Welfare-to-work policies are based on the idea that people can work their way out of poverty. **Richard Dickens** and **Abigail McKnight** explore this assumption by examining the changing earnings of employees, the integration of migrants and the progression of low-paid families in Britain since the late 1970s.

The changing pattern of earnings: employees, migrants and low-paid families

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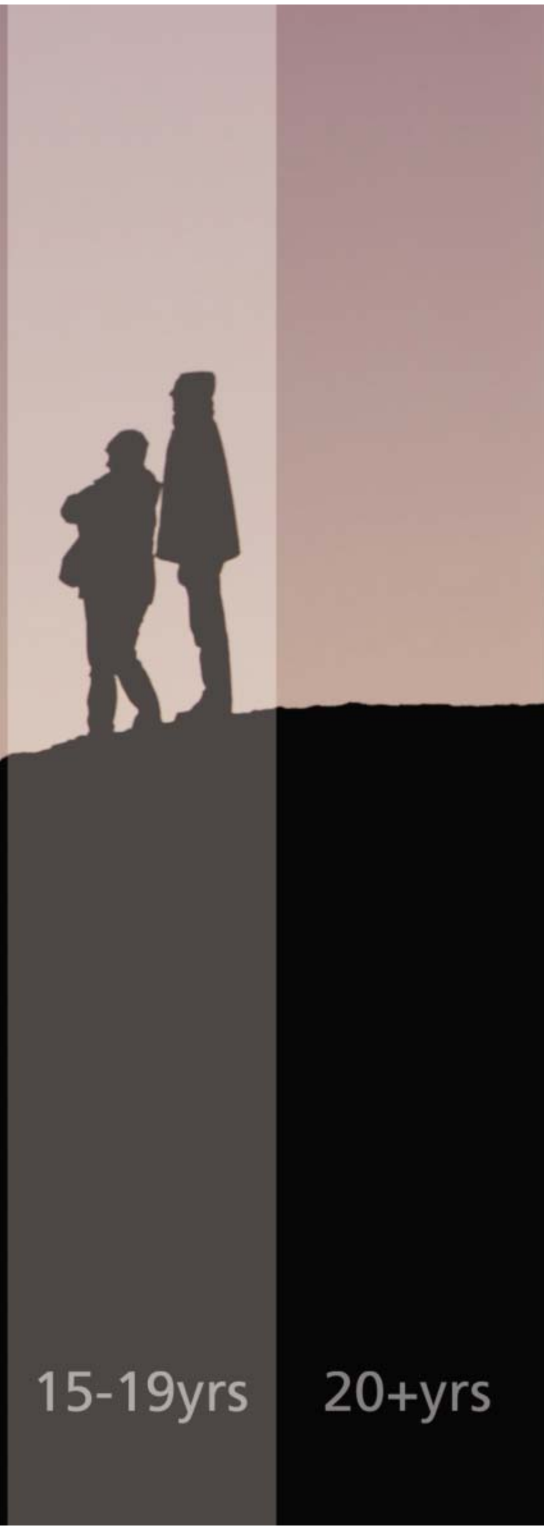


The 1980s and early 1990s saw sharp increases in the inequality of earnings, income and the distribution of work across households. These changes contributed to large increases in child poverty so that by 1997 about a third of all British children lived in relative poverty. Important contributory factors were concentrations of low skills, high unemployment and benefits set at levels that were insufficient to lift families out of poverty.

Since taking office in 1997, the Labour government has focused on tackling poverty through employment, complemented by increases in benefit levels for some groups, mainly parents and pensioners. This has all been based on the expectation that with the help of some targeted benefits, individuals can work their way out of poverty. Our study looks at whether their progression in the labour market over the past few years demonstrates that they have been able to do so.

One of the Labour government's flagship policies, the Working Families Tax Credit (WFTC), was designed to increase the incentives to find and stay in work for individuals in low-income families. Our research looks at the impact of the WFTC on the extent to which individuals remain in employment (job retention) and wage growth.

Recent migrants are known to be disadvantaged in the labour market, both in terms of finding work and the wages they receive when in work. We examine this group to assess changes in the 'pay penalty' across different migrant groups and look at the time it takes for their earnings to catch up with those of their British-born counterparts and how this has changed since the late 1970s.

The analysis is based on a unique administrative data source, which has tracked the same large random sample of individuals since the late 1970s to the present day. The Lifetime Labour Market Database contains a wealth of information on individuals' labour market status, their annual earnings and receipt of a range of benefits. It includes information on personal characteristics, including migrant status.

Earnings inequality/mobility

To assess the impact of the unequal distribution of work and the unequal distribution of earnings for those who are in work, we examine changes in the inequality of annual earnings – variation in the amount that individuals earn over a year – and earnings mobility for two groups of individuals: those with secure patterns of work and a wider group who experience some years without any earnings.

There are many different measures of inequality and they all have different strengths and weaknesses. For example, some measures place greater importance on differences between those on very high incomes and those on very low incomes, while others put more weight on variation around average earnings. We use a number of different measures of inequality to provide a better understanding of how differences between individuals' earnings change over time; decile ratios, Gini coefficients and three that belong to the 'general entropy' class of inequality indices (see our working papers listed below for definitions and full results).

The term 'long-run inequality' means the inequality of individuals' earnings when they are added up over a number of years; and 'earnings mobility' measures changes in individuals' earnings when the same person is followed over a number of years. In other words, we compare inequality in total earnings added up over a number of years, say four years, with a measure of earnings in a single year. The difference between these two provides a measure of earnings mobility.

Changes in the inequality of annual earnings 1979-2005

Inequality in annual earnings increased between 1979 and 2005. It was higher among women than men, which is likely to be due to a greater variation in annual hours worked. But earnings inequality increased more among men than among women during this period.

A number of different measures of inequality show increases in inequality in annual earnings since 1979. There is some evidence that inequality has been gradually falling among women since 1997.

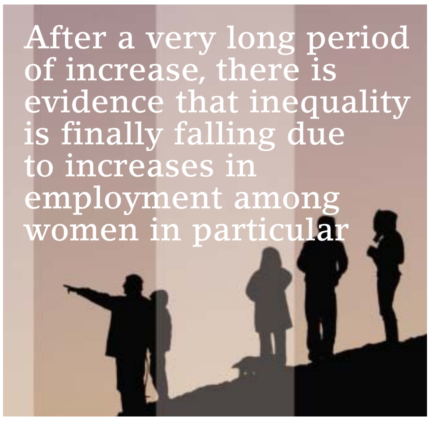
The inclusion of individuals with no earnings from employment in a given year has the effect of increasing measured inequality and thus during the recessions of the 1980s and 1990s and up to 1997, increases in unemployment translated into higher levels of inequality. On the other hand, when employment increased in the late 1990s, inequality fell. Increases in employment among women further reduced inequality.

'Long-run inequality' in earnings and employment

Over time, individuals' earnings change in absolute terms and relative to other employees, so that their longer-run prospects are not necessarily well represented by a snapshot of their earnings at a single point in time. A simple way of looking at the longer-run picture is to compare the employment status and earnings of the same individuals at two points in time. This analysis reveals that:

- People with low annual earnings are more likely than those with higher earnings measured in the same year to have no earnings and to receive benefits in subsequent years.
- People with no earnings and receiving benefits are more likely to have low annual earnings should they re-enter employment in the future.
- Although there is variation over time and between men and women, overall the position at both the bottom and top of the earnings distribution persists, with limited long-range upward mobility for those on low earnings and receiving benefit, and very little downward mobility for high earners.

A more complete picture is gained by



using a more sophisticated measure of earnings mobility. This methodology summarises individuals' earnings over a number of years, measures inequality in earnings averaged over these years, and compares it with a single year measure. This provides a measure of how much mobility offsets any increase in cross-sectional inequality (a snapshot of inequality taken in one year) and can be used to assess how long-run inequality has changed.

Our results show that mobility among male earners fell between 1979 and the mid-1990s; in other words, over this period there was an increase in the inequality of lifetime earnings. But there is also evidence that earnings mobility for men has started to rise a little since 2000.

For women earners, there was less variation in mobility than for men over the same period. While there were some changes over time, mobility rates were quite similar in the late 1970s and the mid-2000s. Again, there is some evidence that mobility has started to increase since 2000. We think this is likely to be due to improvements in job retention, improving the number of months with continuous employment; increasing earnings both within years and across years among low earners.

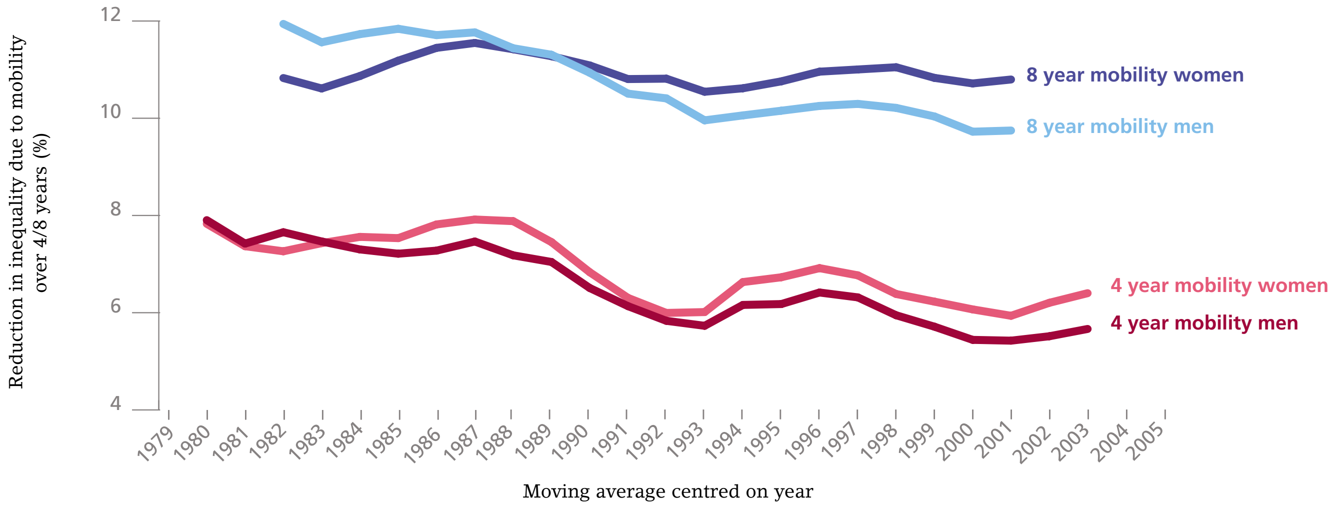
Figure 1 shows mobility measured over four- and eight-year periods for men and women using one of our inequality indices (the Gini coefficient). It shows that mobility among all individuals, including those without earnings from employment, fell until 2000, with increases since then. There was greater turbulence in mobility among men but an overall downward trend until the mid-1990s, followed by an increase in mobility from 2000.

Migrant pay gaps

Since we want to explore routes out of poverty, we look at employment data of migrants as they have lower rates of employment and, when in employment, attain lower average earnings. This places their families at greater risk of poverty. We look at entry pay relative to migrants' British-born counterparts (the pay gap) and patterns of convergence in this pay gap for different groups of migrants, men and women at different ages and by country of origin.

Not only has there been a big increase in migration into Britain over the last 25 years, but patterns of migration have also changed over time. Since the late 1970s, there has been an increase in the proportion of migrants from Africa and Central Asia, and large increases from the European Union's accession states in

Figure 1:
Changes in earnings mobility among male and female employees



recent years. These factors could easily affect the average position of migrants in the labour market.

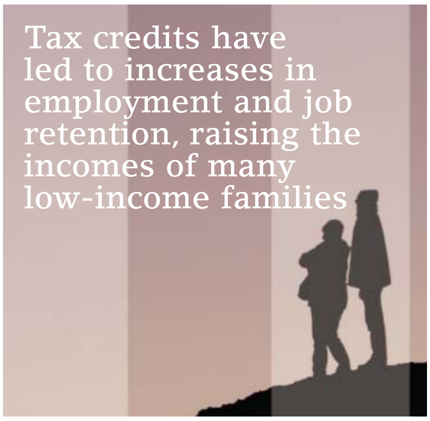
Our statistical model, controlling for age and current year, shows that when migrant workers first arrive, they experience a weekly pay gap relative to their British-born counterparts of over 30% for men and 15% for women. We find that for migrant men, it takes 20 years on average to eradicate this difference and for migrant women no more than six (see Figure 2). The greater rate of convergence in pay and lower average pay gap for women may be due to higher relative weekly hours of work among migrant women compared with their British-born counterparts.

Separate estimates for migrants from different regions of the world show that different nationalities experience varying rates of earnings convergence, with Europeans catching up the fastest but Asian men showing few signs of catching up at all. They also have a higher initial pay gap, at 45%.

More recent entry groups of migrants – those who arrived in Britain in 1985-90 and 1995-2000 – have fared better than migrants who arrived in 1975-80. But this is largely because they entered with a smaller pay gap rather than experiencing faster pay growth.

The impact of tax credits on job retention and advancement

The introduction of tax credits in 1999 represented a step change in employment



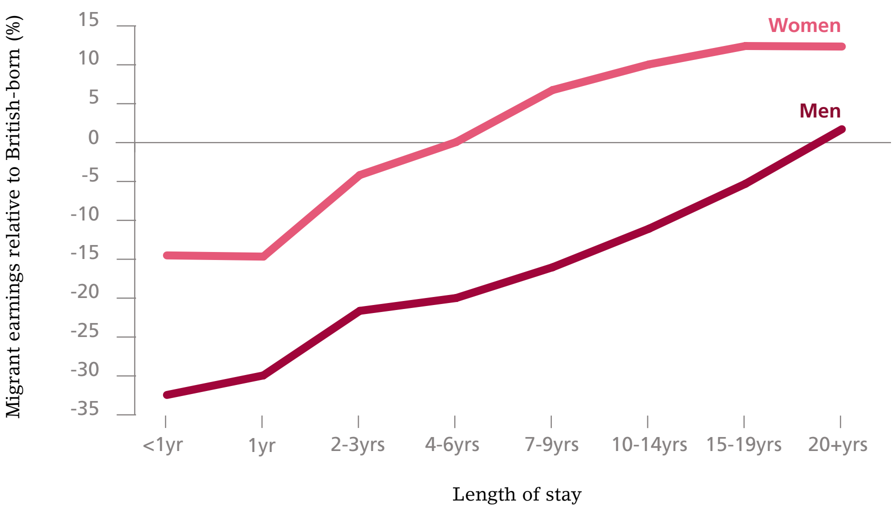
policy with the launch of an in-work benefit scheme that had greater coverage and was considerably more generous than its predecessors.

The WFTC was designed to make work pay, even in low-paid jobs, by supplementing the incomes of low-income families and so help to reduce child poverty, moving more people off benefits into work and reducing the number of households without any working members. By making work pay, the idea was also to improve job retention in low-paying jobs and assist with advancement to higher-paying jobs. The introduction of the WFTC led to an increase in the number of families receiving in-work benefits and an increase in the average value of awards.

A statistical analysis of job retention among individuals entering work and claiming the WFTC, compared with their counterparts who had claimed Family Credit, shows that the WFTC did indeed increase job retention among male recipients after controlling for differences in age and entry pay. But our analysis of earnings growth a year after in-work benefit recipients entered employment reveals that the WFTC did not appear to increase earnings compared with Family Credit.

Some feared that employers would take advantage of the tax credit to keep wage costs down using the tax credit to subsidise low-paying jobs rather than boost the incomes of low-paid workers. There is no evidence that the more generous WFTC has been used by employers to keep wage growth down and this may have been more difficult to do anyway because of the simultaneous introduction of the national minimum wage, which established a wage floor in the low-wage labour market.

Figure 2:
Earnings of migrants relative to British-born employees, by length of stay



Conclusion

After a very long period of increase, there is some evidence that earnings inequality is finally falling due to increases in employment and a reduction of inequality among women in particular. Earnings mobility also appears to be on the increase after a long period of decline.

Migrants remain disadvantaged in the labour market. Although the length of time it takes for wage convergence is shorter than in the past, this is due to higher average entry pay rather than higher convergence rates among migrants who have arrived more recently.

Tax credits have led to increases in employment and job retention, raising the incomes of many low-income families.

This article summarises research by Richard Dickens and Abigail McKnight funded by the Joseph Rowntree Foundation (http://www.jrf.org.uk/knowledge/findings/socialpolicy/2323.asp). Three background working papers – 'Changes in Earnings Inequality and Mobility in Great Britain 1978/9-2005/6', 'Assimilation of Migrants into the British Labour Market' and 'The Impact of Policy Change on Job Retention and Advancement' – are available as occasional papers on the CEP website and on the website of the Centre for Analysis of Social Exclusion (CASE) at LSE.

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