

Autumn 2011

Poverty and inequality in London: anticipating the effects of tax and benefit reforms

London is England's richest city but also its poorest and most unequal. Of all regions, London has the highest proportion of households in the top tenth of incomes nationally, and the highest proportion in the bottom tenth. The capital has the highest rate of income poverty of any English region, and inner London has the highest rates for all age groups including children, working-age adults and pensioners after housing costs are taken into account. Inequality in London grew during the economic boom between the late 1990s and 2008, as the incomes of the richest accelerated and poverty rates remained unchanged. But how has this changed during the recession, and what will be the impact of the Coalition's proposed changes to taxes and benefits, including housing benefit, on poverty and inequality in the capital and its spatial distribution? This briefing combines analysis of London's current poverty profile and its economic performance during the recession with modelling of the likely effects of tax and benefits changes.

This briefing

This briefing has been prepared by Ruth Lupton from the Centre for the Analysis of Social Exclusion (CASE) at LSE drawing on contributions made at an event jointly organised by LSE London, CASE and the GLA. It is based on the presentations by James Browne from the Institute for Fiscal Studies, Alex Fenton from the Cambridge Centre for Housing and Planning Research, Jonathan Hoffman from the GLA (using material prepared by Melissa Wickham) and Peter Kenway from the New Policy Institute.

Policy implications

- London has been cushioned from some of the worst effects of the recession by the strong profitability of its firms, a reduction in relative wages and the growth of the public sector in the period up to 2008. However further job losses and rising unemployment are likely as public sector employment contracts.
- The capital already has the highest poverty rates in the country. Worsening economic conditions will create increasing pressure on housing, welfare and local services.
- Patterns of poverty are changing. Half of children in low-income households in London are in working families, and a majority of London's poor now live in outer London.
- Housing costs play a crucial part in poverty in London. The Government's changes to Local Housing Allowance (LHA) will have more severe effects in London than elsewhere. By 2016 most inner London boroughs are likely to become almost entirely unaffordable to low-income tenants on LHA, many of whom will be pushed to outer boroughs.
- Maintaining affordable housing in Inner London is a critical issue, for social justice and cohesion reasons, and for inner London's economy as employers rely on low-waged workers who need to be able to get to work.
- LHA changes will also mean that households in London on average will lose more overall as a percentage of income from the Government's tax and benefits changes than those in other regions.

London’s economy in recession

In terms of economic output, the 2008 recession has been more severe in London than the recession of the 1990s. 18 months after the economic peak, output in London had fallen 6.1%, similar to the position in the UK as a whole (see table). By contrast, at the same point in the 1990s recession, London was doing relatively worse than the rest of the UK. However, to date, the impact of the 2008 recession on job numbers and unemployment claimants has been smaller than in previous recessions, and London appears to have suffered rather less than the UK as a whole.

A comparison of London and the UK in the current and previous recessions

| Indicator | Recession | London | UK |
|--|-----------|--------|------|
| % Output decline from peak to trough | 2008 | 6.1 | 6.4 |
| | 1990s | 6.2 | 2.5 |
| | 1980s | - | 4.6 |
| Percentage point change in unemployment claimant count (from UK output peak for 11 quarters) | 2008 | 1.7 | 2.1 |
| | 1990s | 6.5 | 4.7 |
| | 1980s | 4.1 | 5.4 |
| % Change in employee jobs numbers (from UK output peak for 10 quarters) | 2008 | -3.5 | -4.3 |
| | 1990s | -11.1 | -6.1 |
| | 1980s | - | |

Source: GLA Economics

London seems to have been protected from job losses and unemployment mainly by the strong profitability of its firms, which to some extent have been able to absorb the downturn, and by some reductions in wage costs, particularly in comparison to other countries. The strong growth of the public sector up to 2008 is also an important factor. When jobs in public administration, defence, education, health and social work are excluded, trends in job numbers look very similar to those of previous recessions, despite the larger fall in output during the 2008 recession. Public sector employment is now expected to fall at a similar rate over the next 5 years as the private sector experienced between 2008 and 2010. At the same time, employment recovery may be slowed by cuts in working hours imposed by some firms to survive the recession, and the withdrawal of some government support for business. Continued low interest rates and exchange rates favour business survival but the outlook for employment looks uncertain in London.

- **The changing spatial distribution of poverty**

In recent years there has been a shift in the spatial distribution of poverty in London. Inner London still has the highest rates of poverty, but rates have come down since the late 1990s, while they have gone up in outer London. A majority of people in poverty in London now live in outer London. Ten years ago they were evenly split between inner and outer. In addition, across London, in-work poverty has risen over the last decade while out of work poverty has fallen. As a result, half of children in low-income households in London are in working families.

The distinction between inner and outer London are also now becoming less useful. The deepest problems are not evenly spread around inner London but concentrated in the inner east, which has more in common with the outer east than the inner west; a situation exacerbated by the experience of the recession. On many deprivation indicators, the inner west boroughs, such as Camden and Westminster, had the lowest rates in London in 2009 and also the least negative change 2009-2010. The inner east boroughs, such as Haringey and Hackney, were worst off on many indicators in 2009, while outer east boroughs, such as Enfield and Havering, suffered the greatest decline 2009-2010. Neighbourhood level analysis using Indices of Multiple Deprivation shows a similar picture for the period 2007-2010.

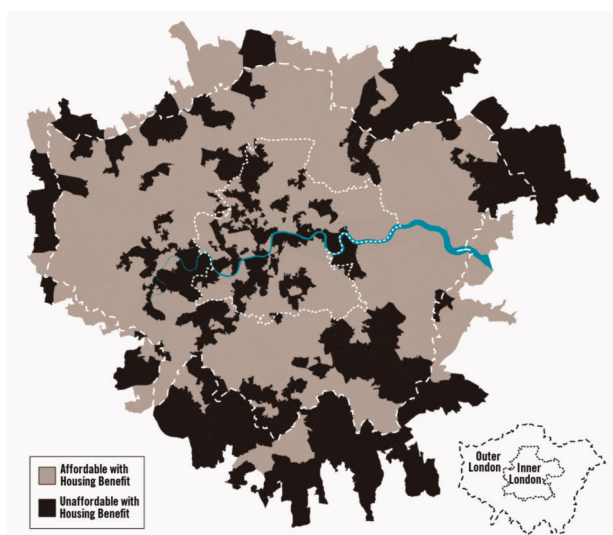
Further analysis is needed to untangle the relative effects of the different processes underlying these changes: gentrification in inner London, in-migration of poorer residents, diffusion into outer boroughs, and the different economic fortunes of different sectors of the economy in different parts of London. However, it seems clear that the social and economic divisions between inner London boroughs are increasing, and that poverty is increasingly shifting to outer London. The crucial role played by the high cost of housing is becoming clear. Housing costs account for much of the difference in the poverty rates between London – if housing costs are disregarded, poverty rates in London are similar to those in other regions. Housing benefit is counted as income in these calculations. Reductions in the amount of housing benefit available to households as a result of new government policies will therefore not only have a greater impact in London than elsewhere in the country but also have implications for the way poverty is spatially distributed in the capital.

- **Anticipating the effect of the Coalition's Local Housing Allowance reforms**

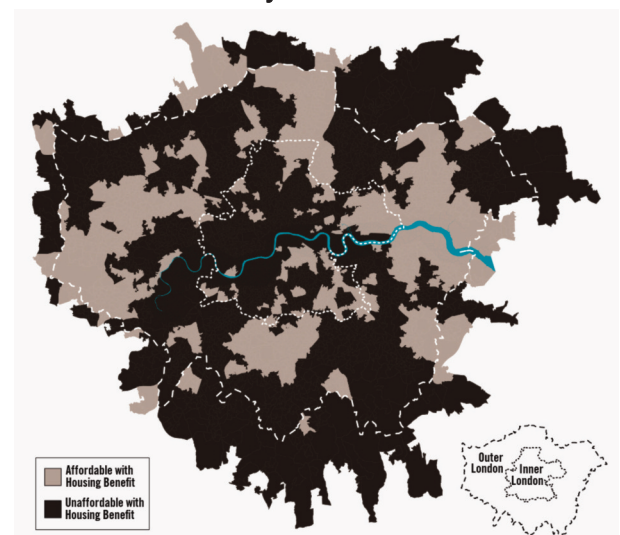
The Government paid out £8bn in Housing Benefit in England in 2009/10, of which £1.5bn was spent in London. In an attempt to reduce this, a number of changes are being introduced to the Local Housing Allowance (LHA), which sets the maximum amount of rent that can be met from Housing Benefit. From 2011 LHA is being reduced from the median level of local rents to the 30th percentile and an absolute limit is being imposed on the allowance. From 2013, LHA will be increased in line with consumer price inflation (CPI) not with rents themselves. Cumulative CPI inflation between 1997/8 and 2007/8, for England, was 20%, compared with 70% for rents.

One way to anticipate the effects of these changes is to consider which neighbourhoods will be 'largely unaffordable' as the changes are rolled out: 'largely unaffordable' is defined here as when the LHA is lower than the cheapest 25% of neighbourhood rents. This means that someone seeking accommodation will find it hard to find a property that is available, affordable, in adequate condition and offered by a landlord who is willing to let to LHA claimants. Using this definition, the changes from 2011 will immediately reduce the proportion of London neighbourhoods affordable to LHA claimants from 75% to 51%. This falls further to 36% by 2016. Most inner London boroughs are likely to become almost entirely unaffordable to low-income tenants on LHA by 2016. See map below.

London neighbourhoods largely unaffordable to LHA claimants in 2010 and 2016



Source: Fenton A. (2011))



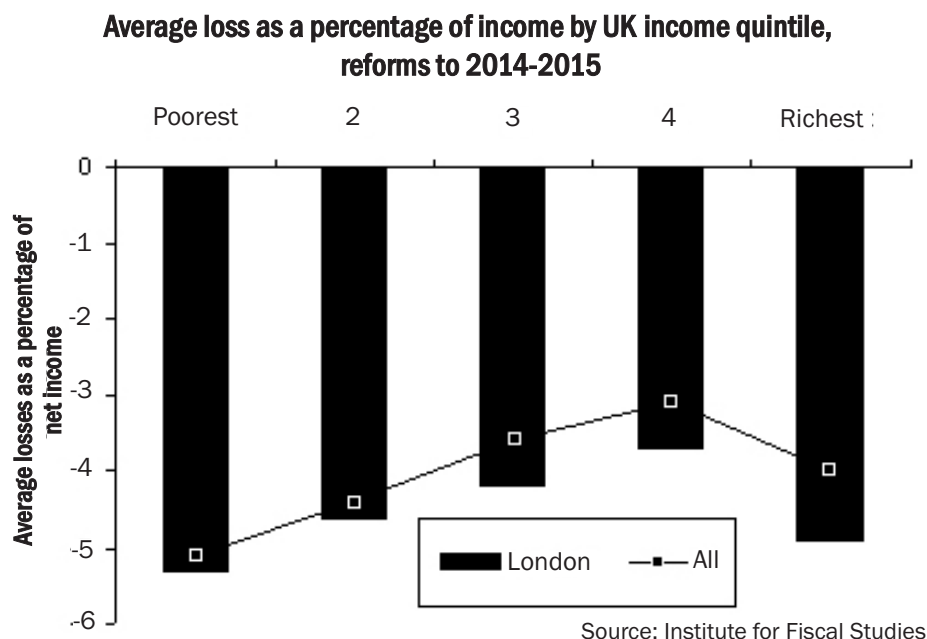
Source: Fenton A. (2011)

Moreover, the large clusters of neighbourhoods in outer East, South and West London that will remain affordable in 2016 are likely to house increasing numbers of low-income tenants as a result of the reforms. These areas are already characterised by high rates of multiple deprivation and unemployment among the existing population. Thus the reforms are likely to intensify the spatial concentration of disadvantage, and increase the segregation of poor and better-off households within London.

- Anticipating the effect of the Coalition's tax and benefit reforms

The LHA reforms are a clear example of the way that changes to the national system of taxes and benefits can have much sharper effects in some parts of the country than others because of differences in the distribution of income, demographics, rent levels and so on. So how will London fare under the Government's other tax and benefit changes?. These include: an increase in National Insurance rates, the reduction in the higher rate tax threshold, restriction of tax relief on pension contributions, greater means-testing of tax credits, withdrawal of child benefit from higher rate taxpayers, and the uprating of benefits using the consumer price index not the retail price index.

The overall picture is that households in London will lose more on average, as a percentage of income, than those in any other region from the reforms to be put into effect by 2012-13 and this is still true when later reforms (to 2014-15) come into play, although the gap between London and other regions will close. The picture for London is worse partly because of the Housing Allowance changes, but partly (in the earlier period) because of the impact of the restriction of tax relief on pension contributions, which will affect the very richest households most. While the former change will affect the poorest households and probably increase poverty rates, the latter will affect those on the highest incomes, and may have some effect on reducing the high level of inequality that has characterised London in recent decades.



- Conclusions

These findings present, on the whole, a rather gloomy picture for London's economy, for poverty rates, and for spatial segregation. The overall direction seems to be towards a more divided city. The anticipated movement of poorer households to outer boroughs could also be expected to have economic consequences – many members of these households occupy low-skilled and low-paid jobs in inner London which support the London service economy in particular. There is a need to monitor what will be a moving picture, to understand how different ethnic groups are affected by the changes, and to keep a close eye on the way that cuts in local government and third sector services interact with the wider changes reported here. Changes need to be anticipated and up-to-date information on what actually happens will be essential in order to plan and respond effectively.

- Further reading

The presentations including podcasts from the LSE London/CASE/GLA event are available at <http://www2.lse.ac.uk/geographyAndEnvironment/research/london/events/londonDevWorkshops/newlondonenvironment/PovertyandinequalityinLondon/Home.aspx>

Browne, J., Kenway, P., and Phillips, D. (2010) Poverty and the impact of tax and benefit changes in London IFS <http://www.ifs.org.uk/publications/5358>

Fenton, A. (2011) Housing Benefit reform and the spatial segregation of low-income households in London CCHPR <http://www.cchpr.landecon.cam.ac.uk/outputs/detail.asp?OutputID=240>

McInnes, T. and Kenway, P. (2009) London's Poverty Profile (and updates in 2010 and 2011) City Parochial Foundation/New Policy Institute <http://www.londonspovertyprofile.org.uk/>

Wickham M. (2010) Working Paper 44: London's labour market in the recent recession GLA Economics <http://www.london.gov.uk/publication/working-paper-44-londons-labour-market-recent-recession>