



# **The Modernisation of Britain's Tax and Benefit System**

## **Number Four**

### **Tackling Poverty and Extending Opportunity**

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# FOREWORD

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The Government's aim is to raise the rate of sustainable growth, and achieve rising prosperity, through creating economic and employment opportunities for all. To do this it has pledged itself to improving fairness and opportunity. The seeds of poverty and lack of opportunity are sown in childhood. Children who grow up in poverty are much less likely to succeed as adults. The Prime Minister has set out the Government's aim of ending child poverty over the next twenty years. To achieve this the Government is committed to a new approach to the problems of poverty and inequality of opportunity which tackles them at source.

Tackling the causes of inequality of opportunity requires a clear understanding of the processes and events which increase opportunity and those which prevent people fulfilling their potential. It was difficult to develop a clear understanding of these relationships when the available data was based on snap-shop pictures of where people are at a particular point in time. But with the advent of new panel datasets which follow the same people over time, we have the potential to gain new and important insights into the causes of inequality of opportunity.

This paper sets out an analysis of inequality of opportunity. It is the fourth in a series of Treasury papers marking the staging posts of reform of the tax and benefit system. It draws heavily on the results of research into the dynamics of opportunity using the newly available panel data. This research was presented at a workshop organised by the Treasury and chaired by Professor John Hills from the Centre for the Analysis of Social Exclusion (CASE) in November 1998. The workshop brought together leading academics and policy makers to review the evidence on persistent poverty and lifetime inequality. Full proceedings from the workshop are being published alongside this paper.<sup>1</sup>

<sup>1</sup> 'Persistent Poverty and Lifetime Inequality: The Evidence' HM Treasury Occasional Paper No.10 and CASereport No. 5.





# INTRODUCTION AND SUMMARY

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## Opportunity today

**1.01** Economic prosperity depends on people having the chance to fulfill their potential. Yet in Britain access to opportunity is unequal, and over the last twenty years the poorest groups in society have been largely excluded from the general rise in prosperity. Since the late 1970s average incomes have risen by more than 40 per cent in real terms but for those on the very lowest incomes they have remained broadly static. Almost eight million more people now have incomes below half the national average. Other OECD countries have not experienced this rise in inequality to the same extent.

**1.02** Over the last twenty years not only has the gap between the richest and poorest increased, but the amount of movement between income groups has been limited. What is more, damaged life chances perpetuate across the generations. Children who grow up in disadvantaged families do less well at school, and are more likely to be disadvantaged as adults. Their own children's chances of prosperity are also affected.

**1.03** The increased concentration of opportunity reflects the fact that many people have been denied access to work opportunities. The proportion of households where no-one has a job has doubled over the last twenty years. Many of these people are trapped on low incomes and have become cut off from the labour market mainstream. However, the problem is wider than unemployment. Many people who have work have become trapped on low pay. It has become more difficult for people in low-paid work to climb the earnings ladder and improve their life chances and those of their family.

## A new approach

**1.04** In the past, analysis of these factors has focused on static, snapshot pictures of where people are at a particular point in time. Snapshot data can lead people to focus on the symptoms of the problem rather than addressing the underlying processes which lead people to have or be denied opportunities. To understand why people's life chances differ, it is important to look for the events and experiences which create opportunity and those which create barriers, and to use this as a focus for policy action.

**1.05** By understanding the factors which influence people's trajectories through life, it is possible to develop strategies to reduce the incidence, duration and severity of events which place people at greater risk of economic disadvantage. Equally important, Government can also work to promote those factors which help people climb the ladder of opportunity.

**1.06** Family life and the world of work have changed out of all recognition since the foundation of the welfare state. But the system has not kept pace with these changes - it has focused on the consequences of inequality of opportunity and given too little attention to the underlying causes. The Government is committed to a new approach which tackles both - by extending work opportunities to all those who can work and providing security to those who can't.

## Putting the framework in place

**1.07** Critical to people's life-chances are their opportunities to succeed in the labour market. The Government has already embarked upon a programme to:

- Modernise the **Tax and Benefit System** to remove the extra barriers created by the poverty and unemployment traps and improve rewards from work.
- Extend work opportunities with the **New Deal programme** to help more people move from welfare to work.
- Make work pay with the introduction of the **National Minimum Wage** to promote fairness in the workplace.
- Direct resources to services which extend opportunity. The Government undertook a root and branch review of public expenditure in the **Comprehensive Spending Review** (CSR). The CSR has refocused public spending. The additional investment in education and health, particularly for children, and new resources to regenerate the poorest communities will enhance opportunity and increase fairness.
- Spend £800 million on the **New Deal for Communities** (NDC) over the next three years. This will be used for the intensive regeneration of small neighbourhoods. Getting people into jobs is a key objective of the NDC, along with bringing together investment in capital and investment in people and improving neighbourhood management and the delivery of local services.

**1.08** As background to these ongoing reforms this paper sets out an analysis of the causes and dynamics of inequality of opportunity. This draws on new research into the dynamics of opportunity, and how people's experiences change over their lifetimes. It particularly reflects contributions to a workshop hosted by the Treasury and chaired by Professor John Hills, Director of the Centre for the Analysis of Social Exclusion (CASE) in November 1998<sup>1</sup>.

**1.09** The paper:

- Shows how work and the chance to progress in work are the key routes to opportunity. Chapter two looks at how differences in people's access to work and chance to progress up the earnings' ladder are major sources of inequality;
- Identifies how opportunity in childhood shapes life chances. Chapter three examines the critical role of education in shaping people's adult opportunities, the impact of childhood disadvantage on children's educational opportunities and the pattern of childhood disadvantage in Britain today;
- Looks at the events which can occur during people's working lives to constrain their future opportunity. Chapter four shows how unemployment, low pay and changes in people's family life can affect people's subsequent success in the labour market and the importance of early intervention after these scarring events to keep people connected with the labour market.

**1.10** The main findings of the paper are as follows.

<sup>1</sup> Workshop on Persistent Poverty and Lifetime Inequality 17 & 18 November 1998. Treasury Occasional Paper No. 10, CASEREport No. 5.

**Chapter Two:  
Work as the  
route to  
opportunity**

**1.11** Income inequality has risen sharply over the last twenty years. Earnings are the largest component of income. The rising gap between the high and low paid, and the increasing polarisation between workless households and those with two earners, have been the driving forces behind the rise in inequality of income from employment. More than half of the people below retirement age who are living on low incomes live in households where no-one has a job. Getting a job and moving up the earnings ladder are the most important routes to improved living standards. But for most people, income and earnings mobility is limited, and for earnings mobility the situation has, if anything, been getting worse.

**1.12** The evidence shows that:

- Earnings and income inequality have increased: the earnings of men in the top decile rose at double the rate of the bottom decile over the past two decades - the gap for women was even higher. Incomes in the top decile grew by at least five times as much as those in the bottom decile.
- Most people who are trapped on low income are living in a workless household. More than three-quarters of people below retirement age who have persistently low incomes live in a household which is either workless or only partially employed. And the number of workless households has doubled over the last twenty years, from nine per cent to twenty per cent of all working-age households.
- Getting a job lifts people out of low incomes - for eight out of ten people in the bottom fifth of the income distribution getting a job moved them out of low income. And over two-thirds of all the escapes from low income are the result of someone getting a job or moving up the earnings ladder.
- Work-related changes are the main reason people fall into low income but changes in people's family life are also important. Between ten and fifteen per cent of families fall into the bottom fifth of the income distribution when they have a child.
- People at the bottom have limited chances to move up the income distribution. Half of the people who were in the poorest group in 1991 were also there in 1996 and just eleven per cent had made it to the top 40 per cent of the income distribution.
- People at the bottom have limited chances to climb up the earnings ladder over their working lives. Over 60 per cent of people who were at the bottom of the earnings distribution in their mid-twenties are likely to be low-paid or no longer an employee fifteen years later, at forty. Just fourteen per cent will have made it to the top two-fifths of the earnings distribution.

**Chapter three:  
Opportunity in  
childhood and  
life chances**

**1.13** The seed of inequality in adulthood is denial of opportunity in childhood. Education is the most important transmission mechanism - people with few skills and qualifications are much less likely to succeed in the labour market. Childhood disadvantage frequently leads to low educational attainment, low educational attainments leads to low pay and low employment, which in turn leads to low income and denial of opportunity for the next generation. There are strong links between people's own life chances and those of their parents and possibly even grand-parents. The number of children who are growing up in relatively disadvantaged families has grown dramatically over the last twenty years. Many of these children will spend a large part of their childhood in poverty.

**1.14** The evidence shows that:

- The number of children growing up in relative poverty has increased over the last twenty years. Four million children, a third, were living in households with less than half average in incomes by 1995-96. This is more than three times the rate twenty years ago. Most of these families are without full employment.
- Children's life chances are linked to those of their parents. A child's chance of ending up in the top quarter of the earnings distribution as an adult are four times higher if their father was also in the top quarter of the distribution rather than the bottom.
- Education drives life chances and the link between education and wages is getting stronger. In the late 1970s people who stayed on at school beyond sixteen had earnings which were, on average, 40 per cent higher than those who had left school by this age. In 1990 this had increased to 60 per cent.
- Children from disadvantaged backgrounds are much less likely to succeed in education. They are less likely to stay on at school and are more likely to have poor literacy and numeracy skills.
- The differences between advantaged and disadvantaged children are apparent from a very early age. At 22 months children whose parents are in social classes one or two are already fourteen percentage points higher up the educational-development distribution than children whose parents are in social classes four or five.

**Chapter 4:  
Opportunity  
and events in  
adulthood**

**1.15** Opportunity in adulthood is closely linked to opportunity in childhood because of the critical importance of skills in the modern labour market. But the events and experiences which occur in people's adult lives can also have a strong influence on their subsequent labour market opportunities.

**1.16** Unemployment and low pay can have long-term effects which damage people's subsequent chance of getting work and moving up the earnings distribution. There are particular problems for older workers. Those over 50 are much less likely to be in work than in the past, particularly if they lack qualifications or have been in low paid jobs. This premature displacement from the labour market reduces their opportunity to save and plan for retirement and puts many of them at risk of poverty in old age. Events in people's family lives can also affect subsequent labour market opportunities, particularly for women. Lone parents and women without qualifications find it particularly difficult to combine their work and family responsibilities.

**1.17** The evidence shows that:

- People who have been unemployed or low paid are at much higher risk of subsequent unemployment and low pay, even after taking account of differences in their education and skills. In the mid 1990s about half of those leaving unemployment were unemployed again within the year.

- Education and training reduce people's risk of becoming unemployed or low paid but do not protect people from the scarring effect of these experiences, for the minority of the more educated who lose their job.
- Displacement hits older workers particularly hard. In 1979 eight out of ten men aged between 55 and 65 were in employment. By 1997 this had fallen to less than six out of ten.
- Once people lose their job after age 55, it is very difficult for them to get back into the labour market. Only eleven per cent of them manage to do so. People who had prolonged spells out of work are at high risk of poverty in old age.
- Balancing work and family is often difficult. Over half of the gender gap in pay is due to the effect of having children on women's subsequent earnings. But having a child has little long-term impact on lifetime earnings for mothers who have access to maternity leave and return to work.
- The impact of having a family on women's employment and earnings depends on their circumstances. The employment rates for lone parents and women with non-working partners are typically 30 percentage points lower than for women with working partners.