A LADDER OUT OF POVERTY:
From state-dependence to self-reliance

Rt Hon David Blunkett MP

Resolution Foundation

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About the Author

David Blunkett was elected as the Member of Parliament for Sheffield Brightside in 1987. However, his political career began in local government as a member of Sheffield City Council where he worked for eighteen years, seven of those years as Leader of the Council.

In Parliament, David led Labour's campaign against the poll tax as Local Government Spokesman. Promoted to the Shadow Cabinet in 1992, he was responsible for, in turn, health, education and then education and employment.

Following the 1997 Labour election victory, David became Secretary of State for Education and Employment where he oversaw improvements in basic standards of literacy and numeracy, reductions in class sizes and the introduction of tuition fees. He also oversaw the introduction of the New Deal for the unemployed and the reduction in the unemployment claimant count to below a million.

From June 2001 to December 2004, David was Home Secretary, where he concentrated on fighting terrorism, tackling crime and anti-social behaviour, and managing immigration and asylum.

He returned to the Cabinet in May 2005 where, as Secretary of State for Work and Pensions, he set out a vision for reforming the welfare state and led a nationwide debate to find a long-term solution to the pensions challenge.

On 18 November 2004, Alice Jere, a 47 year old chicken farmer from Zambia, helped launch the UN Year of Microcredit by opening the markets at the London Stock Exchange.[1]

Throughout the developing world, microcredit and microfinance are playing a major role in eradicating poverty by providing millions of people, many of them women, with access to loans and other financial services. Four years previously, Alice and her family had been living in acute poverty. Their lives were transformed by a loan of just £20, which she used to start her chicken farming business. Now a successful businesswoman, she is able to put her children through school and support her extended family.

Alice's chicken farm in Africa may seem a world away from the macrofinance of the Stock Exchange and a country where the top five banks, between them, made profits of nearly £30 billion last year.[2] But there is much that we in the UK can learn from her inspiring story. Her £20 loan did not just provide Alice and her family with temporary respite from their poverty. It helped build the self-esteem, independence and self-reliance needed to build a lasting escape from it. A ladder out of poverty, not just a safety net to fall back on.

This should be the principle on which our own welfare system is based. A modern welfare state must do more than simply dispense benefits; it should empower people and encourage self-reliance. This means harnessing several strands of thinking behind a new strategy that tackles inequality of wealth as well as inequality of income, builds on policies to promote asset-ownership and, critically, accelerates efforts to tackle financial exclusion.

Poverty and inequality in the UK

In Britain, the intensity and scale of deprivation is very different to that of the developing world. But it is painful nonetheless. In 1997, one third of children in the UK were born into poverty, leaving us languishing at the bottom of the EU child poverty table. And, with nearly 5.5 million people on benefits,[3] our welfare state was locking people into dependency, rather than empowering them to escape from it.

Since then, substantial progress has been made in moving away from dependency. The New Deal programmes for unemployed people, alongside a consistent and stable economic policy, have led to an increase of more than 2.5 million in the number of people in work compared to 1997.[4]

The National Minimum Wage and the incentives to make work pay introduced through the tax credit system have also had a dramatic impact on poverty. The number of people in absolute poverty has halved since 1997,[5] while child poverty fell by 23 per cent between 1998/9 and 2004/05.[6]

And, by promoting therapeutic support, geared to create an expectancy of self-reliance, and underpinned by principles of mutuality and the support of an enabling government, the current Welfare Reform Bill will provide another important step on the road to modernising the benefit system.

However, notwithstanding these achievements, striking inequalities remain. Despite an overall reduction of nearly a quarter, our child poverty rates are still above the EU average when our ambition is to lead the way and to eradicate child poverty by 2020.

Some socio-economic groups remain more likely to be disadvantaged than others. For example, although lone parent employment rates have increased by nearly a quarter since 1997, nearly half of all children born into poverty are born into single parent families.[7] And, despite the New Deal for Communities and neighbourhood renewal programmes, we have not yet managed to break the cycle of deprivation that blights some of our most excluded communities; worklessness in the worst 10 per cent of neighbourhoods is over 20 times higher than in the best.[8]

There is also increasing evidence that poverty is being passed on between generations. We know that children born into poverty are more likely to have low birth weight or to die before their first birthday, that they are less likely to succeed at school, more likely to end up in the worst jobs or with no job at all, and more likely, both to be the victims of crime, and to offend themselves.

A modern welfare state

This is why we need to go much further to entrench and extend the achievements of recent years by breaking down the remaining barriers that impede social mobility and prevent people from fulfilling their potential. In doing so, we must do much more than just alleviate poverty by increasing welfare payments. We must continue to drive it down by tackling the corrosive effects of dependency and, where necessary, changing culture and behaviour. And we must do this in a way that reinforces aspiration, engages with the expectation of something better and helps people to make the leap to a more optimistic future.

Despite the scale of the challenge, Britain today is very different from the late J K Galbraith's description of a 30-30-40 society. It is closer to 10-75-15, reflecting the fact that the majority of people have greatly benefited from economic prosperity and rising living standards in recent decades. However, there is no doubt that a small but substantial minority have not shared in this success and continue to find themselves trapped on the margins of society.

This 15 per cent includes not just those who are socially excluded or living in poverty, but also those struggling just above the poverty line, working hard and paying taxes, who see benefits going to those on incomes only marginally below their own and feel resentful as a result. It is this group who often feel most strongly about how the welfare state operates, demanding a 'something for something' approach that links rights with responsibilities.

So, the challenge is very different from the one that confronted William Beveridge when he set out his prescription for tackling the five giant evils of want, disease, ignorance, squalor and idleness in 1942. We need to re-shape the system created subsequently which for too long, and in contrast to his

original vision, simply provided a safety net into which people fell and remained, handing out benefits but asking nothing in return.

A modern welfare state must continue to provide security and support for people when they need it, but it must also work with them to encourage them to take responsibility for helping themselves. In this way, it becomes the ladder that helped Alice Jere, supporting and enabling people to realise their potential and fulfil their ambitions. This also sends out a message - that the support to which people are rightly entitled is accompanied by responsibilities.

This is the principle behind Jobcentre Plus, which brought together the Employment Service and the Benefits Agency, and the New Deal which rejected the passive dependency of the past in favour of tailored support, emphasising people's own responsibility for taking the necessary steps to get back to work. And it is the principle behind the Government's current welfare reform agenda which is rightly focusing on reducing the number of people on incapacity benefits.

There is no social justice in condemning millions of able and willing people to a life on benefits. Yet, although most claimants want and expect to work again, after two years on incapacity benefits, the shocking fact is that they are more likely to die or retire than find a new job. This is why it is so important to press ahead with reform in this area.

Promoting financial inclusion

Although it is often seen as a peripheral issue, promoting financial inclusion is central to this more active vision of the welfare state.

The UK has one of the largest and most competitive financial services sectors in the world and financial products are more widely available than ever before. However, as the range of products accessible to the majority of people has increased, a significant proportion of the population has been left behind.

This has been exacerbated by the mainstream banks pulling out of deprived areas as they strive to reduce costs and improve profitability. Between 1995 and 2003, around 3,000 bank and building society branches closed in areas with high concentrations of low income households.[9]

In a world in which people are increasingly reliant on financial services, the cost of financial exclusion is significant. For example, those without bank accounts are forced to pay more for basic transactions such as cashing cheques and do not benefit from being able to pay their bills by direct debit.

Despite the efforts of some of the banks to locate free cash machines in disadvantaged neighbourhoods, a recent report by Citizens Advice showed that the number of fee-paying machines is growing in these areas.[10] Unlike those in more affluent areas, this often leaves people living in these communities with no choice but to use fee-paying machines, incurring a typical charge of £1.50 each time they do so, a significant cost for those on low incomes.

Increasing access to financial services also plays an important role in empowering people and building self-reliance. For example, the Government is currently

reforming Housing Benefit by paying it directly to private tenants, rather than to their landlord. This will help tenants take personal responsibility for their finances and assist in developing essential budgeting skills. However, the ability to make benefit payments directly into a functioning account is an essential pre-requisite of these reforms.

The Financial Inclusion Taskforce, set up to monitor progress in tackling financial exclusion, reports that steady progress is being made in increasing access to basic bank accounts,[11] although as evidence given recently to the Treasury Select Committee showed, a number of practical problems still need to be overcome, especially around identification issues and account charges.

The Select Committee also heard evidence about the future of the Post Office Card Account (POCA), which has played an important role in enabling benefits to be paid electronically into claimants' accounts. Although it has proved popular, with over 4 million accounts opened, the POCA offers only a limited service and does not therefore promote real financial inclusion.

While the end of the scheme in 2010 could provide an opportunity to increase financial inclusion and find imaginative ways of expanding the banking system to those who are currently excluded from it (including through Post Offices), it is also highly controversial. It will be critical, therefore, to link imaginative ideas for financial inclusion with measures to increase choice for POCA holders and ensure that they have access to accessible and acceptable alternatives to their existing accounts.

This will also be an important opportunity to develop ideas, not just to allow account holders to draw benefits and pensions, but to promote savings. This should include stronger co-operation between the Post Office, mainstream financial institutions and credit unions.

Tackling exploitative lending

The most significant and corrosive aspect of financial exclusion is the continuing scandal of exploitative lending. Recent decades have seen a huge expansion in the availability of credit. For the majority, this is available at relatively low interest rates. However, people on low incomes are often forced to borrow on rates far in excess of those available in the mainstream market.

In many cases, the need to borrow will be to see people through a temporary crisis such as the breakdown of the cooker, the fridge or the television. For others it will be to cope with the consequences of a family catastrophe, illness, relationship breakdown, the loss of a job or a multiplicity of events that have led to depression and despair.

It is unjust that people who are poor, and who need to borrow to cope with the problems that life throws at them, have to pay more for this 'privilege' than those who are better off and choose to borrow simply to increase their consumption.

Yet, for around 3 million people who rely on the home credit market, which is currently being investigated by the Competition Commission,[12] APRs of well over 100 per cent are a way of life. And this is to say nothing of the illegal loan sharks who exploit tens of thousands of people by charging several hundred per cent or, in the case of one rogue lender who was successfully prosecuted in early 2006, over 1,000 per cent.[13]

A transformation in the face of lending to people on low incomes is needed. The new Consumer Credit Act will help by clamping down on irresponsible lending practices, as will the new approaches to tackling illegal money lending currently being piloted by the DTI in Birmingham and Glasgow.[14]

Recent research has also highlighted the vital role credit unions play in reducing reliance on high interest credit. Membership has grown steadily in recent years, with over 600,000 people across the UK now benefiting from their services.[15]

In contrast to doorstep lenders, a typical APR for a credit union loan is around 12 per cent. In addition to providing affordable credit and savings accounts, a number of credit unions are also currently piloting their own current accounts in partnership with the Co-operative Bank, offering the prospect of a range of mainstream financial services being provided through this route.

As Alice Jere's story shows, access to affordable credit can often be the key to escaping poverty. As well as credit unions, a range of community development finance institutions are also bridging the gap between mainstream sources of finance and the doorstep lenders and loan sharks.

For example, the University of Salford has pioneered a new form of community finance initiative; the Community Reinvestment Trust. Perhaps the leading example of this is the Portsmouth Area Regeneration Trust which provides affordable loans to people on low incomes and to small businesses, as well offering financial advice and a cheque-cashing service.

The Sheffield Investment Bond is another innovative initiative working to keep people out of the hands of high interest lenders. The scheme was established with the support of Barclays Bank and is administered by Citylife. It enables local people and businesses to invest in bonds which fund advice and affordable loans for people with debt problems, whilst guaranteeing a small return on their investment. By the summer of 2006, it had raised nearly £750,000.

Community banking partnerships, whereby credit unions and community finance organisations work in partnership with banks and money advice agencies to deliver one-stop services, are another example. The first of these to be set up, the Birmingham Community Banking Partnership, includes 28 credit unions, has over 22,000 members and holds over £20 million in assets. The Partnership's 'Factor 4' scheme offers low income households four key services – affordable credit, financial advice, bill payment services and energy efficiency assistance.[16]

To support this innovative and growing sector, the Government has launched a £36 million growth fund. This will significantly increase the range and coverage of affordable credit providers. However, it will not, on its own, be enough to deliver the step change needed.

Reforming the Social Fund

For many years, the Social Fund has provided a valuable safety net by delivering a range of grants and loans to those most in need, including community care grants, funeral payments and maternity grants.

However, the bulk of the Fund's budget, £700 million in 2005/06, is used to provide interest-free budgeting and crisis loans. Additional government investment of £210 million over three years is significantly

boosting the loans budget.[17] Reforms have also helped make repayments more affordable and abolished the ‘double debt’ rule which often prevented those with outstanding debt from receiving much needed payments.

Despite this, the Fund continues to fall a long way short of meeting need, with a quarter of applications turned down and many loans made for less than recipients apply for, often forcing them to make up the difference by going to high interest credit providers. Awareness of the Fund is also low. A survey by the National Audit Office found that less than half of people on low incomes were aware it existed and only 14 per cent of those in need had used it.[18]

Although organisations like the Family Welfare Association, which in 2005 administered over £800,000 worth of grants to low income households,[19] fill the gap as best they can, this means that large numbers of people continue to fall into the clutches of the very lenders the Fund should protect them from.

This has led to widespread criticism and calls for change from parliamentary select committees, think tanks, academics and the voluntary sector. Proposals for reform have often focused on increasing the range of grants provided under the scheme and the funding available for these. However, as worthwhile as some of these suggestions are, there is a limit to how much more public subsidy can be provided.

It is time to look more fundamentally at the role and purpose of the Social Fund and how it is financed. For too long, it has remained a legacy of the old, passive welfare state, encouraging dependence and undermining self-reliance.

Although it provides a vital lifeline in a crisis, the Fund does little to prevent another crisis from occurring further down the line. A bold new solution is needed that does much more to meet need and turns it into an agent of financial inclusion, by linking the provision of loans to access to other financial products. This solution should meet five key tests:

- Firstly, it must be focused on the needs of its customers; this means ensuring that administration is simple and transparent, that a variety of loans are available for large and small sums with flexible repayment options, and that deductions can be made directly from benefit payments to facilitate easy re-payment.
- The second key test is that it must promote financial inclusion and self-reliance. Where recipients do not possess one, the loan should be conditional on them opening an account, for example with a bank or a credit union,[20] that is appropriate to their circumstances (arrangements for this should be closely linked to those for POCA customers when the current scheme comes to an end in 2010). This would of course be dependent on further progress being made in developing suitable products.

Building on the commitment already made by the Government, loans should also be linked with the provision of financial advice to improve financial capability.[21]

- Alongside this, it should also promote asset-building. This could be achieved by making loans conditional on an agreement to continue making small additional payments once the loan has expired, so that a savings pot is simultaneously built up (linking the scheme to the Savings Gateway initiative offers an opportunity to accomplish this). Separate arrangements to provide crisis loans and grants for people in severe need would, of course, also be retained.
- Fourthly, drawing on the inspiration of Alice Jere and thousands like her in the developing world, once people's immediate needs have been met, low interest loans could also be available to support small-scale employment initiatives. The idea would be to encourage people on low incomes to develop initiatives of their own to sustain themselves and perhaps, over time, employ others. Providing personal services such as domestic cleaning, home or business catering, child minding or caring for older people are just some examples of the kind of services that people could initiate with this kind of support.
- Finally, it must also work alongside existing initiatives and support the development of the wider affordable credit sector. This means working with a range of intermediaries such as credit unions, housing associations, money advice centres, Job Centre Plus and the Post Office to facilitate access to the Fund and ensure that need is effectively targeted.

Based on these objectives, the Fund must also deliver a step change in meeting need. The Government cannot be expected to provide the scale of funding to achieve this. This means exploring ways of attracting private investment to bolster the lending pot.

There are two key reasons why the Social Fund could attract this investment. The first is the large sum of government funding available under the loans scheme. This could be used as underpinning capital to attract substantial funds through a partnership with a bank or consortium. The Social Investment Bank proposed by the Commission on Unclaimed Assets, chaired by Sir Ronald Cohen, could potentially draw this together.[22] This would provide an opportunity to replace the current regime of budgeting loans with a new system of more widely available affordable and interest-free loans.

The second reason it could attract private investment is that default rates are very low as repayments are largely collected at source via benefit payments. Recovery rates for budgeting loans are as high as 97 per cent, significantly reducing the lending risk.[23]

Some have already begun to develop these kinds of ideas. The National Consumer Council has proposed a new affordable credit model built around direct deductions from benefit. The Joseph Rowntree Foundation published work in 2005 by Bristol University's Personal Finance Research Centre highlighting the potential to bring in private capital to the Social Fund via a public-private partnership.[24]

And A4e[25] have suggested incorporating the Fund into a large scale new financial institution providing a range of products targeted at this income group, including a new system of affordable loans financed using the Social Fund's budget as the basis for attracting private equity.

These are all interesting ideas which are worthy of serious debate over the coming months, in order to develop a radical new delivery model for the Fund. The ambition should be to significantly boost the availability of loans (initial estimates suggest a total lending pot of up to £3 billion could be achievable), transform the financial well-being and dignity of those on low incomes, and engage them in taking responsibility for their financial affairs. In this way, crisis loans could be transformed into a ladder out of poverty.

Bridging the asset divide

Reform of the Social Fund is just one aspect of the strategy for supporting a modern welfare state. In many respects, although it receives much less attention than income inequality, the asset divide is becoming the defining feature of poverty in the UK.

Nearly a quarter of Britain's wealth is owned by just 1 per cent of the population, while the proportion of households with no assets at all doubled to 10 per cent of the population between 1979 and 1996.[26] The result is that the gini coefficient, which is used to measure inequality, is twice as high for wealth as it is for income.[27]

This has been fed by rising inequalities in housing wealth. The share of national wealth held in the form of housing doubled between 1971 and 2002, fuelled by a 50-fold increase in the overall value of people's homes. Many people have benefited from rising house prices. But these statistics hide the unequal way in which these benefits have been distributed.

Research for Shelter showed that, in the decade up to 2003, housing wealth per child in the best-off 10 per cent of areas increased 20 times more than in the worst-off 10 per cent of areas.[28] This makes it more difficult for people to move between areas, entrenching area-based inequalities, undermining labour market mobility and impeding social mobility. And, of course, those who rent do not benefit at all.

This is why we need to look afresh at housing policy, as the Government is doing, to ensure that it does more to promote asset ownership and social mobility. For example, as well as promoting low cost home ownership schemes, we should look again at the potential for social tenants to build up a stake in their home over time.

Home ownership, particularly in high value regions, creates substantial assets which are passed on between generations but are not available to people living in low value areas or those who rent. This is one reason why, although there is a strong argument for re-shaping inheritance tax and for clamping down on the mechanisms used by the rich to avoid paying it, to abolish it entirely would simply reinforce disadvantage.

Assets prevent people from falling into poverty by helping them cope if their circumstances change and their income falls. Research has shown that holding assets in early adulthood leads to improved health outcomes, better labour market performance and greater marital stability.[29] Critically, they have also been shown to have a positive impact on behaviour and attitudes, encouraging people to save more, plan for the future and raise their expectations.

In this way, assets promote aspiration and self-reliance, helping people to find their own route out of poverty. As Michael Sherraden said in his seminal text *Assets and the poor* in the early 1990s, 'Incomes feed people's stomachs, assets change their minds'.[30]

Thanks to the introduction of the Child Trust Fund, all children will in future have a financial asset when they turn 18, providing an important opportunity to break the cycle of inter-generational disadvantage.

Nearly 1.7 million Child Trust Fund accounts have been opened so far, with the Government contributing a minimum of £250 when an account is set up and again at age seven, and consultation is currently taking place on whether a further payment should be made when a child reaches secondary school age. For those on low incomes, these payments are £500. This means that, by supplementing these payments with a parental contribution of just £3 a month, a child could have a lump sum of more than £2,500 when he or she turns 18.[31]

The Child Trust Fund is not only about building up a financial asset for the future. It also helps build self-reliance by encouraging people to develop a savings habit and is linked to financial education initiatives to equip children with the financial skills they will need as adults.

Promoting the savings habit and improving financial capability are also key objectives of the Savings Gateway which is currently being trialled in a number of areas across the country. By matching the savings made by individuals with a government contribution, Savings Gateway accounts encourage people on low incomes to save and enable them to build up a larger asset than would otherwise be the case.

Over 20,000 accounts have been opened in the latest pilot areas. So far, the results have been very positive, with independent evaluations showing a significant increase in savings among participants. Again, these accounts do much more than just help participants build up savings. After 18 months, the accounts mature, providing a stepping stone to mainstream accounts and services, with all the benefits they bring. And the scheme is also linked to advice and information designed to improve financial capability.

These initiatives have put the UK at the cutting edge of international developments in asset-based policy-making. We must now refine and build on them to develop the next generation of policies.

As ippr have argued, the Child Trust Fund could be developed into a 'citizen's stake',[32] with top up payments to reward those who volunteer or make other contributions to their communities and for those groups who the Social Exclusion Taskforce has identified as being most at risk of social exclusion.

As ministers have already indicated, this could include children in the care system.[33] The Government could, for example, look at ways of ensuring that looked after children receive regular payments to top up their account. We also need to explore how best to roll out the Savings Gateway which could, potentially, be linked to the ideas for reforming the Social Fund set out above.

In turn, policies to promote individual assets and encourage small-scale business ventures should be linked to capacity-building initiatives to develop community assets. Charity Bank and the Futurebuilders Fund are examples of the latter, providing vital investment to build capacity and encourage innovation in the voluntary sector. The proposal of the Unclaimed Assets Commission to use dormant funds to support the sector offers the opportunity to deliver a step change here.

Conclusion

By tackling inequality of wealth as well as inequality of income, and by promoting self-reliance in place of dependency, we can re-shape the welfare state to overcome the barriers that prevent people from fulfilling their potential.

Crucially, it will be necessary to bring together all existing initiatives and potential ideas into a coherent programme to address immediate inequality and poverty, while also facing down the long term challenges of the asset divide and inter-generational disadvantage.

This should include increasing the availability of information, advice and support for people on financial issues. The publication of a new 10 year strategy on financial capability later this year provides an opportunity to make progress here.

It will mean creating new routes through education and employment to re-engage those on the margins of our wealthy society, enabling them to share norms and aspirations they currently view from a distance. Critically, it will mean transforming the availability of affordable credit and re-shaping the Social Fund into an agent of financial inclusion based on the five tests set out above.

Above all, it will involve an outlook that does not simply call for increased benefits and more hand-outs. Instead, it will mean basing policy on a ‘something for something’ approach that matches the obligation of society to ensure that opportunity is extended to all, with the responsibility and self-determination of people to lift themselves out of poverty.

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