

# Understanding Society

Austerity and Growth: The Balance of Opinion

May 2012



## In brief

Do you need to understand the changing priorities in the public sector and anticipate future challenges and risks? Why not use our regular survey of public sector leaders, tapping into the opinion of those responsible for managing change.

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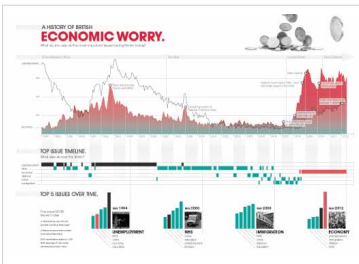
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## Foreword

**Welcome to the latest edition of the Ipsos MORI Social Research Institute's Understanding Society. In this issue, we concentrate on the state of the economy – the public's number one concern, as our foldout graphic shows.**

The government is convinced that, in David Cameron's words, "deficit reduction and growth are not alternatives....Getting our debt under control is necessary for growth", while their opponents argue they need an alternative plan.

Our aim is to make sense of society by combining our understanding of public opinion with analysis of the wider world, and in this issue we have brought together expert economic commentary and the latest on the public mood. Even in the field of economic affairs, we believe understanding public opinion is vital, not just because it is key to how a government is viewed, but also because public confidence is both a leading indicator and a prerequisite of growth.

To help us understand the economic quandary facing the UK, we are delighted to have an interview with Tim Besley, LSE Professor and co-chair of the LSE Growth Commission. The LSE Growth Commission aims to provide an authoritative contribution to the formulation and implementation of a long-term growth strategy in the UK. In a wide-ranging conversation, he discusses the work of the Commission and the best way for the government to balance the urgent need to restore robust levels of economic growth with the need for a more austere fiscal settlement in the UK.

We are also very pleased to have an article by Matthew Oakley, Head of Economics & Social Policy at Policy Exchange, one of the UK's leading think tanks. Matthew Oakley succinctly sets out his view of where the Government should introduce reforms to boost economic growth and deliver better public services for less: business finance, pay negotiations and performance related pay in the public sector, and the way in which tax policy is formulated.

Public attitudes on the state of the economy cannot be viewed in isolation. So as well as a discussion on the trends in economic optimism, we also include articles looking at Britons' attitudes to the housing market and welfare provision.

Housing plays a crucial role in determining an individual's health, overall wellbeing, affluence and ambitions for the future. The housing market, if not properly considered, can undermine the economic stability of a nation and upset public policy intentions. But by the same token, measures to improve the quality and supply of housing stock can generate considerable economic, social and political returns for a government. Recognition of this, and a growing sense of crisis, has seen housing return as an important issue in the UK, with public opinion central to its future prospects.

The government has also embarked on an ambitious programme of welfare reform with a view to reducing the state's welfare bill and removing inbuilt barriers which discourage people from working. Our research shows that simplification of

the system is welcome, as claimants have struggled to understand their entitlement and how to claim. But in doing so, within a restricted spending envelope, what is the impact on the day-to-day lives of the worst off?

We also test the well-used phrase "It's the economy, stupid" (which originated in Bill Clinton's 1992 US Presidential election campaign war-room). 'Of course it is economics that wins and loses elections', commentators say. But what is the evidence for that? Our analysis shows it is not quite as simple as everyone makes out.

We hope you enjoy reading our latest thoughts on public opinion and the state of the economy. At the Ipsos MORI Social Research Institute, we remain committed to sharing the messages from our research in the belief that a better understanding of public opinion will lead to better social outcomes. If you would like to discuss any of the issues raised in our report, or wish to learn more about what we do, please get in touch.

A handwritten signature of Bobby Duffy.

**Bobby Duffy**  
Managing Director,  
Ipsos MORI Social Research Institute



# Real economy, real politics



Gideon Skinner



Tom Mludzinski

Nick Robinson, the BBC's Political Editor, recently said that there is the real economics, and then there is the real politics, and in the last few years the two have been hard to prise apart. Our monthly Issues Index in the Economist makes it abundantly clear that the economy is seen as the number one issue facing the country, and has been every single month

since 2008 (our pull-out infographic at the back of this report brings to life Britain's history of economic worry). People are telling us at Ipsos MORI that they are anxious about the real impact of the economic situation on their daily lives, with unemployment a major issue, concern about inflation creeping up, and growing doubts about their ability to pay the bills.

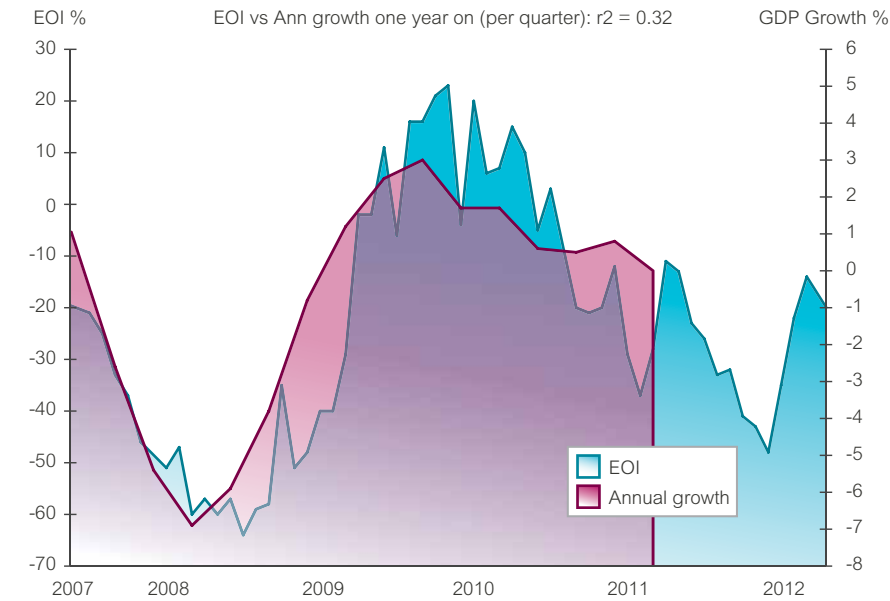


Unsurprisingly, hand-in-hand with this the economy has also become the key political issue (although see Roger Mortimore's piece later in this report to understand that the relationship between the two isn't a simple one). The economy was the number one topic determining people's vote in 2010, and the inability of any party to take a clear lead on the issue goes a long way to explain the indecisive result. Since then, being trusted to handle the economy has done much to bolster the Conservative's resilience in the polls despite high levels of economic concern, but in recent months that reputation has been damaged. So what does our analysis of public opinion have to say about the interaction between the two; politics and economics?

A constant drip of indicators paint a detailed – if depressing – picture of the 'real' economy. The biggest headlines were reserved for the news from the Office of National Statistics that Britain was officially in a "double-dip" recession (even if the underlying picture is more of stagnation, once any likely revisions to the data are taken into account). But there are a number of other indicators that give us insight into the upcoming state of the economy.

Markit's Purchasing Managers' Indexes™ (PMIs) survey selected companies across sectors, monitoring what is happening on key variables such as output, employment, new orders and so on<sup>1</sup>. Their latest results paint a mixed picture. The UK's PMIs for manufacturing and services both saw a fall in April, from 51.9 to 50.5<sup>2</sup> and from 55.3 to 53.3<sup>3</sup> respectively. Both of these are above the 50 mark that separates growth from contraction (only just in the case of manufacturing, if more solidly for services), but they are also the lowest

**Since the crash, economic optimism has been closely related to growth one year on...**



Source: Ipsos MORI Economic Optimism Index, ONS  
GDP annual growth figures are quarter on quarter annual growth figures from ONS.  
Note: GDP figures have been time lagged by 12 months (ie 2010 GDP figures are shown against 2009 EOI)

for 4 to 5 months. The construction PMI was stronger at 55.8, but this also has to be interpreted alongside ONS figures showing the sector's output fell significantly in the first quarter of the year<sup>4</sup>.

But if this is the pattern for the economy as a whole, and for the experiences of private companies, what do Ipsos MORI's latest figures tell us about the more intangible, if no less vital, state of

**The economy was the number one topic determining people's vote in 2010**

consumer confidence? Let's examine two indicators: our Economic Optimism Index, running since 1979, and the Ipsos MORI Retail Traffic Index covering over a billion visits to retail stores across the UK. A third, the Ipsos MORI/Halifax Housing

Market Consumer Confidence Tracker, is discussed later in this issue.

The Ipsos MORI Economic Optimism Index (EOI) has been running since 1979, providing a monthly track of whether the British public think the economy will get better or worse over the next 12 months, and the last five years have shown a public mood as volatile as any stock market over that time. The fall began in 2007 (incidentally, before many economists picked up the crisis), hitting its lowest ever point in July 2008 (only equalled in January 1980, which again was an advance herald of the recession later that year). Confidence then rose to a peak in late 2009 as people began to hope that the worst was over, but this was only fleeting. Since then, there have been more dramatic swings, down to another three-year low in December 2011 in the midst of the eurozone crisis, before rising as a bailout (appeared) to have been

agreed, but falling once again in the last two months after the Budget and news that Britain has again entered recession.

Just as interesting as the twists and turns in economic confidence, is the link we have been able to find between Ipsos MORI's EOI and future levels of GDP. We have, in previous editions of *Understanding Society*<sup>5</sup>, discussed this relationship - while there is little correlation between economic confidence and the current level of GDP, there is a much stronger link between the EOI and GDP in 12 month's time. This is by no means perfect<sup>6</sup>, and there are many occasions when the public are much more pessimistic than the real state of the economy would warrant, but even so it would suggest that commentators are right to forecast a slow recovery ahead.

Furthermore, new analysis we have carried out suggests that the link between consumer confidence and future GDP has become much stronger since the crisis started in 2007<sup>7</sup>. Of course, this is just a simple correlation, and a somewhat arbitrary choice of periods - and it as much highlights that, in times of relative prosperity, people's economic optimism can be swayed by events that have much more impact on perceptions than the real economy. But, nevertheless, it makes the very important point that in a time of economic crisis and uncertainty, such as we are living through now, the state of public opinion can't be ignored.

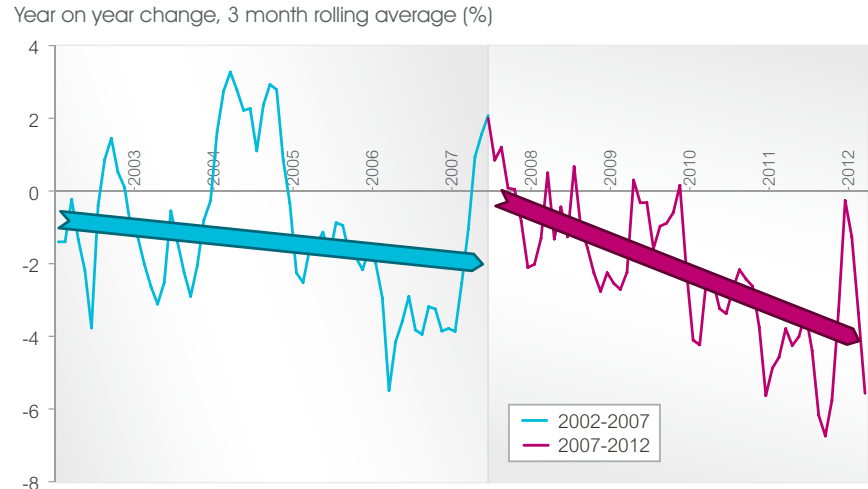
Unlike surveys which measure people's perceptions, Ipsos MORI's Retail Traffic

Index<sup>8</sup> (RTI) measures over 1.2 billion actual shopper visits every year to retail outlets throughout the UK. As such, it is a highly accurate barometer of consumers' shopping activity and confidence. Looking at year on year changes (to take account of cyclical variations), it lays bare the slow-down in consumer activity since the crash, and, by extension, the difficulties being faced by retailers in high streets across the land. In the 55

is that the general trend in footfall was down even before 2007 - but this clearly accelerated after the crash.

Of course, consumer confidence can also react sharply to events. We have seen this often in the past - for example in 1998 at the time of the Russian financial crisis, when our EOI fell from +1 to -46 in just five months. This was an even more rapid fall than in late 2007 at

**The trend in footfall was down before the crash - but this accelerated in 2007**



Source: Ipsos MORI Retail Traffic Index

months since September 2007, footfall has fallen year-on-year in 47 of them. Furthermore, despite a strong Christmas in 2011, activity has fallen again in the first quarter of this year.

Once again, the full impact of the crisis can be seen if we split the RTI into before and after June 2007 - the point at which, according to the Economic Optimism Index, consumer confidence started to fall. What is interesting in the chart above

the beginning of the financial crisis and the collapse of Northern Rock - with the big difference, of course, that in 1998 economic optimism recovered almost as quickly as it had fallen, as UK GDP continued to grow seemingly unaffected. This time, the economy may not recover so quickly, with the eurozone widely seen as the most dangerous risk:

**"We are navigating through turbulent waters, with the risk of a storm"**

1. [www.markit.com](http://www.markit.com)  
2. <http://www.markiteconomics.com/MarkitFiles/Pages/ViewPressRelease.aspx?ID=9487>  
3. <http://www.markiteconomics.com/MarkitFiles/Pages/ViewPressRelease.aspx?ID=9523>  
4. See [http://www.markit.com/assets/en/docs/commentary/markit-economics/2012/may/UK\\_construction\\_12\\_05\\_11.pdf](http://www.markit.com/assets/en/docs/commentary/markit-economics/2012/may/UK_construction_12_05_11.pdf) and <http://www.telegraph.co.uk/finance/economics/9240601/UK-construction-PMIs-offer-recovery-hope.html>  
5. See "A crisis of confidence" in *The Power of Opinion*, Ipsos MORI, July 2011  
6. An r-squared of 0.32 for those who are interested  
7. An r-squared of 0.79, compared to an r-squared of 0.22 in the period August 1979 to June 2007  
8. <http://www.ipsos-retailperformance.com/>



*heading our way from the Continent. Uncertainty can sometimes add a certain spice to life – as we saw vividly in the conclusion to the Premier League season at the weekend – but it has the opposite effect on the economy. We don't know when the storm clouds will move away. But there are good reasons to believe that growth will recover and inflation will fall back."*

Mervyn King,  
Governor of the Bank of England<sup>9</sup>

On this point, the British public concurs. In December last year, 70% said that they thought the greatest risk to Britain's national interests was the state of other countries' economies, almost twice as many as said over-population, in second place, while just over half think our economy will be no better nor worse off than most other European countries in 12 months' time. And despite everything that the coalition can try to do to create the conditions for growth, people think the



British economy is even more influenced by Europe's economy than any decisions our government may take. Given the outcome of recent elections in France and Greece, they may well be right.

All this suggests that, perhaps, it should be

just as important to consider the state of consumer confidence in other countries, not just our own. Sadly, Ipsos' Global @dvisor shows that any search for good news here is likely to be disappointed. Of the ten most pessimistic countries of the 25 it covered in April, seven are European (including Great Britain), and the bottom four are Portugal, Spain, Hungary and Italy (when Greece and Ireland have been included they made it into the bottom five too). So if consumer sentiment is an indicator of the future state of our economy, it seems as if there is little on either side of the channel to be optimistic about.

But how is all this playing out in the UK political arena? What has been striking is the extent to which, despite all the pessimism, and despite seven in ten Britons consistently preferring a slower

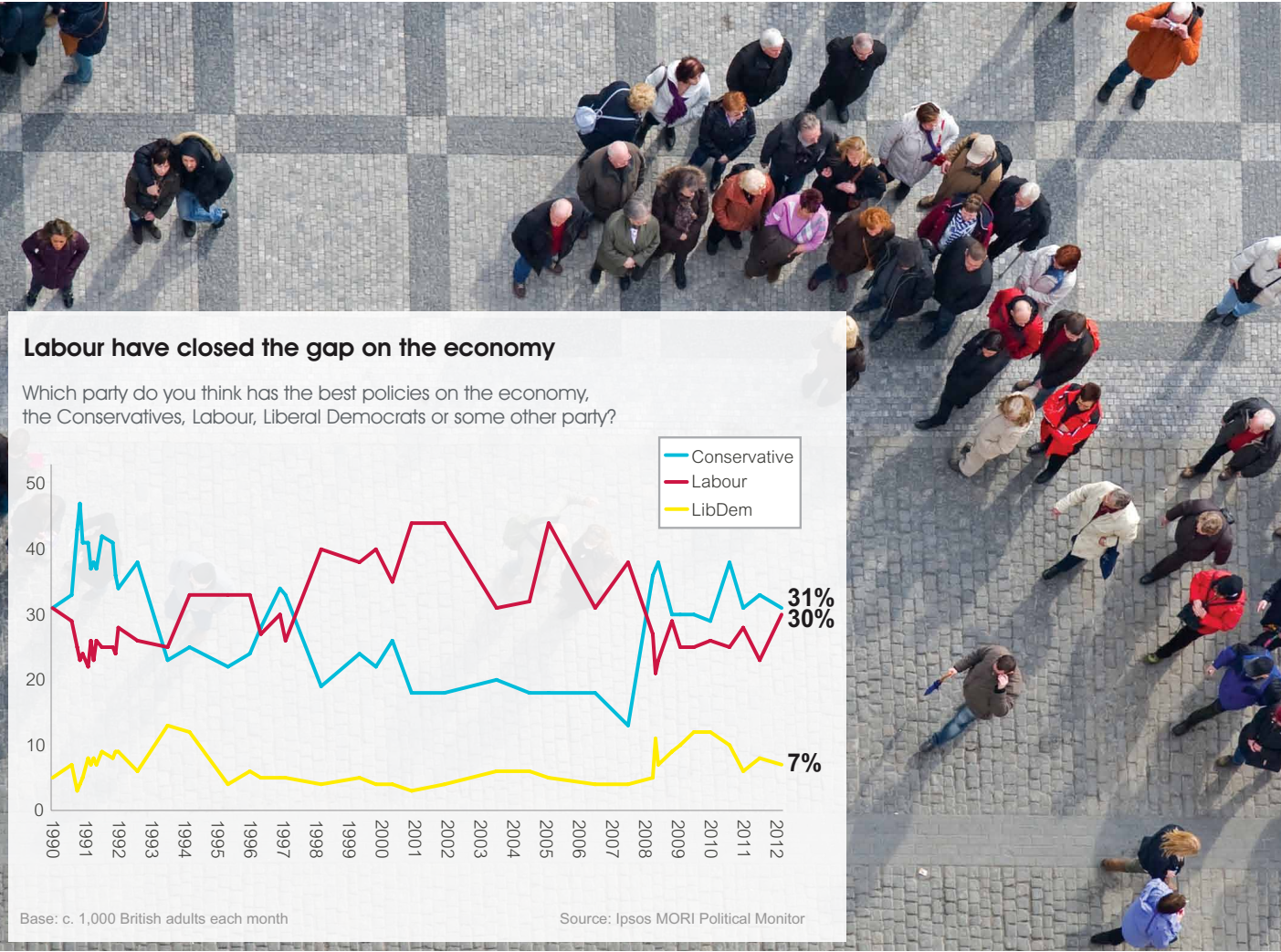
rate of cuts, the government – and especially the Conservatives – have managed to maintain their reputation for economic credibility. This may have been at least partly because, even if they were in short term pain, people felt they were still taking the right decisions for the

Of the ten most pessimistic countries, **seven** are European (including Great Britain).

country. In the honeymoon six months after the election, people were confident that the government's policies were right in the long term for Britain's economy. Even in March 2012, the country was only just split down the middle with 47% disagreeing and 46% agreeing that the governments' policies were right in the long term (including one in five Labour voters who had confidence in the government's long-term policies). This is still a better score than Labour received throughout most of its second and third terms in power.

Just a couple of months later, though, May 2012 feels as if it has the potential to be a turning point. Suzanne Hall, in her article later in this report, discusses the impact of the economic crisis on society's most vulnerable, and before it was announced, half thought the Budget would benefit those on high incomes the most. Subsequent reaction contributed to the Coalition's April "omnishambles"; the worst-rated Budget since the mid-1990s, the worst ratings ever for David Cameron, the government, and George Osborne, and big falls among bedrock Tory support such as older people (not helped, surely, by the criticism over the so-called "granny tax"). This played out in the local elections, where, in terms of national equivalent vote, Labour received their highest share, and the Conservatives their lowest, since 1996<sup>10</sup>.

Labour have also clawed back the Conservative's position as the best party on the economy, and the two are now neck-and-neck. However, Labour hasn't held a clear lead on this vital issue since September 2007, and they still have to convince the public that they



can be trusted to make the right decisions on the economy, rather than just relying on Conservative and Liberal Democrat disenchantment.

Going back to the words of Nick Robinson, he identifies a change in the emphasis from deficit reduction to growth as explaining why this is a key moment:

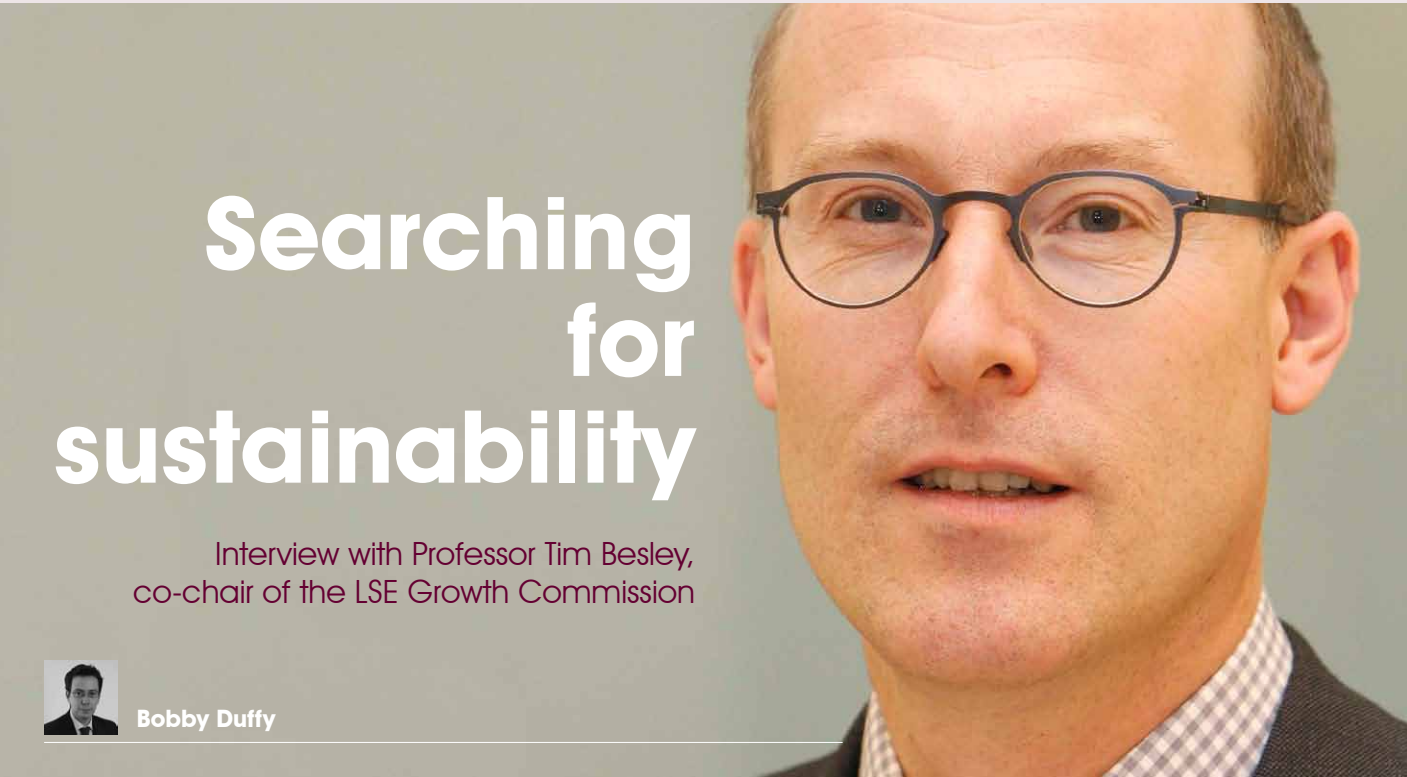
*"The Coalition believed that it was winning the argument on deficit reduction, but fears it is in danger of losing the argument on growth....The reason Labour are so desperate to respond to it is they think this is their one moment where they might be about to win the argument on the economy."*<sup>11</sup>

Nick Robinson is right about this being a key moment, and not just in the UK. Up until as recently as the end of 2011, there

was a definite focus on deficit reduction. Even in countries with relatively high proportions of public debt such as Greece, Ireland, Italy, and France, around eight in ten agreed that measures to reduce the public debt and deficit cannot be delayed (as did 84% of Brits, and rising to 92% of Germans)<sup>12</sup>. Since then, though, elections in France and Greece suggest that the mood may be shifting. Our very latest research for the Munk Debate still shows a majority in France, Germany and Italy favouring cutting government spending to reduce public debt. But this seems more contested now, with calls for growth increasing – as seen, for example, at the debate at the G8 summit, and even in the latest from the IMF which endorses the fiscal credibility of the British government at the same time as recommending policies to boost low growth. Austerity or growth, or austerity and growth, the argument isn't over yet. □

9. <http://www.bankofengland.co.uk/publications/Documents/inflationreport/irspnote160512.pdf>  
10. In a non-General Election year  
11. <http://www.bbc.co.uk/news/uk-politics-18100533>  
12. Standard Eurobarometer 76 <http://www.bankofengland.co.uk/publications/Documents/inflationreport/irspnote160512.pdf>





**BD: Can you tell us about the LSE Growth Commission, its aims and the work it has undertaken so far?**

**TB:** Sure. The aim is to make a lasting contribution to the debate about the long-term future of the UK economy. We're not naïve enough to believe the Commission's work can be entirely divorced from where the economy is now, but the idea is also to look further into the future.

The Commission is made up of academics as well as non-academic members and we are holding evidence sessions, of which we've had three so far and a number coming up in the next few weeks. The Commission has also received written evidence and commissioned experts to provide us with their views on various topics. At the end of that process all the members of the Commission will come together to formulate the main messages and then publish a report in January next year.

**BD: The current debate about the UK economy is being seen as growth versus austerity. Do you agree with that definition?**

**TB:** The Growth Commission hasn't tried to reach a collective view on this yet. In my personal opinion, it is a bit dispiriting to frame the debate this way. Surely everyone accepts that, whatever the government's policies, we must have sustainable public finances, whichever way Britain chooses to go, and that requires some caution in spending. We have to accept that we are going to live in an era where there are going to be limits on the ability of the government to spend as much as ideally everyone would like.

I think one of the core tenets of what the Commission will most likely argue is that the economy needs to have appropriate sustainability. That doesn't just mean fiscal sustainability. It could mean environmental sustainability; it could

mean also political sustainability in the sense that you don't want a programme or a strategy which falls foul of its political constraints.

It's clear that growth is not likely to be generated by household consumption. British consumers are stretched. For many, they took on a lot of debt in the last 10, 15 years, which makes them cautious now. And then there are significant headwinds, particularly from Europe.

It looks to me as if it is a story about investment, both in terms of public policy and supporting strategies by government to stimulate private investment, and also public investment – and to do it in an intelligent way. This means really identifying sensible priorities. That is a big issue for the Growth Commission.

**BD: Are there any main themes from the work the Commission has done so far?**

**TB:** We are still working through the programme, but there are some key themes that will feature.

For example, we have sessions coming up on energy and infrastructure. A lot of the members of the Commission are particularly interested in the possibility of a private sector investment strategy for the low carbon economy. This is going to be a huge area in the future and it spills over into issues about transport and infrastructure.

We've also got a session on whether we are too GDP obsessed. After all, growth is often just thought of as synonymous with GDP, but actually, even if you just widen the remit slightly to growth and material well-being, it's not clear GDP always gives you the best take on what it is that contributes to material wealth.

We are specifically looking at technology and the question of whether the UK is good at basic science and applied science. There are a lot of issues around links between universities and business, and even schools and business. This is a particular area of interest for Sir Richard Lambert<sup>1</sup>, one of my fellow commissioners, who of course wrote a report for government on the subject, and also Lord (John) Browne<sup>2</sup> for whom this subject has been one of his passions.

We also have a session on management. One of my colleagues on the Commission, John van Reenen<sup>3</sup>, has written a lot about this. When you look at the UK from an international perspective, many aspects of the

management practice here are just not as good as what is considered best practice around the globe. The question is, is this an impediment to good levels of performance and what can we do to improve?

**BD: I would like to pick up on one of the themes you mentioned. At Ipsos MORI we have also looked at measures beyond GDP, and this is obviously also a theme for the Government with the focus on well-being. But do you think it will be possible to shift the focus away from just looking at narrowly defined GDP measures as indicators of "progress"?**

**TB:** That is a good question. I'm confident we ought to be able to make some impact. That said, it would be naïve to think that we could shift overnight to a world in which some other indicator is released periodically and people put as much effort into constructing and dissecting its implications as they do for GDP. A lot of

the measures that we might think of to supplant GDP are much more involved to compile, and GDP is hard enough.

So we end up putting a lot of weight into something we can measure relatively easily and in a relatively timely way. Now I know perhaps if you're coming from a polling organisation, you're used to timely production - but there is a real challenge for some of the more involved measures, particularly those that might have a distributional component.

In one of the evidence sessions we discussed measuring average well-

being and whether, in fact, we ought to be looking at median well-being. Now that might sound like a sleight of hand, but actually the difference between what happens to the average person and the median person, over the last 20 years, is quite significant. And you might have thought that what happens to somebody who's halfway in the middle of the distribution - the median - being more relevant. But you have to know about the distribution of well-being to be able to say what happened, whether you take the 90th percentile, or the 10th. The data series that we have are hugely lagging for anything as sophisticated as that on a representative sample, so it is much more difficult to produce anything timely.

So one of the challenges, and maybe this is something a polling organisation ought to take up, is how you make the kinds of statistics on well-being that are meaningful and available in a very timely way.

**BD: You made the point about the importance of distributional issues, and I wondered if you see that linked to your earlier point about political sustainability?**

**TB:** Absolutely. I think in retrospect many of us would say that there was perhaps less attention or less concern paid to the rapid increase in inequality over almost 20 years. There are some questions around morality here. But thinking in a more pragmatic sense, inequality sets in train certain social trends, and this does bring about political tensions. So yes, addressing inequality is very much a part of maintaining political sustainability.

**BD: So just looking at the current debate, are there important issues that you think are being missed in the**

**debate from the more in-depth work that you're doing?**

**TB:** I would like to see more discussion of policy alternatives, in particular in the area of public investment. The debate ought to be about concrete measures to improve the quality of either public investment or to stimulate private investment.

So for example, we have had a chronic problem with housing provision. What really concrete and tangible policies are being taken to stimulate housing investment? I think the answer is not much, with lots of name calling between politicians about why more isn't being done.

By way of example, why haven't we considered the kind of housing finance scheme that means you build housing and then somebody becomes a renter of last resort? So you effectively underpin the possibility of a return on investment, constructing guarantees to stimulate housing investment but so that it doesn't require an increase in public debt.

**BD: Ipsos MORI carries out regular economic optimism indices and we have found them to be very good leading indicators of the downturn and how it has gone since. We did an exercise of comparing economic optimism to economists' forecasts and very simple public confidence measures seemed to be a better predictor of the economic downturn. Why should the public listen to economists when people themselves are coming up with more accurate views of how things are going?**

**TB:** Good question! I'm intrigued by what you say and I would very much like

to see and test your work! When I worked at the Bank of England, I looked at one measure of consumer confidence and I remember that it didn't do a particularly good job in tracking consumption or predicting consumption. The recent economic downturn has been a fairly traumatic event though, so maybe under those circumstances measures of consumer confidence do much better – when things are going badly as opposed to when you have a normal growth path where it is hard to pick anything out.

That said, I think it's a big leap from there to incorporating them in the way we do either forecasting or economic policy evaluation. It may be they do actually have a role to play in forecasting when the economy's going badly but at what point does their reliability run out?

You're absolutely right, however, to say that economic models have been bad at tracking a lot of features in the current downturn. It may be that economic models are better at projecting the two to three year trend but pretty bad at projecting the short term ones.

Economics was never really designed for forecasting. I was forced to be a forecaster at the Bank of England because it was part of the job - but it is not something that most academic economists get involved in as they can see the pitfalls.

But of course that doesn't mean that there's not such a thing as the best forecast, it's just the least wrong forecast. The question is, is it going to be intelligently or unintelligently wrong. Occasionally someone will get it right, but

probably they just got lucky, as opposed to having some magical ingredient. If economics were judged on its ability to forecast, I think it would fail miserably.

But to take an analogy, are economists better or worse than the medical profession in forecasting the prognosis and development of complex diseases? I have no idea. In a sense the issues we deal in at the macroeconomic level are complex diseases with multiple causes and multiple symptoms. You could ask then why am I not embarrassed to be an economist? And the

question is, what would be the alternative to relying on economic analysis? It's analogous to Winston Churchill's view of democracy; it may be imperfect but I've never seen a better alternative.

**BD: Polling has shown that 61% of people in this country think that their earnings will be permanently reduced by the rise of the BRIC countries and other fast-developing countries<sup>4</sup>. Are they right to feel that, and what does that mean for what we can actually control within our own growth programme?**

**TB:** I think they're wrong to think that, to be honest. The rise of the BRIC countries and other emerging markets presents massive opportunities for the UK. You know, as these countries get richer, there'll be more demand for the things we do well. The UK may need to adjust what it produces to recognise those areas where they are more competitive and this may erode some of our traditional strengths. I think we're still at a stage where the opportunities that arise because of the success of the emerging world far, far outstrips any of

the downsides. The UK needs to focus on up-skilling its workforce and training them to produce higher value-added products.

**BD: How is the Growth Commission going to embed its ideas and affect some of the debates that are going on?**

**TB:** We are going to produce our report and hopefully gain some good coverage and, with any luck, we will become part of the news agenda for a time. Then the question is, does anyone ever look at our report again? We are only too aware that the fate of all commissions is to be forgotten to some extent.

But what I'm most interested in is moving forward the public discourse on these issues. If we are bold enough to think we can have a sustained impact on the debate, we've got to continue to promote our key messages and recommendations beyond the day the report is published. So far the signs are good. We've had a lot of interest, across the political spectrum, at the highest levels of government and with senior policy makers.

**BD: There was an interesting article in The Times<sup>5</sup> that you might have seen about the sub-contracting of policy-making to think tanks, academics and others external to the traditional civil service. What are your views on that?**

**TB:** We have some really excellent think tanks and consulting organisations in the UK that can add value to the policy process – we sometimes underestimate how fortunate we are compared with other countries. But I have some concern that this approach will move us to a different mode, because it will be contractually driven.

There is also a question mark over how commissioned policy-making is made public. Can you just stick it in a drawer if you don't like the advice? That would mean you haven't done anything to enhance public debate. Whereas if it comes from an independent source, then whether the commissioner likes it or not, it can be made public. It must be an open source process to improve the quality of the debate.

The Growth Commission was an idea that we took the initiative to make a reality, which means we'd set the agenda. We are not beholden in any way to what any politician or anyone else thinks ought to be the agenda.

**BD: What do you think is going to happen over the next couple of years to the UK economy? Knowing you're not a forecaster...**

**TB:** Obviously a lot depends on whether the Eurozone gets itself sorted. That's what I'll be watching – and any projections right now are contingent on that. There have been a number of attempts to draw a line under this, none of which has been successful yet. And if the Eurozone is

going to survive as a viable entity, there needs to be decisive action and proper structural measures put in place to stabilize it for the long term. For the UK, sorting the Eurozone out matters more than anything I can think of today. So in that sense, I haven't really given you an answer but any honest person at this point in time wouldn't pretend to know. □

1. Sir Richard Lambert is Chancellor, University of Warwick and a former Director General of the Confederation of British Industry. In 2003, Sir Richard published the Lambert Review of Business-University Collaboration. The report made a series of recommendations which encouraged universities to identify distinctive strengths in research, and encouraged business to give a greater priority to understanding the opportunities for exploiting innovation and creativity through universities.
2. Lord Browne is Partner and Managing Director of Riverstone and co-head of Riverstone's Renewable Energy Funds. Prior to joining Riverstone, he spent 41 years at BP serving in turn as Group Treasurer, Managing Director and Group Chief Executive of BP and Amoco.
3. John Van Reenen (also co-chair of the LSE Growth Commission) has been a full Professor of Economics at the London School of Economics, and Director of the Centre for Economic Performance since 2003. He has served as a senior advisor to the UK Prime Minister, Secretary of State for Health, and the European Commission and in 2009 Professor Van Reenen was the winner of the Yrjö Jahnsson Award of the European Economics Association.
4. Base: 25,103 European adults, Eurobarometer Flash survey April 2008. Question: In 20 years' time, people will earn less than today because of competition from rising economies, such as China, India or Brazil?
5. Think-tanks will take over civil service policy role in The Times newspaper, by Jill Sherman, published on 16.05.2012.

Timothy Besley is School Professor of Economics and Political Science at the London School of Economics and Political Science (LSE). He is also a Visiting Professor at the Institute for International Economic Studies at Stockholm University. From September 2006 to August 2009, he served as an external member of the Bank of England Monetary Policy Committee. He is also the Gluskin-Granovsky Fellow in the Institutions, Organizations and Growth Program of the Canadian Institute for Advanced Research (CIFAR). Professor Besley was educated at Aylesbury Grammar School and Oxford University where he became a prize fellow of All Souls College. He taught subsequently at Princeton before being appointed Professor in the economics department at the LSE in 1995.

He is a Fellow of the Econometric Society, the British Academy, and the European Economic Association. He is also a foreign honorary member of the American Economic Association and of the American Academy of Arts and Sciences. In 2010 he served as the President of the European Economic Association. Professor Besley is a past co-editor of the American Economic Review, and a 2005 winner of the Yrjö Jahnsson Award of the European Economics Association which is granted every other year to an economist aged under 45 who has made a significant contribution to economics in Europe. His research, which mostly has a policy focus, is mainly in the areas of Development Economics, Public Economics and Political Economy.





# The housing economy: boom, bust and consumer sentiment



Ben Marshall

Housing is central to health, wellbeing, prosperity and aspirations. There are significant economic, social and political returns to expanding and improving housing stock. Conversely, the housing market can play a destabilising role in

the wider economy and disrupt public policy intentions. Recognition of this, and a growing sense of crisis, has seen housing return as a key issue again with consumer sentiment central to its future prospects.

Back in the 1940s Sir William Beveridge identified squalor as one of the five 'giants of want'. But housing's place in the welfare state he created has been described as a 'wobbly pillar'<sup>1</sup> as successive governments have left unchallenged, or have actively encouraged, private sector provision of housing. Owner-occupation has risen since the war and, while currently on a downward trajectory, it is both the majority tenure and the tenure of aspiration for most<sup>2</sup>. These trends have been accompanied by an improvement in housing conditions, and an Ipsos MORI survey last year found Britons satisfied with their home by a margin of 18 to 1<sup>3</sup>.

But, and it is a big but, the housing market is susceptible to boom and bust. This is a worry because it has a profound effect on the wider economy, not least because of the central role of housing in household finances and futures<sup>4</sup>. For example, according to Prudential, a third of people aged 50+ plan to use their home as their pension (this group has been called "Hippies" – Home is Pension). During most of the 2000s confidence in the housing market strengthened and house prices almost doubled in a decade<sup>5</sup>. As a result, 42% of household wealth is wrapped up in property and household debt secured on property<sup>6</sup> is at historically high levels. When the price of houses falls, the value of debt secured on them does not.

The last housing boom had positive consequences; dynamism in the house market contributed to the wider economy. Clearly, markets need consumers with confidence, and the housing market is no different. To function effectively, it needs adequate supply and demand, developers to build, consumers to

buy and those same consumers to sell. 'Momentum behaviour' plays an important role, impacting on the house market and, thus, the wider economy:

***"If an explanation is to be found for recent dramatic house price rises, it is not to be found in the usual supply and demand fundamentals but rather in the behaviour of consumers and banks."***

**Andrew Farlow  
(University of Oxford), 2004**

***"Housing makes a significant direct contribution to economic output and job creation, and also has a big impact on business and consumer confidence and spending."***

**John Cridland  
(CBI Director-General), 2011**

Keen to measure and understand consumer sentiment, and working for the Halifax, Ipsos MORI has surveyed representative samples of British adults periodically since April last year. The House Market Consumer Confidence Tracker is in its infancy and its analytical and predictive capability will grow with longevity, and when we can start to compare consumer expectations of property prices with actual market trends<sup>7</sup>.

In January this year we found that more Britons expect prices to rise rather than fall over the next year (a small swing in opinion since October), although both owner-occupiers and the wider public only expect modest price movements. This is consistent with the real picture in the market; since the onset of recession in 2008-9 the Halifax House Price Index has shown that house prices haven't settled into a consistent trend but have been resilient (in contrast with the slump in the United States)<sup>8</sup>. Mortgage holders have not been tipped into negative

equity, in contrast to the recession in the early 1990s. Record low interest rates continue to support the market.

Chiming with other surveys, more of the public, and owner-occupiers, sense the next twelve months is a good time to buy than not – 50% of the former take this view against 35% who think it is a bad time to buy. But our survey goes further and asks respondents whether they think the forthcoming year will be a good time to sell. We have found two things. Firstly, five times fewer think it is a good time to sell than buy (10% against 50% in January). Second, sentiment has hardened significantly since our first measure in April 2011. The imbalance in sentiment in buying and selling betrays an imbalance in the market, and one which is crucial given that many active consumers are selling to buy. In fact, only 6% of adults, and 7% of owner-occupiers, think the next 12 months will be a good time to buy and to sell.

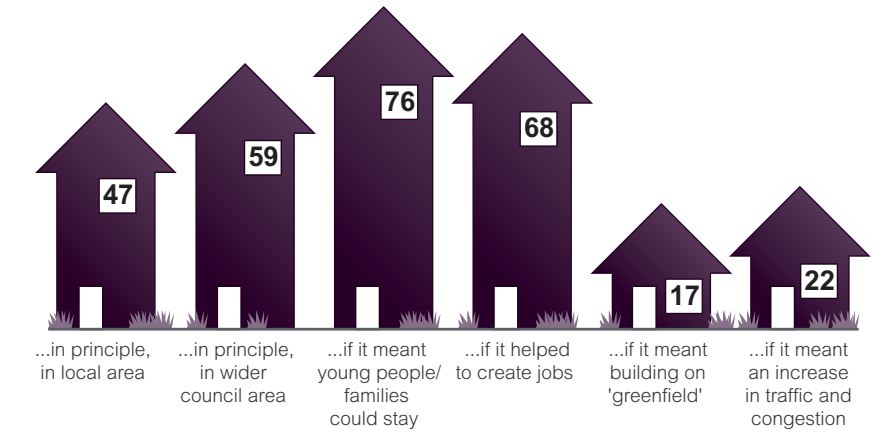
The imbalance in sentiment in buying and selling betrays an imbalance in the market

As is often the case though, headline figures only tell part of the story. For example, price alone isn't driving sentiment about the housing market, which might be because we have not yet seen much consistent movement in prices (there are, of course, many regional and local variations), and/or because wider worries about economic conditions are dominating outlook. Those considering the next 12 months to be a bad time to buy are more likely than those with the opposite view to identify high prices as a barrier but, still, such mentions pale in significance to those



**Public attitudes towards local building**

% strongly/tend to support building new homes...



Source: Ipsos MORI Base: 902 adults 16+, Dec 2011-Feb 2012, In one district in England

related to worries about household finances and the difficulties of raising a deposit.

Those same conditions are squeezing consumers. Mortgage-holders are benefiting from record low interest rates and an Ipsos MORI survey in July 2011 found only 6% of them reporting difficulty paying their mortgage. But an estimated 96% of low-to-middle earners with mortgages stand to lose from a one percent rise in interest rates; 19% losing at least £1,000 a year<sup>9</sup>. Mortgage repayment affordability could become the issue later this year or next if inflationary pressures, or other macro-economic considerations, force a change in Monetary Policy Committee thinking, interest rate policy and lender's rates.

Volatility and faltering confidence create challenges for our "property-owning democracy" and for governments keen to harness aspirations and build social mobility. The genesis of a priced-out 'Generation Rent' has been well documented – 59% of renters believe that they will never be able to afford to buy and

rents have risen – and Shelter's recent briefing, "Held-back households" brought together a range of evidence to show that housing costs are squeezing low/middle

**5.6 million people are unable to move for work because of housing costs**

earners and inhibiting life choices. For example, over a fifth of 18- to 44-year olds without children admit they are delaying starting a family because of a lack of affordable housing and, with implications for the economy, an estimated 5.6 million people are unable to move for work because of housing costs. According to an ESRC study, between 2009 and 2010 only 10% to 14% of people who wished to move actually did<sup>10</sup>.

**What does government do next?**

More pertinently, what can it do next? A sector which is part-free market, part-publicly owned – the wobbly pillar – is hard

to control. In one very high profile way, the government is attempting to exercise control in the private rented sector by reforming housing benefit, capping benefit and pegging subsidies to a lower percentile of the local housing market. Earlier this year the Prime Minister claimed that these reforms were suppressing rent levels, a claim which was hotly disputed<sup>11</sup>.

Much of the crisis talk last year was couched in terms of supply, and this is undeniably important. Some want to see house-building used as economic stimulus, and the Prime Minister used his party conference speech last autumn to hail a "Tory housing revolution". The government's Housing Strategy is an important step forward and the sector has welcomed boosts for house building, keen to see them realised quickly and effectively. This sentiment is shared by the public who sense a housing crisis in Britain and attach top priority to house building<sup>12</sup>.

On the supply-side, the Government's National Planning Policy Framework will see local authorities and communities exercising greater influence, and responsibility, for what happens where. Here, again, consumer sentiment will be crucial and the LGA and HCA are among those urging local authorities to update their local plans and engage with communities on planning and development<sup>13</sup>. But are we all NIMBYs now? Yes and no. We have recently polled in one district authority area in England and, as the chart shows, the findings underline those of previous surveys; opinion in respect of building new homes is conditional<sup>14</sup>. Taking specific projects forward will require careful attention to local sentiment and clarity about the benefits of building plus mitigation of perceived and actual adverse impacts.



Source: Halifax/Ipsos MORI Base: 2,009 British adults (393 private renters) 16+, 6-19 January 2012

Housing is important because it is strongly linked to the wider economy, to society and its aspirations. Right now, the UK housing economy is neither in boom, nor bust territory. Consumer sentiment is circumspect about price movements. It is also strongly negative about the prospects for selling and needs convincing on building homes on the scale Britain needs. Such sentiments are going to be crucial. So too is aspiration, as the Prime Minister himself knows:

***"It's not just about the economy, it's also about people's hopes and dreams...You always remember that moment, if you've done it, when you get that key and walk into your first flat...It's a moment I want everyone in this country to have."***  
**David Cameron, 2011** □

1. Peter Malpass, Housing and the Welfare State (2005).
2. DCLG, Public attitudes to housing in England (2011).
3. Ipsos MORI for Channel 4, 1,006 British adults aged 16+, 11-17 November 2011.
4. See ippr Forever blowing bubbles? Housing's role in the UK economy (2011).
5. Analysis by Halifax (sourced: <http://www.guardian.co.uk/money/blog/2011/jan/31/house-prices-doubled-decade>).
6. DCLG, New Horizons Research Programme. Social Mobility and Homeownership: A Risk Assessment (2007).
7. Our question asks 'Do you think the average property price in the UK will be higher or lower in 12 months time, or will it be the same?'. From April we will be able to compare consumer expectations for the next 12 months with actual market trends.
8. Commenting on Halifax's January House Price Index, Martin Ellis (Housing Economist) said "Notwithstanding monthly fluctuations, the average UK house price is very close to where it was eight months' ago, at around £161,000."
9. Vidhya Alakeson in Homes for Citizens, James Gregory (ed.), Fabian Society, 2011
10. Shelter, Held-back households (2012) and <http://www.esrc.ac.uk/news-and-events/press-releases/20039/a-nation-of-frustrated-home-movers.aspx>.
11. <http://www.insidehousing.co.uk/tenancies/inside-housing-proves-meron-rent-claim-wrong/6520500.article>
12. Three-quarters (76%) agree that "There is a housing crisis in Britain". Source: Ipsos MORI for Channel 4 (as before).
13. LGA and HCA, Meeting local housing demand: a guide for elected members (2011). 'Councils urged to recognise housing need', Inside Housing, 27.3.12.
14. See, for example, Glen Bramley 'Housing: homes, planning and changing policies' in British Social Attitudes 28 (2011).



# The future's bright but reform is needed



**Matthew Oakley**  
Policy Exchange

**Very few forecasters will suggest that the UK is likely to see surging growth and job creation over the next few years. With this in mind, policy makers and commentators across Whitehall seem focussed on whether looser fiscal policy would boost or hinder the UK's growth prospects. Is the Government cutting 'too deep, too fast' or have the cuts been instrumental in keeping borrowing rates down and allowing the Bank of England flexibility to implement a loosening of monetary policy?**

In truth, only time, and many revisions of the GDP statistics, will enable us to tell. In the 1990's recession, initial estimates of GDP suggested that we had experienced a double dip recession. Revisions since then show that, in fact, we did not. In the last 15 years initial GDP estimates have been revised by as much as 0.6 percentage points.

This does not mean measures of GDP are unimportant. It just means that, given the uncertainty surrounding them, we should not be using them to guide policy or measure the success of the Government. Indeed, a constant focus on these statistics, and calls for knee-jerk responses to continued low growth,

have drawn attention from the underlying problems with the UK economy.

The size of some of these underlying structural problems should not be underestimated. The proportion of the working age population on out of work benefits was the same in 2004, at the height of the boom, as it is today. UK productivity lags the G7 average by around 15% and we have a public sector that is both unproductive and remunerated in a way that reflects neither performance nor local labour market conditions.

UK productivity lags  
the G7 average by  
around **15%**

The problems with the UK economy are not restricted to the labour market. The UK has some of the most expensive commercial and residential property in the world and last year's World Economic Forum infrastructure quality index saw the UK being ranked at just 33rd, below France, Germany and Spain. A bias towards the public sector and finance has also seen the UK's manufacturing sector plummet in its share of the economy in recent times.

The impact of these factors on our performance, prosperity and future prospects are huge, and the seriousness of the situation is amplified by the future prospect of ever stronger competition from emerging parts of the world economy.

Within the context, a continued debate around fiscal policy simply marginalises the real issues that need tackling. Ultimately, growth in the UK economy will come from productivity increases, innovation and increased labour supply. Economists have always known this, but at the moment we are focusing too much on short-term politics and not on long-term economic sense.

To give the Coalition credit, amongst the noise we have heard talk of fundamental reform in many areas of the UK economy. The 2011 Autumn Statement and recent Budget talked of reform to planning and welfare; launched a National Infrastructure Plan; made a step towards reform of the system of National Pay Bargaining in the public sector; and talked of tax reform to boost UK business.

But in each of these areas, actions have not quite kept up with the rhetoric. Reform of the planning system has stalled, and failed to tackle the question of the green belt and nimbyism in an adequate fashion. Welfare reform has come up against vocal opposition, and implementation of both the new benefits system, Universal Credit, and the Coalition's £18 billion of cuts are likely to prove difficult. On the side of business, cuts to corporation tax have been welcomed but an anti-business rhetoric still permeates discussion both outside and within Parliament. The tax system is also still too volatile, with constant changes undermining business confidence. Coupled with difficulty in securing finance,

this reduces the desire of business to invest.

It seems that, overall, we have started to slip into the worst habits of the pre-2010 years of making policy by announcement.

**The recent Budget was too much about shifting money around and making relatively small-scale announcements, and too little about tackling the major structural barriers in the economy.**

It is true that significant reforms of the status quo will draw criticism. In welfare, those used to unconditional benefits will stand to lose and their lobby groups will launch vocal complaints. In planning, those looking to constrict growth and not willing to consider the needs of a growing population will cry foul play. And those reliant on an over-inflated public sector will use misguided arguments to suggest that reforms are unfair. This means that the Government must be bolder. Only by implementing large-scale and fundamental reforms will it ensure that productivity is increased, business growth and innovation spurred, and better public services delivered with less money.

These are the areas where Policy Exchange is focusing. In publications before the 2011 Autumn Statement and 2012 Budget we made a number of key recommendations.

On business finance, we argued that the retail market for corporate bonds should be spurred by extending an allocation of the ISA allowance to this fledgling market. We also called for an Enterprise Kick-Off fund to provide start-up loans to young entrepreneurs who would otherwise struggle to obtain finance, in return for a small equity stake in their business. We were encouraged to see a pilot of Enterprise Loans announced in the Budget, but remain convinced that this should be

privately financed with Government acting only to secure last-resort recovery of bad debts through the tax system. Both of these proposals would channel more money into new and growing businesses.

We also think that reform to pay negotiation in the public sector must go further. Based on the remit that the Chancellor issued to the Pay Review Bodies, who are to make proposals for reform, the government will end up suggesting a system of zonal pay bands. This would mean different parts of the country being put into different pay zones, based on the cost of living in quite broad geographic areas. While a positive step forward, this will do little to help local managers increase productivity, boost recruitment where vacancies are high and improve public services. To do this, zonal, regional or local pay must go hand in hand with a drive to introduce performance related pay and allowing local managers the flexibility to vary wages where recruitment proves difficult.

Finally, on taxation, we argued for a wholesale reform of the way in which tax policy is made. To introduce greater transparency, certainty and stability we proposed that the Government set out tax reform plans over a five year period at the start of each Parliament. We also suggested that basic reforms to rates, duties and allowances should be legislated for over a rolling five year period. This would give businesses clarity over the tax landscape for the immediate future and greatly aid their investment decisions.

Matthew Oakley is Head of Economics & Social Policy at Policy Exchange. Prior to joining Policy Exchange he was an Economic Advisor at the Treasury, where he worked on a number of tax and welfare issues for the previous eight years. He was closely involved in analysing the labour market impacts of, and responses, to the recession and in the Green and White Papers on Universal Credit. Before this, his other roles at the Treasury included working on property tax strategy, microeconomic analysis of the labour market and on medium-term tax strategy. He has an MSc in Economics from University College London, where he specialised in labour economics and econometrics.



If we focus on the drivers of productivity and growth, reform can be used to tackle structural problems in the UK economy

However, the tax system would remain complex for the small firms least able to navigate the maze of allowances, reliefs and rules. For this reason, we proposed a separate tax code for start-ups and businesses below a certain size. This would provide a basic flat-tax regime for these businesses and allow them to focus on what they are best at: innovating, creating jobs and driving growth, rather than trying to navigate around the tax system.

These are just three areas of many where we believe that fundamental reform is needed. They show that if we focus on an evidence-based debate around the drivers of productivity and growth, significant reform can be used to tackle structural problems in the UK economy, without spending more money. This is the approach the Coalition must now take if they are to secure the future of growth in the UK. □



# Pressures on the POOREST



Suzanne Hall

With figures showing that the UK is experiencing a double dip recession after the economy shrank by 0.2% in the first three months of 2012<sup>1</sup>, it is little wonder that - as has been shown elsewhere in this issue – the economy is the number one issue for the British. As the Prime Minister put it on his recent visit to Essex with the Deputy Prime Minister, the “unvarnished truth” is that “first quarter growth figures have shown a tough task getting even tougher”<sup>2</sup>.

A significant area of our recent work has considered the impacts of low growth and the tight fiscal spending envelope on those on low incomes, those who are often the

biggest users of public services and most reliant on welfare assistance.

The impact of the economic downturn on this section of the population is recognised as a key concern by all parties. The day before the Budget, Nick Clegg was at pains to tell the House of Commons that the wealthiest should “bear the heaviest burden” and that the government is steadfast in its commitment to protecting the poor.

Mr Clegg told Shadow Deputy Prime Minister, Harriet Harman, “the priority for me, and for the whole coalition government, will be to provide real

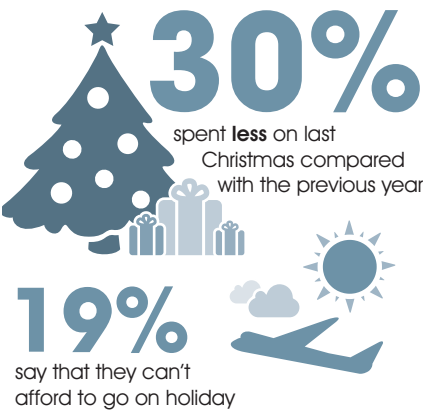
help to people of middle to low level incomes who face higher prices [and] who’ve had to face great difficulties because of the economic enclosure she and her colleagues presided over in government”<sup>3</sup>

In his budget speech, the Chancellor of the Exchequer, George Osborne, also emphasised raising the personal tax free allowance, to take over a million low income people out of tax, the largest proportion of people ever, as a key measure designed to help those on low incomes<sup>4</sup>.

In the weeks after the Budget, however, reactions varied as to the impact on those at the bottom and top of the income scale. The Labour Party called it a millionaire’s budget thanks to the loss of the 50p tax rate, while the Institute of Fiscal Studies has cast some doubt over the Government’s claims that the most well-off will shoulder the lion’s share of the burden. This is a hot political topic (with Labour seen as the party most trusted to be fair to all sections of society), and the argument continues with Exchequer Secretary to the Treasury, David Gauke MP, telling the House of Commons that **‘the percentage of total income tax paid by the top 1% will be more than 27% in 2012-13 and in subsequent years, compared with an average of less than 23% between 1997 and 2010’**<sup>5</sup>.

Nevertheless, our work shows there is considerable uncertainty amongst those on low to middle incomes, and this is

having an impact on how people behave and spend their money in the present. To take just one example, three in ten (30%) spent less on last Christmas compared with the previous year - in fact this was fairly consistent across all income groups - while one in five (19%) maintain that they can’t afford to go on holiday (rising to 28% among low income groups).



While this could be seen as part of a wider trend towards favouring staying at home as opposed to going out – “enterstayment” – driven by a desire to reduce our pace of life and in recognition of environmental concerns<sup>6</sup>, analysis by the respected Institute of Fiscal Studies<sup>7</sup> has found that in the three years running up to the most recent budget, there has been the steepest fall in household spending power in British history. And, when times are tight, the first cutbacks to be made are on those areas of non-essential spending like holidays and treats for the family. This is confirmed by Deloitte’s consumer tracker showing that, in the face of rising prices, consumers are cutting down on entertainment (41%) and holidays (28%)<sup>8</sup>.

That people’s spending power has been reduced isn’t just because of worries about the future. While the latest employment statistics from the ONS show that unemployment has fallen by 35,000<sup>9</sup> – the first fall since May 2011 – people (and mainly men) are moving into part time as opposed to full time work<sup>10</sup>. Of course, this is better than no work at all and there is financial assistance in the form of tax credits for those whose household income falls below a specific threshold.

Our qualitative work has consistently shown us what a difference tax credits can make to families; quite simply, they often prove to be the difference between whether or not work is viable. This is particularly true of claimants with children who, if eligible, are able to recoup some of the costs they spend on formal childcare through the childcare element of Working Tax Credit.

*“It was the fact that HMRC said you’ll get 80% back of your costs; 80%! Now my maths isn’t that good but I thought, you know, I can get back out there to work [and will] actually be able to manage.”<sup>11</sup>*

However, since April of this year, the eligibility criteria for joint claims for Working Tax Credits has changed. Instead of having to work a minimum of 16 hours per week in order to be able to claim, joint claimants now have to find an additional eight hours of employment. For many, this is a real challenge – often because the work just isn’t there; something that has been endorsed by much of our recent

1. <http://www.bbc.co.uk/news/business-17836624>  
2. <http://www.number10.gov.uk/news/prime-minister-and-deputy-prime-minister-economy-speech/>  
3. <http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120320/debtext/120320-0001.htm#12032051000008>  
4. [http://www.hm-treasury.gov.uk/budget2012\\_statement.htm](http://www.hm-treasury.gov.uk/budget2012_statement.htm)  
5. <http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120424/debtext/120424-0001.htm#12042451000029>  
6. See Ipsos MORI Trends and Futures presentation  
7. See [www.ifs.org.uk](http://www.ifs.org.uk)  
8. <http://www.bbc.co.uk/news/business-16223864>  
9. <http://www.guardian.co.uk/business/2012/apr/18/unemployment-fall-hopes-economic-bounce>  
10. <http://www.guardian.co.uk/commentisfree/2012/apr/19/chris-grayling-job-snob-toynbee-left>  
11. Quote taken from Ipsos MORI/DfE/HMRC report (2011), Qualitative research into families’ experiences and behaviours in the Childcare Affordability Pilots (CAP09): 100% costs Pilot. At the time of this research, the Childcare Element covered up to 80% of formal childcare costs for eligible families. However, the 2010 Spending Review reduced this to 70% from April 2011 onwards.



research where people have discussed the difficulties they face in finding work or increasing their hours. Figures have estimated that, because of this change in policy, some 212,000 households – with a total of nearly half a million children between them – could lose £3,870 a year as a result<sup>12</sup>, although the Treasury argues that this ignores other measures being taken, such as increasing working age benefits and the child element of the Child Tax Credit, as well as the increase in the personal tax allowance mentioned above.

Interestingly though, people's concern about the future isn't necessarily translating into them putting some money aside for a rainy day; the Resolution Foundation's audit of low to middle income earners, Squeezed Britain<sup>13</sup>, highlighted how two-thirds of low to middle income earner households have less than £1,500 in savings, leaving them exposed and lacking resilience in the face of financial shocks. The chart below, from our work for them, shows that, while it may not be unexpected to find low to middle income households most worried about



their finances, across a range of measures they are particularly at risk<sup>14</sup>.

Thus, in a time when pressures on incomes and concern about the economic state of the country are high, that people are financially capable, responsible and able to manage their money independently (or at least know where to get help if they can't) is more important than ever before. Yet there are worrying signs that this is far from the case. PWC's recent report 'Precious Plastic' indicated that payday loans could overtake credit cards

and become a mainstream source of lending<sup>15</sup>, with consumers welcoming the flexibility and speed these lenders offer, while not necessarily paying attention to the interest charged. This is something to be concerned about, given the report also shows that there is increasing doubt among certain segments of the population regarding their ability to pay for purchases or make payments on what they owe. For instance, less than half of those aged 18-24 believe they will be able to repay their debts while one in four 25-34 year olds regularly need to rely on their credit card to fund essential purchases.

This matters for a number of reasons, but, most importantly, because low financial capability 'has significant and substantial psychological costs over and above those associated with low income or deprivation'<sup>16</sup>. For instance, recent research shows that, for a woman, the size of the effect is similar in magnitude to getting divorced. Thus, it follows that improving levels of financial capability would have a positive effect on stress-related illnesses and, in turn, carry sustained benefits for individuals and the economy.

It will therefore be interesting to see the impact that the introduction of Universal Credit has on families with regard to how they manage their money. Of course,

income levels are in no way a proxy for financial capability and we know from our work for HMRC and DWP that it is often those on the lowest of incomes who are the keenest of financial managers, as they need to know how every penny is accounted for.

Low financial capability 'has significant and substantial psychological costs over and above those associated with low income or deprivation'

However, the ongoing welfare reforms designed to both simplify the welfare system and increase work incentives will mean great changes to the way claimants receive their money and, consequently, how they budget. In the current system the different benefits - there are more than 50 – have different purposes, are claimed by and paid to different people (for instance to individuals instead of couples) at different times and are withdrawn at different rates. This complexity causes confusion. **It was estimated that in 2009, 2.3 million contacts to the Department for Work and Pensions were driven by people contacting the wrong agency, while estimates show that around £5.2bn is mistakenly paid out each year as a result of fraud and error**<sup>17</sup>. To tackle these problems, and to improve work incentives, Universal Credit will combine all in and out

of work benefits into one single means tested monthly payment. For couples, Universal Credit will be owned and claimed jointly with the award being paid in full to one partner on a monthly basis. When circumstances change, Universal Credit will be withdrawn at the same rate across all the different elements.

**So far so simple. But further analysis of these reforms show that how Universal Credit will be delivered could have real implications for how people budget.** In the first instance, there is the issue of the single monthly payment. There has been much public debate that this will be difficult for some claimants, and our qualitative work sheds light on why this may be so. Receiving different income streams from different benefits offers a natural budgeting tool for many families, a form of mental accounting<sup>18</sup> which tells them roughly how much they should be spending on different things. While one of the aims of Universal Credit is to promote financial responsibility, a real risk is that by collapsing all the payments into one, the most vulnerable could find it harder to budget.

This brings us on to the other issue raised by reforms – that of gender equality. Existing evidence shows that women are the 'shock absorbers'<sup>19</sup> of poverty, who typically go without in order to provide for their family. This point was well illustrated in our work for DfE and HMRC, evaluating the impact of the childcare affordability

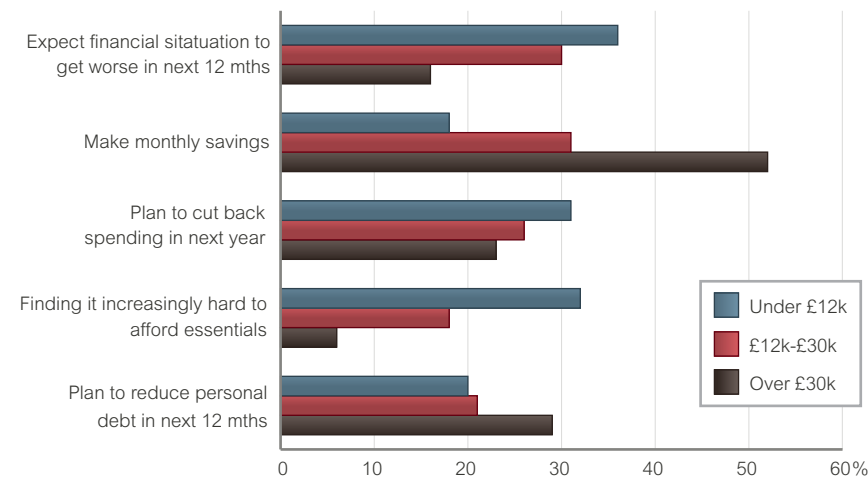
pilots. Selected families were offered 100% of their childcare costs for a limited time, if they took up formal childcare and went into paid employment. This brought social, emotional, and financial benefits to the women from being in work, while they felt their children made educational progress and developed socially. But when the offer ended, in order to keep these benefits, some had to borrow money, and others even cut back on food for themselves just to keep their children in childcare.

Simplification of the welfare system is, of course, welcome and a worthy goal to pursue; for too long, customers have struggled to understand what they are entitled to and how they should claim. Given the welfare system is there to assist those in most need, addressing this is paramount. Furthermore, encouraging financial responsibility and creating a system whereby the payment of benefit closer mimics wages is good preparation for the world of work and will help to address the low levels of financial capability that currently exist.

However, it will be important that support measures and practical tools (such as information on how to budget) are in place in the event of unintended consequences arising as a result of these reforms, to ensure that families, and particularly women, are not left worse off. ☐

### Resilience among low to middle income earners?

Which of the following applies to you?



Source: Ipsos MORI/Resolution Foundation Base: 2,000 British adults, 30 March – 5 April 2012. Figures are those for equivalised household income - see footnotes for details.

12. <http://www.bbc.co.uk/news/uk-politics-16992380>  
13. Resolution Foundation (2010), Squeezed Britain: The 2010 audit of low to middle income earners  
14. Low to middle income households defined as those with household incomes below the UK median - but excluding those with household incomes equivalent to the bottom 10% of working age households - and adjusted for household size. This equates to a gross household income of £12-30k for a couple with no children, £24-42k for a couple with 2 children and £30-48k for a couple with 3 children. Poorest households are defined as those below these income brackets, and higher earners above. Polling figures by household income exclude those who declined to state an income.  
15. See <http://www.guardian.co.uk/money/2012/feb/06/payday-loans-credit-cards> for more details  
16. Financial capability, income and psychological wellbeing, 2011 (ISER)  
17. <http://www.bbc.co.uk/news/business-11735673>  
18. An economic concept established by economist Richard Thaler, which contends that individuals divide their current and future assets into separate, non-transferable portions. The theory purports individuals assign different levels of utility to each asset group, which affects their consumption decisions and other behaviours.  
19. <http://blogs.lse.ac.uk/politicsandpolicy/2011/06/21/universal-credit-inequality/>



# The economy, stupid?



**Dr. Roger Mortimore**

**“It’s the economy, stupid” – right? The maxim that James Carville famously had displayed in Bill Clinton’s campaign war-room during the 1992 US Presidential election was regarded pretty much as a well-established truism then, and it has been little challenged since. “Everybody knows” that economics wins and loses elections.**

But, like many familiar adages, it is perhaps more frequently stated than tested. So, in a paper delivered at a conference in March<sup>1</sup>, we – Sir Robert Worcester, Roger Mortimore and Mark Gill - set out to test it, looking at data since 2007. The global economic turbulence over that period offers us a wide range of economic outcomes, from very positive to very negative. If the basic principle is true, and as simple as everybody seems to think, it ought to produce clear and obvious political effects, and offer exactly the leverage we need to apply statistical tests that will demonstrate it. So we tested a very simple relationship between public perceptions of a country’s economic health<sup>2</sup> and the re-electability of its government.

As a measure of economic perceptions, we used data from the regular Ipsos Global

@dvisor survey, which covers more than 20 countries and asks people “Now thinking about our economic situation, how would you describe the current economic situation in (your country)?”.

We began with election results: 25 governmental (Parliamentary or presidential) elections in 20 countries<sup>3</sup> which we could test against our economic data. We classed each election on a simple yes-or-no basis: either the government/president was re-elected, or it wasn’t<sup>4</sup>.

The outcome of each election and the country’s economic mood at the time are shown on the chart. We can see by simply eyeballing it that there seems to be a relationship between economic perceptions and re-election, but with some startling exceptions. Note in particular Australia and Poland: for both, we have one election where the government was re-elected and one where it was defeated, and in each case the public had a better view of the economy when the voters

ejected a government than when they returned it to office.

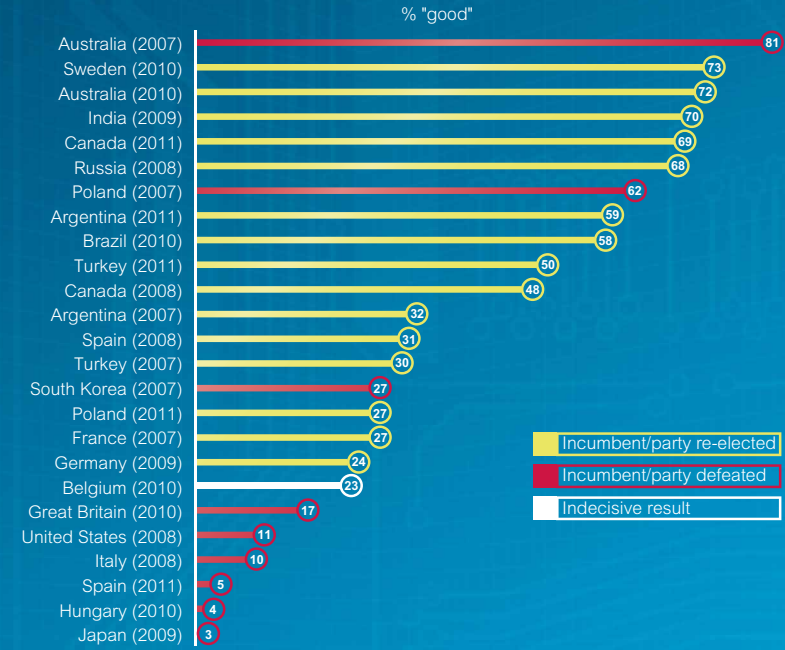
A more formal statistical test of the relationship, using the technique called binary logistic regression, confirms this impression. The relationship between our economic perception measure and the chances of re-election is “statistically significant” (i.e. the evidence is strong enough to suggest it’s probably real). But it’s not very strong. The odds on a government or president being re-elected are about 1.6 times as high for each 10-percentage-point improvement in the economic measure.

Next, we took our analysis a bit further. Is there a relationship between economic perceptions and voting intentions taken in opinion polls between elections? Here we were able to look at ten countries (Australia, Germany, Great Britain, Hungary, India, Mexico, Poland, Russia, Spain and the USA). This covers a considerable variety of political systems and of cultures, several continents, and – just as important – a variety of economic experiences since April 2007.

Pooling the data from all ten countries, we used linear regression to try to find an equation which would predict the proportion intending to vote for the government/president from the economic perceptions measure. Nothing. What about looking at each country separately? Ah! Now we find a statistically-significant

**Now, thinking about our economic situation, how would you describe the current economic situation in ...?**

Figure 1



Source Ipsos Global@dvisor Base: c. 500-1,000 adults aged 16-64 (18-64 in USA/Canada) each survey in each country

**Next, we took our analysis a bit further. Is there a relationship between economic perceptions and voting intentions taken in opinion polls between elections?**

**There's worse to come.**

**Now we're getting somewhere!**

relationship in three countries, but it's not big – a one-point improvement in the economic perception is worth 0.54 points on voting support in Mexico, 0.39 points in India and just 0.13 in Spain. But in the other seven countries, still nothing.

What if there's a better and simpler explanation for those trends in voting intentions? Suppose that, instead of trying to explain them in terms of what the voters thought about the economy, we just predict that all governments got steadily more unpopular between 2007 and 2011, at a constant rate unaffected by the economic mood? We can use the same regression technique to find an equation for us, but this time instead of using the economic perception measure as the predictor we use the number of months

since April 2007. In other words, we assume the voting intentions trend on the graph is basically a straight line. This turns out to be a

better explanation of voting intentions in Mexico... and in India... and in Spain.

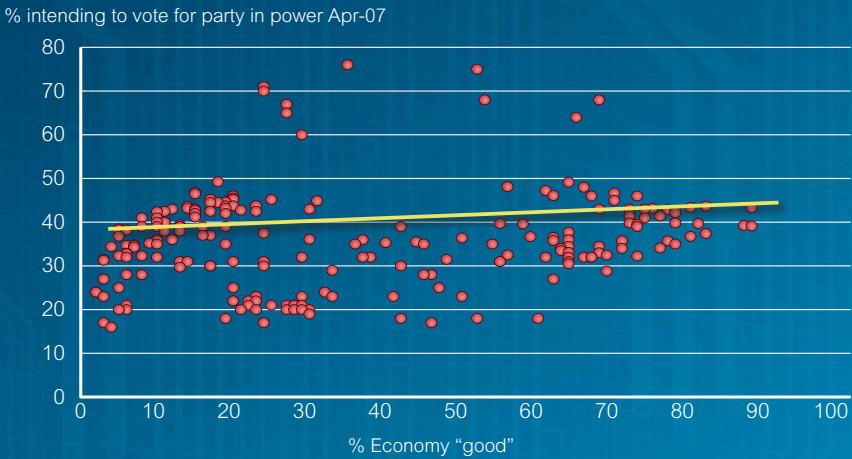
Hang on, though. When one government is voted out, voters wouldn't expect the new government to solve all the problems immediately. Is this the problem with our data? Suppose that when a government loses, we were to carry on looking at that party's support instead of support for the new government, on the basis that the voters will still be blaming them for the mess in which they left the economy.

If we take all of our polls in every country, and plot the voting intentions for the party that had been in power in April 2007 against the economic perceptions each time, we



**Overall, are you satisfied or dissatisfied with the way things are going in our country today? PLUS: Voting Intention**

Figure 2



get the chart shown in Figure 2. And there is – just – a significant relationship, shown by the yellow line: a 13-point improvement in the proportion thinking the economy is in a good state is worth a one-point improvement in voting intentions.

But as can easily be seen from the chart, the yellow line is really not terribly good as a predictor of where the dots are. Statistically, the relationship is detectable but very weak.

So our investigation shows that the link between economics and voting is not as easy to find as we expected after all. If what “everybody knows” is true, the evidence ought to be as plain as a pikestaff.

What have we found? A one-in-thirteen influence on voting support, and a relationship so weak that we have to trust the statistical calculations that tell us it’s there because we can’t see it with the naked eye.

Of course, we have deliberately taken an over-simplistic view of the likely relationship. Probably the link is much more complex: it may be possible to model it, but only by taking many more factors into account and building them into the analysis.

For instance, look again at the graph of election results against economic perceptions, but ignore elections where more than 50% of the public judge the state of the economy to be good:

**If what “everybody knows” is true, the evidence ought to be as plain as a pikestaff.**

**Our analysis backs up the view that we shouldn’t take a simplistic approach to the question of the influence of economic perceptions on voting.**

economic times are good, voters forget to give credit to governments for

delivering economic success and instead decide between the candidates on the basis of the more pressing problems of the day?

For that matter, the relationship between the economy and voting behaviour may well not be just a matter of equating the popularity of the government with economic performance. Perhaps it is the relative economic competence of different parties that is important, or the extent to which people blame parties for external economic shocks, or the different level of influence on different groups of voters. (And what comes first, partisanship or economic perceptions?)

Probably popular wisdom is right that economics can often have an important influence on elections. In Britain, for example, where Ipsos MORI has 35 years of data on economic confidence and voting intentions, we find a slightly stronger long-term relationship whereby voting intention support for the government falls by about

one percentage point for every eight-point rise in economic pessimism (although even this relationship is still relatively weak in statistical terms).

Regardless, our analysis backs up the view that we shouldn’t take a simplistic approach to the question of the influence of economic perceptions on voting. Relying wholly on the mantra “It’s the economy” without taking anything else into account? Now that’s stupid! ☐

# About the Issues Index

The Ipsos MORI Issues Index has been conducted regularly since 1974. For the last thirty-five years and more, it has provided a barometer of the key issues at the top of the public’s mind, and the cycle of changes over time. People are not prompted with the answers, but asked to give their answers to the question, what are the most important issues facing Britain today.

# About the Infographic

At the Ipsos MORI Social Research Institute, we believe that data does not have to be dull. Visual representations help people to better understand data and, ultimately, draw better conclusions. This infographic (overleaf) neatly provides a history of economic worry and the rise and fall in the public consciousness of other top issues. If you would like more information on how we bring our data to life, please contact [chloe.forbes@ipsos.com](mailto:chloe.forbes@ipsos.com).

1. “Economic performance and support for national leaders: a multi-country analysis”, paper delivered at the World Association for Public Opinion Research (WAPOR) European conference in Gdansk, Poland, 15-16 March 2012.

2. Why use a poll-based measure of perceptions rather than objective economic indicators? Mainly because it is perceptions not reality that motivate voters – they can’t vote on what they don’t know. And besides, different aspects of the economy may be most important to people in different countries – taking the public’s judgment of the overall position is the best way of getting a comparable measure in terms of the possible effect on voting behaviour.

3. Four countries of the 24 where we had economic data are excluded. China and Saudi Arabia do not have competitive democratic elections to determine the national government, and we also found no election we could analyse in Mexico (where presidential elections are on a six-year cycle, with the last election in 2006) or South Africa (which was not included in the Global Advisor survey at the time of the last general election, in 2009).

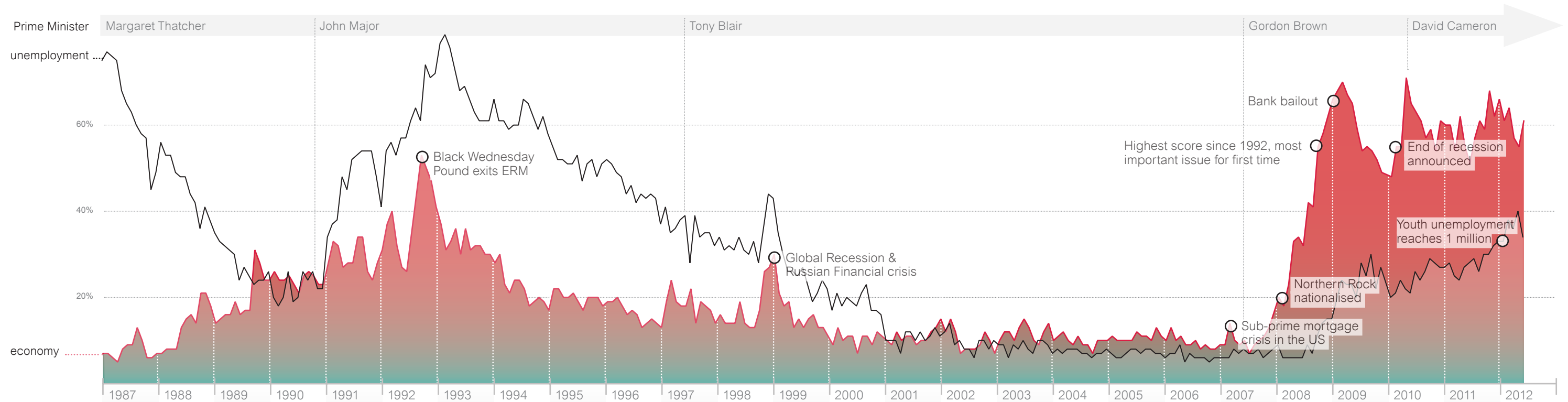
4. Except in Belgium. We gather they have finally decided who won the 2010 election; thanks for letting us know.





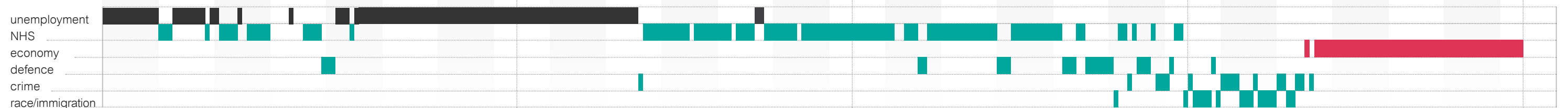
# A history of British Economic worry.

Q: What do you see as the most important issues facing Britain today?



## Top issue timeline.

What else worries the British?



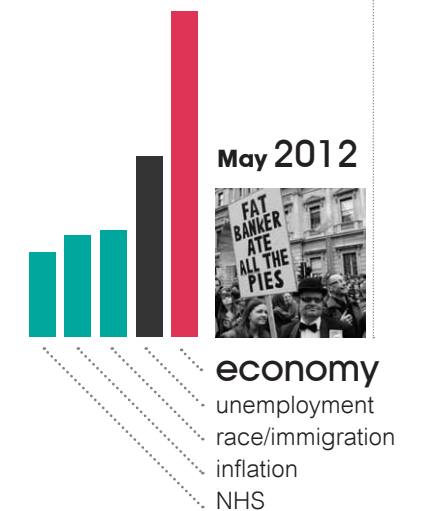
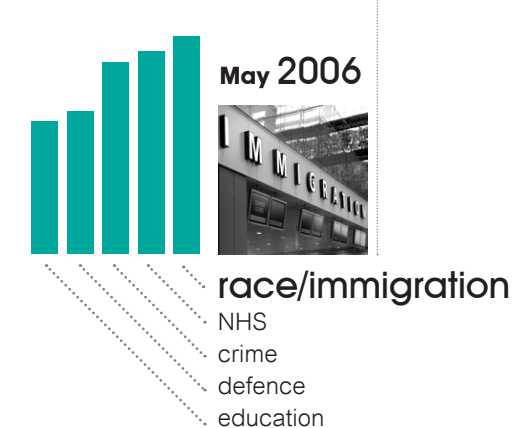
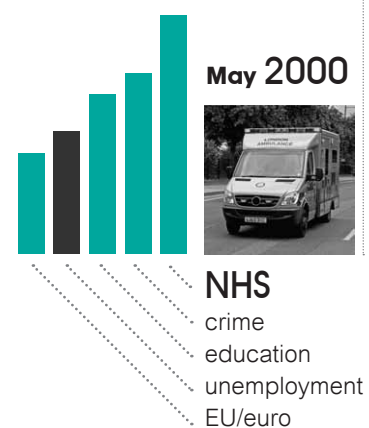
## Top issues over time.

The Ipsos MORI  
Issues Index

Q: What would you say is the most  
important issue facing Britain today?

Q: What do you see as other important  
issues facing Britain today?

BASE: representative sample of c.1,000  
British adults age 18+ each month,  
interviewed face-to-face in home





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