at all. In fact, the extent to which tax and welfare systems redistribute income in different countries is quite similar. This is clear from OECD data which formally analyses the extent of redistribution in tax and welfare systems. Indeed, the UK has, by international standards, a tax and welfare system which is firmly in the top half of the league table for the extent of redistribution. Scandinavian and some other northern European countries, for cultural and historical reasons, have a relatively even distribution of income before tax and welfare interventions – and, with the exception of Germany, they tend to be small countries and relatively homogenous.

It therefore cannot be assumed that we can easily reduce poverty by increasing taxes and welfare benefits. Although different countries have very different models of taxation and welfare provision, there is no obvious model to which we can look which is significantly more redistributive overall. However, projecting forward, the situation will become much more difficult.

The government's Office for Budget Responsibility projects that, on current policies (that is continuing current policy for uprating spending in relation to working age benefits, health spending, pension spending and so on) the national debt will rise to 400 per cent of national income over the next 50 years. Alternatively, to stabilise debt, taxes will have to rise by a huge 15 percentage points of national income. This is simply a functioning of the worsening demographic situation with the increase in the number of older people.

The scale of this increase in taxes that will be necessary to ensure fiscal sustainability is immense and cannot be achieved without both damaging economic growth (and

---

calculate and therefore more often quoted. This figure, which is based on national income at factor cost, is a more appropriate figure to use.

hence real incomes, including those of the less-well-off) and by increasing taxes on poorer groups.

In the mid-1990s, economists warned about a looming crisis from unfunded pensions. This crisis is now upon us. It will not hit us like a financial crisis – it is more like a slowly tightening vice. An approach to child poverty which focuses on substantial further redistribution through the welfare system is simply ignoring these fiscal difficulties.

Given this situation, we need to look in other directions for long-term and sustainable solutions to working-age poverty. There are two areas of policy and aspects of societal structures which, in the UK, are international and historical outliers and which have a considerable bearing on poverty rates. These are considered in the next two sections.

3. Housing[2]

Given high levels of poverty, combined with high levels of redistribution and state welfare benefits by historical standards, it would seem sensible to ask the question "why are so many families reliant on welfare benefits, especially income top-ups?" A large part of the answer to this question revolves around the cost of housing. High housing costs bear especially heavily on low-income families because such families spend a high proportion of their income on housing. Housing benefit, which has doubled in fifteen years, does not meet the burden adequately but, even if it were to do so, the cost of housing benefit to government either lowers the amount that can be spent on other forms of welfare or raises taxes which then lowers disposable incomes for families. All these problems would be reduced or eliminated if housing costs were much lower.

This is not a problem caused by lack of social housing. The UK has the third highest level of social housing in Europe. The underlying problem is that planning restrictions prevent development on the scale that is common in most other European countries. Our planning laws, enacted in 1947, are pretty much unique in the developed world.

Between 1969 and 2019, the average house price rose 3.7 times *over and above inflation* in the UK. In Germany, house prices have risen by only 20 per cent over and above inflation over the same period[3]. Roughly speaking, rents track house prices.

Consider the effect of this with an example. Assume a family on low pay and in receipt of state benefits spent 25 per cent of its income on rent in 1969. Assume that its income rose by 2 per cent per annum between 1969 and 2019. Assume these figures are the same for a family in the UK and Germany. Given this, income before housing costs would have risen by 169 per cent over and above inflation during the period in both countries.

The low-income family in Germany would have seen housing costs fall to 11 per cent of income (of course, in reality, families would have spent relatively more on housing by moving into better accommodation as its relative price fell). The real income after

[2] See *The Scourge of Housing Costs – causes and solutions,* published by Caritas Social Action Network for an extensive discussion: https://www.csan.org.uk/wp-content/uploads/2019/02/Housing-Booklet-digital.pdf

[3] It is worth noting that, since 2010, house prices in Germany have increased by 40 per cent above inflation. From 1975 to 2010, they fell.

housing costs for the family would have risen by 218 per cent over and above inflation because incomes were rising faster than housing costs.

At the end of the period, housing costs for the British family are now 34 per cent of income. The real income of the British family after housing costs will have increased by 135 per cent.

The difference in outturn between the income of the British and German family after housing costs is staggering and the example is not unrepresentative. If both families had started on incomes of £75 a week after housing costs in 1969 (in 2020 prices), the German family would end the period on £238 a week and the British family £176 a week – a difference of 35 per cent.[4]

Today, house price affordability in the North East of England for people on low incomes (that is comparing low incomes to housing costs in the lowest quartile) is lower than it was in London as recently as 1997. In other words, it was cheaper for a poor person to rent a house in London in 1997 than it is for a poor person to rent a house in the North East today. High housing costs are not a regional problem confined to London and the South East: they affect families throughout the country.

As the German experience shows, allowing houses to be built is, something close to a silver bullet in relation to a wide range of policy objectives, including child poverty.

4. Culture, welfare policy and subsidiarity

There is a tendency when the Church of England contributes to discussions about family poverty to ignore the vital role of family stability in ensuring that children do not live in poverty and, instead, to focus on the role of government in providing welfare transfers: this is surprising.

Bringing questions of family stability into these discussions should not be thought of as stigmatising single-parent families (still less single mothers who may well have been left in the situation by fathers). In a sober way, we need to consider the role of individuals, family, civil society, church and other faith groups, and government in encouraging, or at least not discouraging, family formation.

Charities working in the field of child poverty often point to the fact that most families in poverty have working adults, suggesting that work is not a route out of poverty (the Joseph Rowntree Foundation being a notable example). When it comes to lone parents, in particular, the following should be noted:

- Though the adult in such families frequently does some work, it is invariably part time because of the essential duties of looking after the child(ren). Part-time work alone can rarely lift such families out of poverty and cannot be expected to.
- Such families will often need help with childcare costs if the parent is working.

[4] This is a representative example of the kinds of trends in incomes before and after housing costs in different countries. Actual comparisons over a different time period can be found in Niemietz K. (2011), *A New Understanding of Poverty.*

- Lone parent families lack resilience to financial shocks or problems such as illness of the parent.
- Because of these vulnerabilities, lone parent families lead to higher welfare costs and reduce tax revenues and therefore lead to higher taxes for other working families.

In the UK, 22 per cent of children live in lone parent households. This compares with the developed country and EU average of 17 per cent, 15 per cent in Germany and 12 per cent in the Netherlands.

In general, families can move into and out of poverty, especially when poverty is measured by income. To take an extreme examine, a family whose major earner is a CEO may take a career break and, for a year or two, appear in the poverty statistics measured by income. Persistent poverty is more worrying than temporary measured poverty. According to Joseph Rowntree Foundation data, households consisting of a lone parent with children are two-and-a-half times more likely to be in persistent poverty than couple families with children.

This problem requires both a policy and a cultural response. As far as policy is concerned, our tax system, unlike, for example, that in Germany, France and many other developed countries, levies tax on the basis of individual incomes. It therefore strongly penalises families where one parent is a carer. It is therefore not surprising that Joseph Rowntree Foundation data show that, in addition to very high poverty rates amongst lone-parent families, there are also high poverty rates amongst single earner couple families: our tax and welfare system penalises the latter group heavily.

This way of levying taxes is then combined with a welfare system which bases benefits on family income. The combination of our tax and benefits system means that, if a mother in receipt of welfare benefits who is not earning creates a household with a father who is earning, there is a considerable loss of net income. In cash terms, this penalty on family formation is both enormous (especially for lower earners) and unusual internationally.

One solution to this problem in policy terms is to move to a tax system more similar to that in France and Germany which allows transferability of tax allowances within households. This ensures that, when a when a low earning adult joins a non-earning adult in a household, although they may lose welfare benefits, they pay less in tax.

But the question of family formation and the high proportion of lone parents should not be addressed only by the state. The principles of subsidiarity must apply and a change in culture is necessary. We need to find a discourse to discuss the question of lone parent families that does not imply blame. A family with two adults is more resilient, less under strain and more able to earn a reasonable income whilst providing care for children. This benefits both the children and the parent(s). The Church of England should surely feel able to contribute to such discussion and also help build up civil society institutions to help lone parent families as well as couple families which are under stress. Bad public policy in relation to the shape of our tax and welfare system may contribute to this feature of modern society. However, it cannot be assumed that the state is the cause of, or the solution to, every problem.