

Labour's record on cash transfers, poverty, inequality and the life cycle

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Cash transfers (benefits and tax credits) are crucial to the way that inequalities develop over time. This paper looks at how Labour's aims, policies and achievements on poverty and inequality related to its reforms of and spending on cash transfers.

- Labour's aims for poverty and inequality were selective. **'Equality of opportunity'** was the stated aim, rather than equality of outcome – with a focus on lifting the lowest incomes, not reducing the highest ones.
- Labour gave **priority to reducing child and pensioner poverty**, addressing them through a series of reforms. It increased the share of national income provided through cash transfers to children and pensioners, and increased the value of their cash transfers relative to the poverty line.
- By contrast, spending on other transfers to working-age adults fell as a share of national income from the level Labour inherited, while **benefits for those without children fell** further below the poverty line.
- By the end of the period both **child poverty and pensioner poverty had fallen** considerably, in circumstances where child poverty would have risen without the reforms (and pensioner poverty would have fallen less far). However, poverty for working-age adults without children increased.
- The **risks of poverty converged** between children, their parents, pensioners, and other working age adults. Being a child or a pensioner no longer carried a much greater risk of living in poverty than for other age groups.
- Overall **income inequality was broadly flat**, comparing the start and end of Labour's term in office. But differences in net incomes between age groups were much lower. **The smoothing of incomes that occurred across the life cycle** could be seen as a striking, if unremarked, achievement.

What were Labour's aims and goals?

New Labour's aims for poverty and inequality were selective. 'Equality of opportunity' was the stated goal, rather than equality of outcome – it focussed on lifting the lowest incomes, not reducing the highest ones.

Child poverty and pensioner income poverty were key priorities, alongside wider objectives of improving the life chances of children growing up in disadvantaged, low-income families. In Tony Blair's words, its "historic aim [was] that ours is the first generation to end child poverty forever". An intermediate target was set of halving child poverty by 2010 – measured relative to the moving target of contemporary incomes – with the ultimate aim of making Britain amongst "the best in Europe" within 20 years. Chancellor Gordon Brown stated a further aim "to end pensioner poverty in our country" but did not set explicit targets for this.

Cash transfers from the state (benefits and tax credits) were not identified – rhetorically, at least – as the central instrument to achieve the Government's objectives. More stress was placed on achieving improvements through public services such as education, health care, housing, and child care, and reductions in neighbourhood deprivation. The default assumption was that benefits and tax allowances would be adjusted annually in line with price inflation, not with overall living standards. For the working-age population the emphasis was on education, training, 'making work pay' and support into work. However, financial support for families with children through tax credits, in and out of work, was made more generous in real terms reduce child poverty while protecting work incentives.

Labour did not initially restore the link between the basic state pension and earnings growth. Instead, pensioner poverty was to be tackled mainly through increases in means-tested benefits. Only in its final term did it set in train major pension reforms restoring the link between state pensions and earnings.

What did Labour do?

Labour's policies for cash transfers accorded with its priorities, providing more generous support for families with children and for pensioners. Labour market reforms, rather than cash transfers, characterised the main approach taken to raising living standards for other working-age adults on low incomes. Other measures sought to improve the wellbeing of children in their early years and addressed wider aspects of social exclusion.

Children

The main changes came in 1999 with Child Benefit increases and the conversion of an existing in-work benefit into a new (and more generous) Working Families Tax Credit (WFTC) for low-earning families with children. Wider reforms followed in 2003, combining child allowances for those out of work with part of WFTC to create a new Child Tax Credit. This was then increased, at least in line with earnings. A new Working Tax Credit was paid to those without children as well as parents if they worked enough hours. The way tax credits were calculated resulted in extensive under- and over-payments, requiring later additional payments or (unpopular) reclaims.

Pensions

Following a Green Paper in 1998, Labour's first wave of pension reform had four main components:

- Income Support for pensioners became the 'Minimum Income Guarantee', whose value was

increased and linked to earnings. In 2003 this became Pension Credit, including extra allowances for pensioners with small independent retirement incomes.

- New, universal concessions were introduced including Winter Fuel Payments, free TV licences for the oldest pensioners, and concessionary or free bus travel.
- Reforms changed the existing State Earnings Related Pension Scheme (SERPS) into the State Second Pension (S2P). This gave better future pension rights to low-paid workers.
- 'Stakeholder' private pensions were created, trying to get more people to save larger sums for retirement. However, even with caps on charges, their cost deterred take-up.

Labour, in its second term, established an independent Pensions Commission and eventually legislated in 2008 and 2009 to implement its main recommendations. These reforms, carried further after Labour left office, may in the long-term represent its greatest permanent mark left on the cash transfer system, including:

- More valuable, less means-tested state pension entitlements on which people could build non-state pension rights.
- Future increases in the state pension age to reflect growing life expectancy.
- Automatic enrolment for employees into employer pension schemes, or else a new low-cost national funded scheme (but with the right to opt out).

Direct taxation and the labour market

A series of reforms to direct taxation sought to reduce the relative burden on those with lower incomes:

- Reforms to National Insurance Contributions (NICs) reduced them for low earners. But the main NIC rate was raised in 2003, badged as a payment towards extra NHS spending.
- Tax relief was abolished on mortgage interest and for married couples.
- A 10 per cent starting rate of income tax was introduced. This was removed when the main rate was cut to 20 per cent in 2008, a change that left some low earners worse off.
- Tax increases for people with higher incomes were generally limited until the 2008 economic crisis. Labour then raised the top rate of income tax to 50 per cent for incomes above £150,000 from 2010-11.

The backdrop to tax and benefit changes were measures aimed at moving individuals from 'welfare to work' and raising take-home pay for the low-paid. These included the 'New Deal' employment programmes for the young unemployed, lone parents, long-term unemployed, and for partners of the unemployed. The first National Minimum Wage was introduced from April 1999 and there was a series of changes making entitlement to out of work benefits more conditional on efforts to find or prepare for work. This included reducing the age of their youngest child at which lone parents were required to 'actively seek work' from 16 to age 7.

How much did Labour spend?

The transformation of some benefits into 'tax credits' and transfers of responsibility between departments complicate comparisons, but Table 1 uses DWP analyses to produce a consistent time series. In real terms, total spending rose by £68 billion or 60 per cent. This was a little slower than overall spending, so its share of the total fell slightly. For most of the period, spending grew no faster than national income, so that by 2007-08 cash transfers were a slightly lower proportion (10.6 per cent) of GDP than at the start. But as the economic crisis hit, with higher unemployment and falling GDP, cash transfers rose sharply to 12.8 per cent of GDP.

**Table 1: Total benefit and tax credit expenditure 1996-97 to 2009-10:
In the Labour period, cash transfers increased by 60% to £181.5bn**

	1996-7 benefit spending	2009-10 benefits and tax credits (cash transfers)	Change
Real spending (£ billion at 2009-10 prices)	£114 billion	£182 billion	+\$68 billion (60%)
% of total government spending	27.4%	27.0%	-0.2 %
% of national income (GDP)	10.8%	12.8%	+2.0%

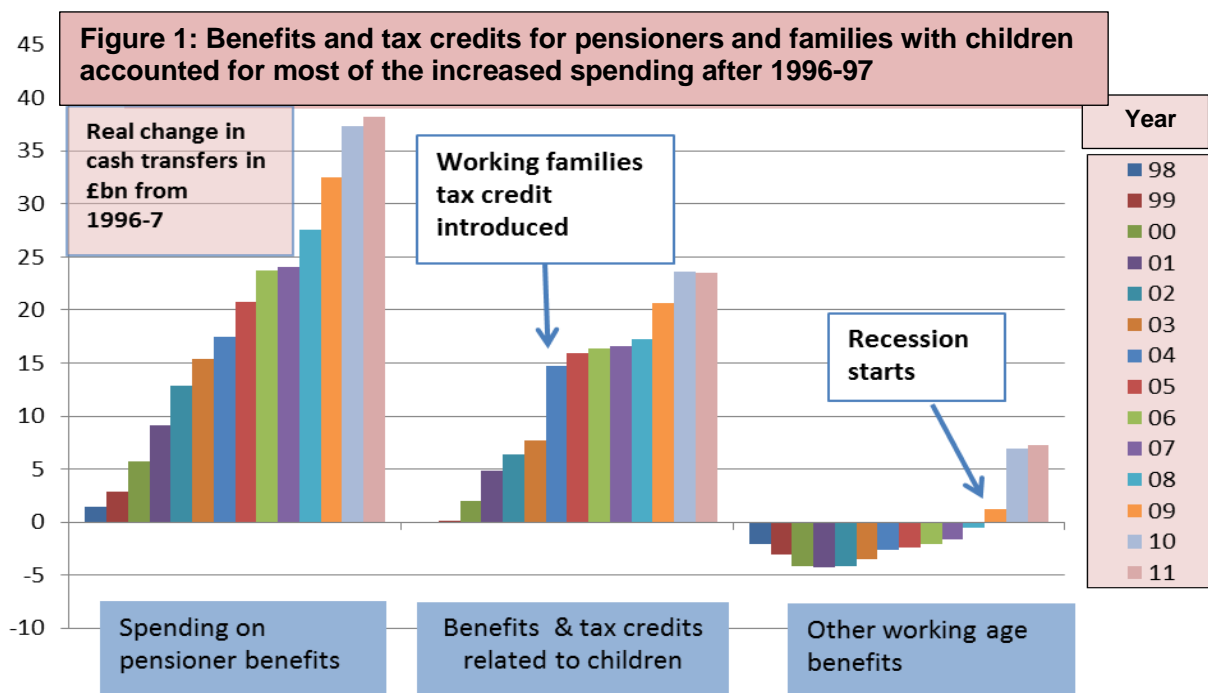
Source: (DWP data for Great Britain)

International comparisons

UK spending on cash transfers remained low in international terms. OECD figures show that in 1995 UK cash transfers (including tax credits) were the twentieth highest out of 30 richer countries as a share of national income. The UK rose only to seventeenth out of 30 in 2009. Within Western Europe, UK spending in 2009 remained proportionately smaller than in any other country apart from Norway. In more detailed breakdowns, UK spending on old age and on family benefits rose as a share of GDP, but that on other cash benefits fell. The UK was the eighteenth highest spender on old age and survivors' benefits in 2009 and nineteenth for other cash benefits. However, on the OECD's classification the UK's spending on family benefits grew to become the third highest, behind only Luxembourg and Ireland.

How was the money spent?

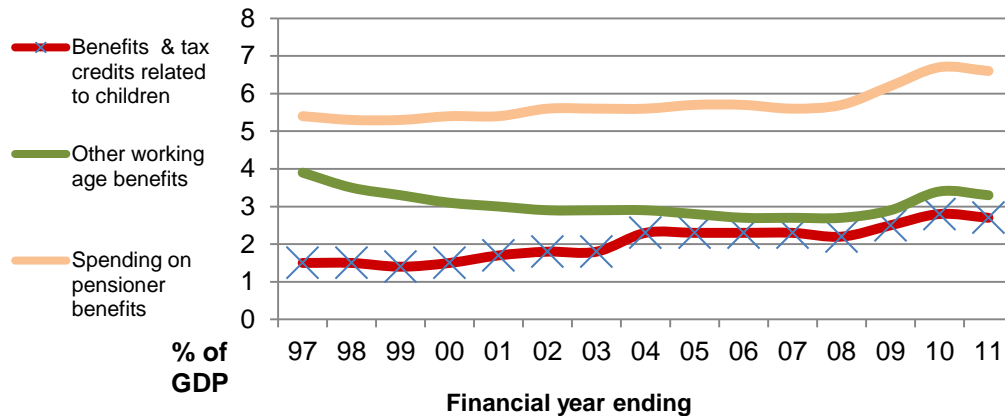
Figure 1 shows more than half of the real terms increase in cash transfers – £37 billion – was accounted for by increases for pensioners; and 36 per cent – £24 billion by 2009-10 – by increases for families with children. Until the crisis hit after 2007, other working age benefits were no higher than in 1996.



Source: Based on DWP data (2009-10 prices)

Figure 2 shows that between 1996-97 to 2009-10, spending on pensioner benefits rose and transfers for children each grew by 1.3 percentage points of GDP. However, other working-age benefits were a *smaller* share of GDP, 3.4 per cent in 2009-10 (and 3.3 per cent in 2010-11) – even in the wake of the economic crisis – than the 3.9 per cent of GDP they had been in 1996-97.

Figure 2: Cash transfers for children and pensioners took increasing shares of GDP 1997-2011



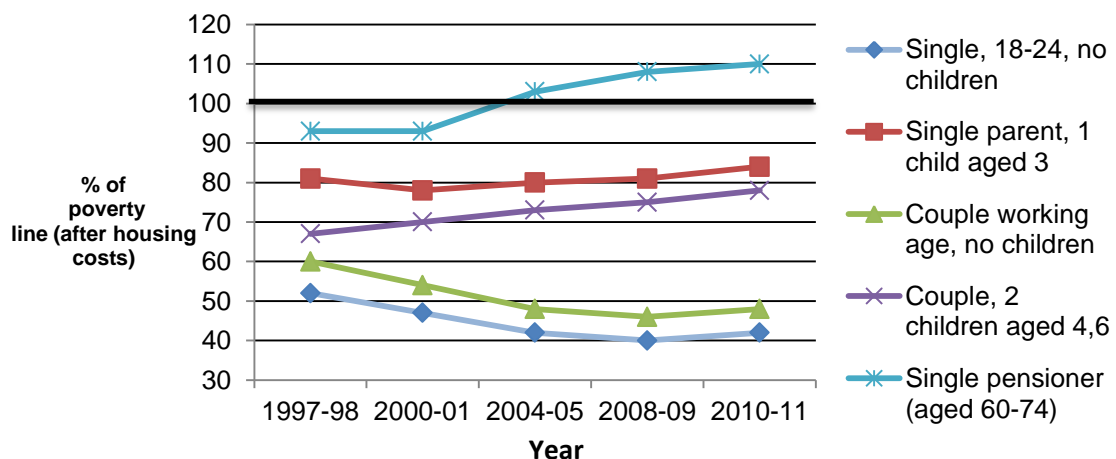
Source: Based on DWP data, using definitions consistent with current allocation of public spending. Excludes Council Tax Benefit.

What was achieved?

Benefit increases took pensioners above the poverty line and brought out of work families with children closer to it

Labour's policies resulted in a restructuring of the benefit system for those out of work. Figure 3 shows benefit levels compared to the poverty line (defined as households living on 60 per cent or less of the median net income). By April 2010, minimum incomes for single pensioners were above the poverty line, and close to it for couple pensioners. Benefits for larger families moved closer to the poverty line, but those for working-age people without children fell further behind – some to less than half the poverty line.

Figure 3: Benefit levels provided incomes below the official poverty line (60% median income), but delivered increases for pensioners and children



If measured against fixed, real thresholds, poverty increased in the final year of Labour's period in office. However over the whole period from 1996-97 to 2010-11 poverty, compared to an absolute threshold, *halved*, and fell by nearly two-thirds for children. Whether measured against an absolute or a relative standard, poverty rates for children, those of working age, and pensioners converged to similar levels, where there had been wide differences at the start.

These changes were not simply a matter of people being moved just above a particular poverty threshold – to 'poverty plus a pound'. Overall poverty rates fell against a range of thresholds, whether measured before or after housing costs.

In international terms, the decline in relative poverty was not enough greatly to shift the UK's generally poor rankings compared to other countries. But while it had the worst child poverty rate amongst fifteen older EU members in the late 1990s, by 2010 its poverty rate for those under 18 was just above the average for those countries, and its ranking had risen to tenth out of the fifteen.

Income inequality did not fall despite modest redistribution

Taken as a whole, Labour's tax and benefit reforms were redistributive towards those with low incomes on average. The scale of this redistribution was relatively modest if compared with what would have happened if the inherited tax and benefit levels had been simply adjusted in line with growing incomes. But it was, nonetheless, progressive, contrasting with the regressive effects of policies in the period from 1978 to 1997. This redistribution was, however, selective, with changes in benefits and tax credits meaning that families with children and pensioners gained, but workless single people and couples without children lost.

While inequality increased at all points in the income distribution during the 1980s, and across the Conservative period from 1979 to 1996-97 as a whole, what happened under Labour depends on the measure used. Comparing incomes near the top with those near the bottom, income inequality fluctuated around a roughly constant level between 1996-97 and 2010-11, but with a fall in the final two years, taking it below the inherited level. By contrast, the 'Gini coefficient' measure, affected by incomes right at the top and bottom, was higher in 2009-10 than in 1996-97, although a sharp fall in 2010-11 took it back to its starting point. Growing incomes at the very top of the distribution were an important reason for the difference between these two measures. The results also depend on the exact start and end years chosen. The fairest summary is probably that income inequality was broadly constant over the period as a whole. The UK remained near the top of the international income inequality range, in 2008-09 behind only Portugal and the USA among richer countries compared by the OECD.

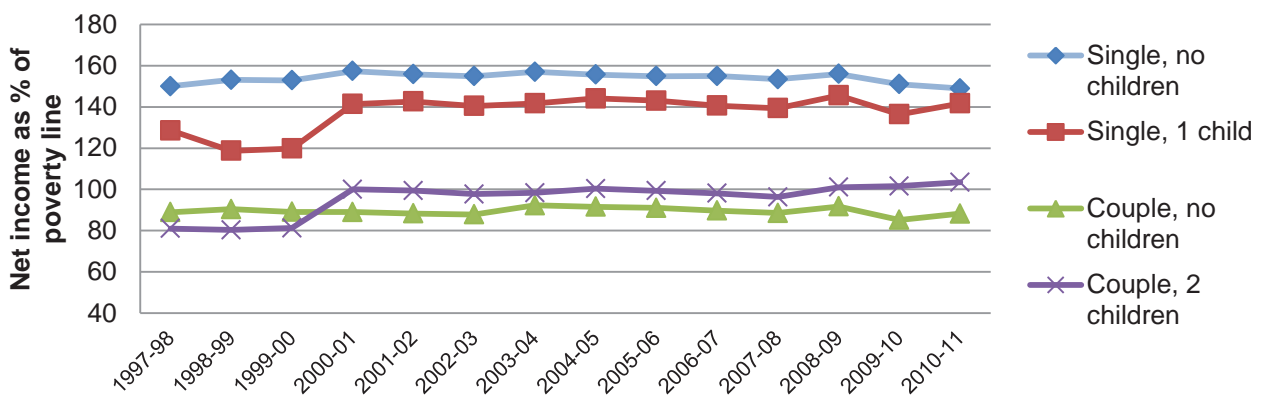
Inequality between age groups reduced

A pronounced feature of the period was the way that inequalities between age groups declined, with the median (middle) incomes of groups aged 16 or under and those aged over 60, increasing towards the overall median. Figure 6 shows that by 2010-11 incomes varied much less by age than they had in 1996-97. In terms of one of the main aims of social security systems – smoothing incomes across the life cycle – this is a very striking success. It is clearly related to the ways in which policy focused on children and pensioners. Relative incomes fell back notably for those aged 17-30 (particularly in the period after the crisis in 2007).

Tax Credits helped to lift low-earning parents out of poverty

Figure 4 shows the equivalent picture for those in work – in this case for people with half average earnings. The striking feature is the sharp rise when the Working Families Tax Credit was introduced in October 1999 for a couple with two children – from 80 per cent of the poverty line to 100 per cent of it – and for a lone parent from 120 to 140 per cent. After 2000-01 the ratios remained roughly constant for all four cases, apart from a slow fall for single people with no children, who still remained well clear of poverty.

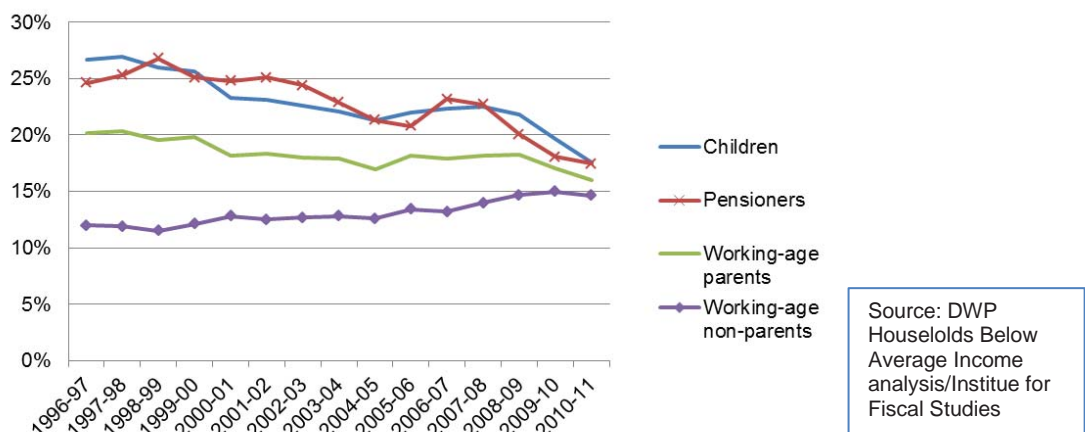
Figure 4: Net incomes for those at work (with half average earnings) rose sharply compared with the poverty line in 1999 when WFTC was introduced, if they had children



Poverty rates fell overall and risks converged for different groups

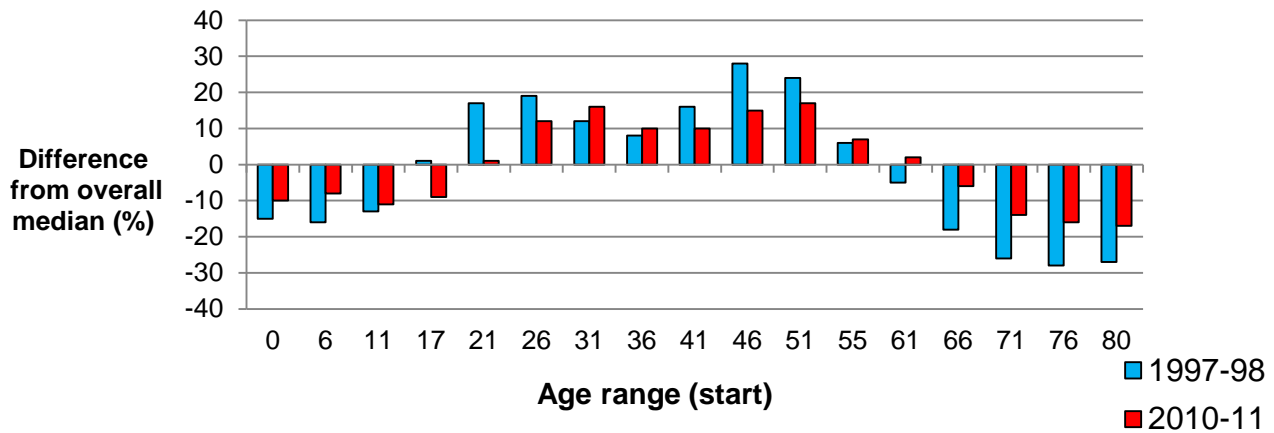
Using the most prominent of the available measures, relative income poverty fell between 1996-97 and 2010-11. This took its level to the lowest for 25 years. But there were sharp contrasts between different household types, as Figure 5 shows (for relative poverty, measured before housing costs). For children the reduction was by a third; a considerable change, but falling short of the government's target of halving it. For pensioners, it fell by a quarter. But relative poverty rose for working age adults without children. Reforms such as the New Deals and the National Minimum Wage were not enough to offset the effects of other labour market changes and the way in which working age benefits in general remained linked to prices.

Figure 5: Poverty rates for children and pensioners fell, so poverty risks for different groups converged



Source: DWP Households Below Average Income analysis/Institute for Fiscal Studies

Figure 6: The largest gains in income went to children and pensioners, so incomes became much flatter over the life cycle



Source: Derived from DWP analysis of Family Resources Survey. Bars show difference between median net income for each age group from overall median income (adjusted for household size and before housing costs).

Conclusions

In one way this summary describes a fairly simple story. Labour gave priority to reducing child and pensioner poverty, carried out reforms designed to address them and increased the share of national income going as cash transfers to children and pensioners. The value of cash transfers to those groups, relative to the poverty line, increased. By the end of the period both child poverty and pensioner poverty had fallen considerably, where child poverty would have risen without the reforms. However, Labour gave much less prominence to reducing poverty for working-age adults without children - it did not see cash transfers as the way to achieve this, or of reducing overall income inequalities, particularly at the top of the distribution. Poverty for working-age adults without children increased, while income inequality was broadly flat over its term in office.

One striking corollary was that the risks of poverty converged between children, their parents, pensioners, and other working age adults. Being a child or a pensioner no longer carried a much greater risk of living in poverty than for other age groups. There was also much less difference in net incomes *between* age groups at the end of Labour's time in office than at the start. In terms of one of the main aims of social security systems – smoothing incomes across the life cycle – this could be seen as a very striking success, albeit one that Labour did not emphasize much itself. Under the Coalition, Labour's pension reforms have been extended, with continued protection of benefits for pensioners. But those for working age families – including those for children – are being cut. Labour's achievements in reducing pensioner poverty, and in smoothing incomes in later life, look more likely to endure than those of reducing child poverty and smoothing incomes at the start of the life cycle.

Further information

The full version of this paper is available at <http://sticerd.lse.ac.uk/dps/case/spcc/WP05.pdf>. This is one of a series of papers produced as part of CASE's research programme *Social Policy in a Cold Climate* (SPCC). The research, concluding in 2015, examines the effects of the major economic and political changes in the UK since 2007, focusing on the distribution of wealth, poverty, inequality and social mobility. *Social Policy in a Cold Climate* is funded by the [Joseph Rowntree Foundation](#) and the [Nuffield Foundation](#), with London-specific analysis funded by the [Trust for London](#). The views expressed are those of the authors and not necessarily those of the funders.