Contesting a budget for working people

Summary

Announcing Wednesday 8 July as the date of his second Budget of the year, George Osborne told the Sun that it would be a budget “for working people”. When the Prime Minister called the Queen’s Speech a “programme for working people”, it was clear that this was no throwaway line but rather how the government intended to present itself.

If one reaction to this is that no Chancellor would ever, if pushed, claim anything else for their budget, the prominence which is being given to this idea suggests that it should be taken seriously, and used not just to judge this budget but much of the economic programme of the government over its full term. The purpose of this note is to make a start in mapping the terrain on which the claim might be tested. It does this by providing evidence in five areas of importance to working people, namely employment, earnings, tax, benefits and housing. It also suggests areas where the government would have to act to deliver a real budget for working people.

Five tests of a budget for working people

What is the government proposing to do make sure that:

1. There are enough jobs for the growing population of working-age, expected to rise by 1.5m over the next five years?
2. Real wages rise during this parliament and that low earners, including those working part-time and in the local public sector, enjoy rises at least equal to the average?
3. Low and middle earners get their fair share of any tax cuts – given that the 6m lowest earners already pay no income tax and that increasing the threshold for higher rate tax hands a big chunk of the money back to the 4m paying higher rate tax?
4. Working-people getting tax credits who pay no tax (and so are not on the Prime Minister’s merry-go-round) don’t just get served up cuts?
5. Home ownership – which the government sees as the answer to the problems working people face with housing – back to where it was a decade ago, something which would require an extra half a million households becoming home owners each year?

1. Background: working and non-working people

To justify its cuts to out-of-work benefits, the Coalition often sought to divide those in work from those not in work.

At any particular moment, the working-age population can be divided into three groups: those in work themselves, those not working but living a household where someone is working and those living in a household where nobody is working. At the end of 2014, of the 40.7m 16 to 64 year-olds in the UK:

- 29.8m were in work, an employment rate of 73.2%;
- some 6m not working themselves were part of working households;
- others not working (4.9m in 2013) were in workless households.

In addition, a further 1.1m 65+s were in work, making a total number employed of 30.9m.

"Working people" are not a static group. Over the last couple of years, the number in employment has gone up by one million. But over that period, around a million people have entered employment in each three month quarter while more than 800,000 have left each quarter. That makes for entrance and exit rates of around 3% per quarter. Of that 800,000, 300,000 move to unemployment – even though the total number unemployed is coming down.

Conclusions

While some of the movement between work and non-work is permanent (entering employment for the first time, retirement), the quarterly entrance/exit rate is far too high for that to be all it is. What this points to is the high number of people moving in and out of employment on a regular basis. JSA is their benefit, a benefit for working people. In Britain's flexible labour market, "working people" and "non-working people" one tribe, separated by a blurred and ever-shifting line.

2. Employment

The growth in employment was the Coalition's biggest economic success

The number of people in employment rose under the Coalition by two million, mainly in the last two years. The only time in recent decades when the five year increase has been bigger than this was in the late 1980s, at the end of the Lawson boom.

But "employment" for many working people falls far short of what they need. 3.1m working people – 1 in 10 – were in poverty in 2012/13. In-work poverty looks different from traditional images of poverty. For example, among working people in poverty:

- 40% own their homes while another 40% are tenants in the private sector;
- 30% live in the south and east outside of London;
- 30% are under 30 but 30% too are in their 40s.

Whether poverty or not, others had either insecure work and/or too little work:

- 1.3m part-time workers (1 in 6) who want but can't get a full-time job
- 0.2m with zero hours contracts (34%) who want to work more hours (among other workers it is 13%);
- 0.6m workers on temporary contracts who want permanent ones.

0.5m of the growth since 2010 has been in self-employment. This is not the same as having a job: unlike an employee, someone self-employed may have neither work nor earnings. They have no security. Some will have been bullied off benefits. The growth in the number of employees since 2010 is far from a record.

Employment among UK citizens rose 1.3m over the five years and by 0.8m for others. Employment among those born in the UK rose by 0.9m (1.1m for others).

Population growth plus the rising state retirement age will push the total number of people of working-age up by 1.4m by 2019. To hold the employment rate for working-age, the number employed needs to rise by a million. If the rising trend in the number of 65+s in work continues, the number needs be more like 1.3m.

Conclusions

Comparison with the late 1980s suggests the UK is nearer the end of a period of growth than the beginning. We reached a similar conclusion (looking at the sector financial balances) in another paper published before the election. The big question is whether the employment performance, as measured by the employment rate, can even be sustained. In-work poverty aside, criticisms of different types of employment requires subtlety..

3. Earnings

Unlike employment, the prospect of rising earnings can be no more than a promise from the government of better things to come.

Under the Coalition, average wages after inflation fell by 3.3% over the five years. The fall was concentrated at the start, up to 2011/12, but although it stopped after that, there has as yet been no recovery.

The OBR's most recent forecast, made at the time of the March budget, projects real wages rising by about 1.7% a year, or nearly 9%, by 2020. This abrupt change of fortune is expected by the OBR to start straightaway.

Income from self-employment suffered a much bigger fall: down 13% after during the first three years of the Coalition and down 31% since the last year before the financial crash. This is the flip side of the growth in self-employment.

The government is emphasising the minimum wage but that is still low pay. 5.2m workers – 21% of all employee jobs – were paid below the living wage in 2014. 3m of them were in part-time jobs; 3.3m were women. Half of families in in-work poverty have at least one low paid worker.

It is sometimes said that low pay is only a problem if it lasts: starting out on low pay and then moving up is fine. The little research that there is on this suggests that a quarter of those who are low paid will be low paid ten years later while a half move out of it for a time but then fall back. On that basis, some 4m workers suffer chronic low pay, escaping it, if at all, only fitfully.

If this is hard to understand, it is because of a faulty image of low pay as something affecting mainly young workers. Those under 30 actually account for only 40% of those paid below the living wage. Part-time work, done mainly by middle-aged women, in occupations like care and often employed either directly or indirectly by the local public sector – this, not Saturday jobs or students working evenings, is where the heart of the low pay problem lies.

Conclusions

Improvement in real earnings must be central to a budget for working people. The OBR's forecast is a yardstick against which to measure how well the government is doing. It is also vital to improve public understanding of who is low paid, the jobs they do and who employs them. If the government justifies cuts to in-work benefits on the grounds that employers should not be being subsidised, it needs to have an answer to how local public sector employers, a big employer of low paid workers, are supposed to respond.

4. Tax cuts

The government is promising further increases in the personal allowance which unlike changing the basic rate, seems to deliver a uniform tax cut

The government has promised not to raise the income tax rate – and to increase the personal allowance from £10,600 now to £12,500 by 2020.

Official estimates for 2015/16 show 24m income tax payers below the state retirement age (SRA). With 30m workers of working-age that implies there are about 6m working people who pay no income tax. Among the rest, 20m pay the basic rate and 4m pay the higher rate of whom some 0.3m also pay the additional rate. If the personal allowance were increased to £12,600 in 2015/16, it would be worth:

- nothing to the 20% of workers with the lowest earnings – 6m – who already pay no income tax;
- an average of £190 a year to the estimated 2.4m (between £10,500 and £12,500) "taken out of tax" as a result;
- £380 a year to 17.6m on basic rate tax earning more than £12,500;
- unless the threshold above which higher rate tax were reduced pound for pound with the increase in the personal allowance, £760 a year to the 4m higher rate tax payers.

30% of the money returned to taxpayers as a result of increasing the personal allowance goes to the 4m higher rate working taxpayers (13% of the total).

Far from reducing the higher rate threshold, the Conservatives have actually pledged to raise it by the end of the parliament so that higher rate tax only starts at £50,000. If that happened in 2015/16, it would be worth an additional:

- £560 a year on average to the estimated 1m "taken out of higher rate tax";
- £1,120 a year to 3m higher rate tax payers earning more than £50,000 a year.

Conclusions

While most working people benefit from a higher personal allowance, 30% of the benefit goes to the 13% who pay higher rate tax while the lowest earning fifth gain nothing. Taking the increases in the personal allowance and higher rate threshold together, the effect is even more skewed, with half of the money returned to working taxpayers going to higher rate tax payers. The cost to the government of these two tax cuts among working people is comparable to the £12bn welfare cut.

5. In-work benefits

The government has begun attacking what it calls the merry-go-round of working people paying tax and getting benefit at the same time

There are at least four groups of working people whose families or households receive in-work benefits:

- The 4m working people in 3.2m families receiving tax credits, made up of the 0.6m receiving WTC on its own, the 2.2m receiving WTC and CTC and the 1.2m receiving CTC on its own.
- The 1m working people with high rents which entitle them to housing benefit. Some of these people will be subject to the bedroom tax (it is not just for those in non-working families).
- Working people receiving DLA, SMA or SMP are also in this situation.
- Some 36% of working people (11m) have dependent children. Since child benefit was in effect withdrawn from high earner families in 2013, the number of working people receiving child benefit is between 9m and 9.5m.

There is a lot of overlap between the first three groups, with around two thirds of workers receiving HB also getting tax credits. On that basis, around 4.5 million working people are in one of the three groups.

Irrespective of the merits of the idea, the factual basis for the merry-go-round is weak. Many working recipients of child benefit pay income tax. For those receiving tax credits, our upper estimate of the proportion of who also pay income tax is 50%. Many in this group are the two adult, single earner families. Most of those who are paying tax and getting tax credit will be getting only small amounts.

Whether recipients of child benefits are to be spared remains to be seen. It is worth recalling that in 2010, a promise to protect child benefit made in the June budget was reversed by the time of autumn spending review.

Conclusions

The merry-go-round claim is inaccurate and a linking of tax credit cuts with an increase in the personal allowance would be misleading as at least half of those affected by the cut would get nothing from the increase because they earn too little. The claim that tax credits and WTC in particular are a subsidy to employers is doubtful. Employers do not know what tax credits are received and two identical employees but with different family circumstances can get quite different amounts. After retail, the sector with the second highest attribution of WTC is human health and social work – largely publicly funded.

6. Housing

The government asserts that the answer to working people's housing problems lies in owner occupation

Half of all working people have housing costs which take 10% or less of their disposable income. On that basis, 20% of disposable income is a measure of "high" housing costs while 30% is a measure of "very high". In which case:

- 7.5m working people have high, and 3.5m very high, housing costs. On both measures, 35% are under 30, 25% in their 30s and 25% in their 40s.
- Two thirds of working people with high or very high housing costs are in the PRS while another quarter are owner occupiers (with mortgages).

If the PRS were mainly a short term home for students and young adults, its neglect by the government would matter less. But with some 4m households in the PRS in England in 2012/13 and just 0.33m exiting over the next year, households now in the PRS can expect to stay there 12 years. Over the ten years to 2013/14:

- Private renting became the most common tenure among 25-34 year olds, its share rising from 21% to 48% while owner occupation fell from 59% to 36%.
- Private renting rose among older age groups too, up among households headed by a 35-54 year old by 1m (with a similar fall in owner occupation).
- The number of PRS households containing children trebled to 1.5m.

Over the last ten years, the share of homes owned with a mortgage has fallen from 41% to 31%. If the government were serious about reviving owner-occupation, reversing that is the kind of thing it would need to do. It is not just a question of helping young adults: just 44% of 35 year-olds today are owner occupiers, 20 percentage points lower than 35 year-olds both 10 and 20 years ago.

Conclusions

The length of time that people can expect to stay in the PRS as well as the number of children now living there mean that policies affecting its affordability, suitability and security remain a high priority. No policy "for" owner occupation alone can therefore be enough. Even so, a restoration of owner occupation back to where it was a decade ago over two parliaments would require 500,000 new owner occupiers a year instead of the current 200,000. Owner occupation is no panacea: even though mortgage rates are still low, a quarter of those with high housing costs are owner-occupiers.