

MONEY AND BUSINESS

Did the Labour government fulfil its pledge to end child poverty in a generation?



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Britain's war on want

29 per cent of poor children live in one-parent families where the parent is not working



Professor Jane Waldfogel examines the Labour government's success in reducing child poverty and proposes strategies for further progress

IN MARCH 1999, Prime Minister Tony Blair made a remarkable pledge – to end child poverty in a generation. Gordon Brown, then Chancellor and later Prime Minister, set a further target of cutting child poverty by half in ten years and committed considerable resources to attaining this goal. What steps did the Labour government take to fulfil this pledge, how successful were they and what further steps are needed to end child poverty?

The anti-poverty initiative of the past decade consisted of three strands: a set of measures to promote work and ‘make work pay’; increased financial support for families; and a series of investments in children. Here, I review the three strands of the reform effort, summarise what we know about its effects and offer some thoughts about next steps if the coalition government is to continue Britain’s war on poverty.

PROMOTING WORK AND MAKING WORK PAY

The first strand included the New Deal for Lone Parents, a primarily voluntary welfare-to-work scheme launched in 1997. It was not until 2008 that some lone parents – those whose youngest child had reached the age of 12 – were required to work or look for work.

This strand also included measures to make work pay, including the national minimum wage introduced in 1999, tax reductions for low-income workers and their employers, and a new tax credit, the working families tax credit, which was later replaced by the more generous working tax credit.

Together, these reforms were successful in promoting work. Lone-parent employment increased by 12 percentage points – from 45 per cent to 57 per cent – between 1997 and 2008, with at least half of this increase attributable to the reforms. In addition, the incomes families could expect from work also increased.

SUPPORT FOR FAMILIES WITH CHILDREN

The second strand of the reforms was a set of measures to raise incomes for families with children, whether or not parents were in work. Child benefit levels were raised substantially starting in 1999, with particularly large increases for families with young children. Income support benefits for families with young children were also raised. The government also introduced a new children’s tax credit for low- and middle-income families with children (later replaced by the integrated child tax credit).

INVESTING IN CHILDREN

Investments in children were the third strand. These were seen as essential to address the ‘intergenerational’ effects of poverty and reduce the risk of poverty being passed on from one generation to the next.

An extensive set of reforms focused on the early years: the period of paid maternity leave was doubled to nine months; two weeks of paid paternity leave were introduced; universal pre-school for three and four-year-olds was introduced; childcare assistance for working families was expanded, and legislation was enacted placing a duty on local authorities to provide adequate childcare; parents with young children were given the right to request part-time or flexible working hours; and the Sure Start programme was rolled out for infants and toddlers in the poorest areas.

For school-age children and adolescents, there was a series of measures to improve education.

Class sizes were reduced in primary schools, and national literacy and numeracy strategies directed teachers to spend at least an hour a day on reading and an hour on maths. Later efforts focused on improvements in secondary schools and measures to persuade more young people to stay on at school (including raising the minimum school-leaving age). Test score

By April 2010, the average family with children was £2,000 a year better off

data showed progress in terms of overall levels of achievement and also narrowing gaps.

Together, these anti-poverty initiatives reflected a very sizeable investment in children, with the additional benefits disproportionately going to the lowest income children. By April 2010, the average family with children was £2,000 a year better off, while families in the bottom fifth of the income distribution were £4,500 a year better off.

THE IMPACT ON CHILD POVERTY

When Tony Blair declared war on poverty in 1999, 3.4 million children – one in four – were in poverty, using both the absolute and relative measures of poverty. But trends after 1999 depend on which measure is used.

Absolute poverty (using the official government measure tied to living standards in 1998/99, uprated only for inflation) fell by more than 50 per cent (1.8 million) by 2008/09, while relative poverty (using the official government measure of the poverty line as 60 per cent of average income) fell by 15 per cent (600,000 children).

The two measures tell a different story because the relative measure is affected by changes in the income of the median family. The fact that absolute poverty plummeted in this period, while relative poverty fell less



sharply, means that the incomes of families at the bottom rose, but not as fast as the incomes of families in the middle.

Statistics on the third official measure – material deprivation – confirm that there were sharp and sustained decreases in material hardship and financial stress over this period for the most vulnerable families.

Analysis of poverty data for Europe and the US confirms that these reductions in child poverty were not inevitable but rather the result of government policy. With overall levels of inequality increasing over the period, it can be argued that relative child poverty rates would have risen had the child poverty initiative not been undertaken. Seen from this perspective, the poverty effects, even on the relative measure, are incredibly impressive. And there is also considerable evidence that the reforms increased family expenditure on items for children and led to improvements in their eventual well-being.

MAKING FURTHER PROGRESS

In thinking about next steps, we must first understand which children are poor and which factors raise the risk of poverty. The demographic data indicates that 55 per cent of poor children live in families in which at least one parent is already working (46 per cent in two-parent families and

nine per cent in one-parent families). A further 29 per cent live in one-parent families where the parent is not working. The remaining 16 per cent live in two-parent families where no parent is working.

There are also some cross-cutting factors, such as parental disability and large family size, which increase the risk of poverty. In addition, child poverty rates are much higher for some ethnic groups, in particular, Pakistani and Bangladeshi families.

These demographics create five challenges that policymakers must address if they are to make further reductions in child poverty. The first is to do more to raise incomes in working families, through measures such as expanding childcare and other in-work support for those on the lowest incomes, raising the value of the minimum wage, improving incentives to work additional hours and expanding measures to improve the skills and qualifications of low-skilled workers.

The second challenge is to move more lone parents into work. Helpful measures here include expanded childcare supports as well as strengthened child support enforcement.

The third challenge is to address poverty in workless two-parent families. Here, I recommend a personal advising model (along the lines outlined by Professor

Paul Gregg of the ESRC Centre for Market and Public Organisation in his December 2008 review, *Realising Potential: A vision for personalised conditionality and support*), alongside policy measures such as expanded childcare supports.

The fourth challenge is to address the elevated risk of poverty in Pakistani and Bangladeshi families. While some of the factors underlying this have been identified (mothers in these families have low employment rates, fathers' earnings are low, family size tends to be large and there are often non-working extended family members), it is not clear what the policy response should be. So here the recommendation would be for more research on the experiences of these families, as well as more local efforts and initiatives.

The fifth challenge is to address underlying trends in income inequality. One important priority must be to continue to work to raise skills at the bottom of the income distribution, to promote more social mobility and to narrow the gap between the bottom and the middle of the income distribution.

Finally, a word about measurement. The experience of the past decade offers some clear lessons. As described above, the government uses three official measures of poverty, and each one has provided useful information. The relative measure tracks trends in inequality, while the absolute measure and material deprivation measure shed light on changing living standards for low-income families.

Although using the three measures increases complexity, it also increases our understanding of poverty and the role that policies play. So using all three measures is a sound decision and one that should be carried forward.

THE LABOUR LEGACY

Tony Blair and Gordon Brown not only achieved a dramatic reduction in child poverty, they also put child poverty on the national agenda. It is notable that even while making deep cuts, the coalition government has emphasised its commitment to protect benefits for the poor. Although it remains to be seen to what extent this commitment will be maintained, it is nevertheless striking that it is being articulated. ■

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Getting finance to support investment

John Van Reenen argues that the risk of another financial crisis has increased

THE FINANCIAL SYSTEM is meant to channel savings towards profitable opportunities for investment, which should in turn lead to higher growth. But in recent years the global financial system has been doing the exact opposite, creating 'toxic assets' that have undermined stability. What is the problem and how can we turn things around?

BIG ISN'T BEAUTIFUL

The basic issue with the financial sector is the 'too big to fail' problem. A single interconnected bank (like Lehman Brothers) can bring the sector crashing down. Finance is the blood that keeps the economic body functioning. The failure of most single industries (think of cars) causes a problem; but the failure of the financial system causes catastrophe.

These contagion effects are why governments had to intervene to recapitalize banks during 2008-09 to shore up capitalism. Bitterly, it meant bailing out many of the debt and equity holders who were responsible for the poor investment decisions in the first place. And because banks knew that when push came to shove they had some bail-out insurance from the state, during the good times they made decisions that were excessively risky, just as car insurance makes people more careless with their vehicles.

These incentives to take on excessive risk and disguise their dangers to get around regulators cascade down the banking hierarchy from the executive suite to the trading floor, where traders live for their annual bonus. Short-term risky ventures are encouraged at the expense of longer-term profitability. Because of this, strengthening corporate governance by itself will not help. Taking excessive risks is in the owners' interests in the face of the government bail-out insurance.

Better regulation would help – for example, through insisting on higher levels of capital and having a regulator overseeing the whole banking system rather than just individual parts. 'Living wills', where a bank states how its assets would be unwound in the event of failure, need to be mandatory as they make clear the counterparties on a bank's positions. This information helps regulators supervise better and reassures investors about the strength of healthy banks to reduce the chances of a drying-up of credit.

Unfortunately, these measures are unlikely to be sufficient to reduce the chances of another banking crisis. The banks will always pay more to attract clever people to find ways around the regulations. A structural solution is necessary to discourage the growth and creation of 'too big to fail' firms.



The collapse of Lehman Brothers on Wall Street in 2008 sent shockwaves around the banking world

One way of doing this would be through a structural separation of the 'utility' (retail) from the 'casino' (investment) activities of banking. But there would also have to be controls on the raising of finance in the short-term wholesale market (which is what brought down Northern Rock). An alternative route would be a sharply progressive tax on these activities (essentially size-related). Some banks would be able to stay large, but they would pay a very high price for this privilege so only the most efficient would choose to remain big.

In my view, the risk of another crisis has increased. Many banks died after the recession so there is now a tighter financial oligopoly. Any doubt about government willingness to intervene has dissipated post-Lehman. The weakness of the public finances is temporary, so it is no surprise that financiers are keen to see sharp cuts in public spending so that governments will once again be able to bail them out.

SMALL ISN'T BEAUTIFUL EITHER

Fixing banking is the top priority for improving investment opportunities. But what about increasing the pressure on banks to lend to small firms and giving them other kinds of investment breaks?

Governments like to do things for small firms – helping a million firms with £1 sounds a lot better than giving one firm £1 million. It also sounds much 'fairer' to help small struggling firms than big behemoths. But this reflects a confusion between helping people with small incomes (a good thing) and helping small firms which can be owned by very rich people (hedge funds, for example).

Governments should decide on their redistribution policies among people not among firms. Capitalism works by allocating more market share to the most productive firms and allowing the less productive firms to shrink and

die. This brutal process of natural selection is the main way that productivity and therefore wages increase. Small and badly managed firms in developing countries are often allowed to hang on indefinitely because a complex system of regulations prevents the more efficient from growing and pushing them out. US markets, by contrast are aggressive at weeding bad firms out.

Policymakers need to specify what is the market failure that prevents firms from obtaining finance. There is a case that new firms with radical innovative ideas are at a disadvantage as it is hard for outside investors to gauge their quality. Support for start-ups through R&D grants, creating a European Union-wide patent, strengthening universities and removing red tape would all help here. But blanket subsidies for small firms (many of which are not even young) are misguided.

LET'S TREAT FIRMS AS EQUALS

Some argue that because large firms lobby effectively and get lollipops from the public purse, there must be offsetting giveaways for small firms. But this reverses policy logic. We need to do everything possible to stop the larger firms corrupting the system, not pander to other special interests and create even more distortions, which distract firms from doing what they are best at – looking after their own business. ■

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Freelance work practices are reducing opportunities for young workers to break into TV production

Harder than ever to get into television production

Budget restrictions and technological advancements are making it even harder to get into this competitive industry

TV PRODUCTION IN BRITAIN has become a fragmented industry with the majority of professionals working on a freelance basis. According to the Advanced Institute of Management (AIM) Research this is having a detrimental effect on young people aspiring to a television career, denying opportunities to learn during early experiences of the workplace.

When the major terrestrial broadcasters dominated the industry, young people developed skills by participating in 'communities of practice.' With work typically undertaken in-house, professionals participated in projects in their entirety.

Novices have limited opportunities to engage with mid-career staff

Novices ran errands and performed simple tasks as a way of joining the community. They watched the experts at work, assisting them and ultimately became experts themselves.

The research by Professor Irena Grugulis, an AIM Service Fellow at Durham University and Dimitrinka Stoyanova, an AIM Associate at St Andrew's University, reveals how the TV production industry has changed and the impact on young people's careers.

Technological developments mean that smaller teams are needed and pressures on budgets further reduce professional involvement. As a result, the community of practice is incomplete.

Novices, who are not allowed to go freelance, tend to be based in small production companies with other novices and owner-managers but no mid-career staff and have limited opportunities to engage with such staff. Experienced professionals are hired only for part of a project and devote their energies to that project. Novices still perform basic tasks and assist in productions, but this often involves clearing up the administrative aspects of the work once the freelancers have gone.

There is nothing new about novices doing routine work but when the labour market is dominated by freelancers, such work leads nowhere. Young people who wish to become camera operators, directors, producers or editors end up typing reports or getting permissions with no opportunity to watch the productions they are assisting being filmed. This leads to much frustration. As one novice said, "I want to work on programmes, I don't want to be the person who clears up other people's mistakes."

This study suggests that while business sectors dominated by freelancers may provide an efficient means of staffing short-term projects, they are less effective at developing or reproducing skills. In TV production, even when novices assume responsibility for their own development and work unpaid for extended periods, there are few opportunities to learn. ■

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Foreign companies have spent almost £300 billion buying British rivals over the last four years

Who owns UK plc – and does it matter?

Analysing the positive and negative consequences of increased foreign ownership of formerly British companies

BRITAIN HAS CONSISTENTLY been one of the most open economies in the world and a preferred location for foreign investors, second only to the US globally. The country has an accumulated stock of foreign direct investment of over \$1.3 trillion, nearly a tenth of the world total. There has also been a rise in both the proportion of listed companies owned by foreign shareholders (now over 43 per cent) and the number of British firms acquired by foreign companies.

It is the second form of foreign ownership – via mergers and acquisitions – that attracts most attention from the public, the media and politicians. Over the past four years, foreign companies have spent almost £300 billion buying British rivals, with ownership of the assets and the capitalisation value of a firm leaving the country and dividends from profits going to shareholders in the new home country.

In recent years, household names like Abbey National, BAA, Corus (once British Steel), Jaguar, Land Rover, MG Rover, P&O and Pilkington have been acquired – plus

beloved football clubs, including Chelsea, Liverpool and Manchester United.

In some cases buy-outs have been funded by other governments, as with Deutsche Bahn's £1.59 billion takeover of Arriva – with all the irony of a privatised British rail service being 'renationalised' by a German company. As sovereign wealth funds and state-owned enterprises extend their reach from China, the Middle East and elsewhere, there will be renewed debate about the role of governments versus markets.

The takeover of Cadbury by the US giant Kraft for £11.7 billion in 2010 had the potential to create a popular backlash against foreign corporate takeovers. A very British brand developed by one of the very few multinational firms still known for its history, its connection with the founding family and community links in the industrial heartland of Britain, acquired by an American colossus apparently best-known for its processed cheese sandwich fillers.

Productivity and profitability tend to increase after buy-outs, but so do plant closures and redundancy

But economic openness is a two-way street and Cadbury's growth over several decades, including the huge merger with Schweppes in 1969, was itself based on international acquisitions. The firm employs over 45,000 people globally, only 9,000 in Britain. It has consistently bought out local rivals abroad to break into growing foreign markets.

In this sense Cadbury illustrates the two sides of corporate ownership at the national level. The \$1.3 trillion stock of inward investment is roughly equal to the volume of overseas assets owned by British companies. And in a list of the largest non-financial multinational firms in the world, ranked by their ownership of foreign assets, Vodafone, BP and Shell are all in the top five, with a combined total of over \$600 billion.

So what does foreign ownership really mean for British business, the British economy and wider society? Professor Simon Collinson of Warwick Business School and Advanced Institute of Management Research Fellow has been surveying the evidence. The findings are mixed but suggest that while specific local communities either benefit or suffer, there are positive overall effects for the nation.

For firms that are acquired, there are several trends. On average, productivity and profitability tend to increase, but so do plant closures and redundancies. So in general terms the stereotype is true. While the restructuring that follows foreign acquisitions typically improves performance and competitiveness, it does not tend to treat employees, dependent contract firms and local communities particularly well.

Individual company experience is tremendously varied, however, depending on the sector, the intentions of the acquirer and the nature of the takeover. Acquisition 'styles' vary significantly – from highly interventionist, 'imperialist' acquisitions where decision-making powers are centralised to a non-interventionist approach where decision-making is devolved to local management. The effects on local employees and communities will reflect the style adopted by the acquirer.

For the wider economy, although foreign takeovers tend to lead to redundancies in the acquired firm, inward investment overall has

Britain benefits nationally from the openness of the economy

a positive effect on employment. This is because it includes greenfield investment and the setting up of new businesses alongside acquisitions.

So while employment in British-owned manufacturing has declined steadily and output has fallen since 1984, employment in foreign-owned manufacturing businesses has remained stable (and output has doubled), resulting in a much higher level of foreign ownership in British manufacturing now than at any time in the past. This effect is even more pronounced in services with greater increases in employment and output in foreign-owned firms than locally owned firms over the past 25 years.

At the local level, foreign buyers are the catalysts of (usually unwelcome) social change. But British-owned firms themselves have a mixed record in terms of community investment and loyalty to employees, in Britain and abroad. Studies show that their management style generally focuses on shareholders rather than ‘stakeholders’, such as employees and local communities.

This is a fairly accurate reflection of Britain’s national culture. Compared with the French or the Japanese, for example, the British (and the Americans) tend to view firms as profit-making enterprises where performance and competitiveness dominate goals related to stakeholders.

So while individual regions experience both the positive and negative consequences of foreign ownership, Britain appears to benefit nationally from the openness of the economy, at least in terms of competitiveness. Professor Collinson concludes: “As a society perhaps we reap what we sow: our culture is characterised by a fairly individualistic, profit-oriented form of capitalism, and this has repercussions at home as well as abroad.” ■

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British household names, such as Liverpool FC, have been acquired by foreign owners



BP has combined its traditional manufacturing business – oil – with a retail service

Manufacturing becomes a service industry

Should British manufacturers reinvent themselves as service providers?

HOW CAN MANUFACTURING based in developed countries compete in today’s global economy? US manufacturers have had to cut the costs of their products by as much as 30 per cent to compete with Chinese producers. Add to this the market opportunities offered by emerging economies and the burgeoning regulatory burden imposed on firms based in the European Union – and it is little surprise that many manufacturing firms are ‘offshoring’ their production to developing countries.

Is this process inevitable? Is it simply a consequence of globalisation and the industrialisation of emerging economies? And if so, should developed economies abandon manufacturing and accept that Margaret Thatcher was right all those years ago when she claimed that Britain could live on services? After all, over 70 per cent of people in employment in this country are now working in the service sector.

The problem with headline grabbing figures like this is that they mask the trends that underlie the data. In fact, as revealed in research by Professor Andy Neely, deputy director of the Advanced Institute of Management Research, the boundaries between manufacturing and service firms are breaking down across the globe – and they have been for at least a decade.

For example, Rolls-Royce’s aerospace business no longer sells aircraft engines. Rather, it offers a TotalCare solution, where customers buy the capability the engines deliver – ‘power by the hour.’ Rolls-Royce retains responsibility for risk and maintenance, generating revenues by making the engine available for use.

Other traditional ‘manufacturing’ firms, such as IBM, have fundamentally reinvented themselves as service businesses, moving

away from the production of hardware to offer ‘business solutions.’ Yet others have integrated service operations with traditional manufacturing. BP and Shell both manufacture oil, yet they also run extensive service retail operations.

The key point is that to survive in developed economies, it is widely assumed that manufacturing firms can rarely remain as pure manufacturing firms. Instead, they have to move beyond manufacturing and offer services delivered through their products. Recent technological developments – especially in data capture and information processing – are enabling manufacturing firms to develop new business models, exploiting the potential of ‘informed products’.

The latest data suggest that manufacturing firms globally are picking up on this trend. For example, just under 60 per cent of US manufacturing firms offer services as well as products. For Britain, the equivalent figure is only 30 per cent.

So does the ‘servitisation’ of manufacturing offer a route to long-term sustainability for manufacturing in developed economies? Sadly not, according to Professor Neely. Rapidly industrialising economies have latched onto this strategy of offering value-added services coupled with their products. A fifth of Chinese manufacturing firms now offer services, up from only one in every 50 in 2006.

The ultimate implications for British manufacturers are clear. They must continue to innovate, seeking to create new and high value-added products and services in the continual race that characterises the modern manufacturing sector. ■

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Realities of recruitment

In a world where graduates are in over-supply, candidates must offer that little bit more

EDUCATION AND TRAINING policy typically tells people that acquiring more and better qualifications is the way to get a job. The general assumption is that the British labour market is meritocratic and that the best-qualified person will normally be selected. Unfortunately, research suggests that this may only be partially true. Other factors can be equally important in deciding who finds employment.

The study by Dr Susan James and Professor Ewart Keep of the ESRC's Centre on Skills, Knowledge and Organisational Performance finds that at the top end of the job market, good qualifications are certainly vital to stand any chance of securing employment. But given ever-higher levels of qualification among new entrants to the labour market, other factors are coming into play as employers raise the bar.

Thus, where a degree once marked a candidate out as being able, in an era of mass higher education and a slack labour market, graduates are in over-supply. It now really matters what class of degree a graduate gets, in what subject and from which university.

For blue chip jobs, a good degree from an elite institution simply buys candidates a ticket in the employment lottery. Without a ticket, winning is impossible, but holding

a ticket does not mean winning. What determines success in getting a job is now extra-curricular activities, work experience, knowledge of the business environment and wider 'employability skills.'

At the lower end of the labour market, large-scale surveys often reveal bleak pictures, with employers seeming to discount the importance of qualifications. This may be slightly misleading. Qualifications are often used to decide which applicants to interview, but they can play a limited role in the recruitment process thereafter.

More broadly, three factors appear to reduce the influence that qualifications have on recruitment decisions for lower end jobs.

First, for many low-end occupations – hotel cleaners and retail assistants, for example – the work is often designed so that the

technical skills and knowledge needed are quite limited. Indeed over-qualification for these jobs seems to be a growing problem.

Second, many of the skills that employers look for – especially in frontline service sector jobs – are to do with appearance, voice, accent, deportment, manners and a range of personality traits. These are not characteristics that qualifications are designed to certify, and employers have to find other ways of sorting out which applicants meet their requirements.

It now matters what class of degree a graduate gets and from which university



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Finally, the processes by which a large proportion of jobs are filled do not conform to the standard personnel management textbook where qualifications and formalised interviews are the norm. More informal selection methods – such as word-of-mouth advertising of vacancies and getting recommendations on potential new recruits from current staff – may risk discrimination, but they can also be highly effective. For example, when recruiting a bricklayer, it makes sense to see how well they build a wall rather than looking at candidates' CVs or giving them a formal interview.

Britain's entrenched inequalities

BRITAIN REMAINS MARKED by deep inequalities in earnings, incomes and wealth. These inequalities were mapped in detail by the National Equality Panel in its 2010 report, *An Anatomy of Economic Inequality*. This set out how economic outcomes differ between groups on the basis of characteristics such as gender, age and ethnicity, as well as the wide inequalities within groups.

The panel, which was chaired by Professor John Hills, director of the Centre for Analysis of Social Exclusion at the London School of Economics, found that inequalities in earnings

and incomes are high in Britain compared both with other industrialised countries and with 30 years ago. Over the last decade, earnings inequality narrowed a little and income inequality stabilised on some measures, but the big increases in inequality of the 1980s were not reversed.

The coalition government is as committed to the goal of 'equality of opportunity' as its predecessor. But the panel's analysis shows that achieving this is very hard when there are such wide differences in the resources to which individuals and families have access.

Many of the differences accumulate across the life cycle: before children enter school; through the school years and entry into the labour market; and on into the wealth and resources people have for retirement.

Economic advantage reinforces itself across the life cycle, and often on to the next generation: it matters more in Britain how your parents are than in many other countries. Mobility between generations seems to be lower in more unequal societies – moving up a ladder is harder if its rungs are further apart, and those who start higher up fight harder to stop their children slipping down.

The Panel set out 16 areas where policy interventions could counter reinforcement



When employing builders which is more important – their CV or their skill?

The realities of recruitment in the British labour market pose a major challenge for policymakers. At the top end of the job market, competition for good jobs is intensifying with qualified candidates outstripping the supply of such work, thereby creating more and more losers. At the lower end, the challenge is to design and deliver vocational qualifications that are really valued by employers. ■

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at each stage of the life cycle. Of central importance are the progressivity of the tax system and levels of social security benefits and tax credits in relation to other incomes.

In the wake of the financial crisis and recession, the government faces the challenge of rebalancing the public finances. How this is done will probably be the most important influence on how inequality in Britain evolves in the future. The key question is whether the costs of recovery are borne by those who gained least in the years before the crisis, or by those who gained most and are in the strongest position to bear them. ■

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University-industry links: the myth of the ivory tower

Many firms and universities are opting for a more strategic approach when it comes to working together

LINKS BETWEEN UNIVERSITIES and industry are important both for extending the frontier of scientific knowledge and for stimulating innovation. Much is made of commercialisation of researchers' intellectual property via licensing or spin-off companies. But there is a range of other important connections between universities and the private sector.

Indeed, according to Dr Markus Perkmann of Imperial College London and Advanced Institute of Management Research Fellow, the income of British universities from contract research and consulting is 20 times their income from intellectual property. This demonstrates the value that industry puts on collaborating with researchers. It also shows that the view of the university as an ivory tower is largely a myth: many academics regularly interact with 'users' in different ways.

Increasingly, firms are attempting to move from small-scale, ad hoc collaboration to a more strategic approach to work with universities. This allows them to access state-of-the-art knowledge and to leverage public research funds. Examples include the Rio Tinto Centre at Imperial, the Systems Engineering Innovation Centre at Loughborough and the Centre for Advanced Photonics and Electronics at Cambridge. Rolls Royce is working with all three universities via their University Technology Centres programme.

Dr Perkmann and his colleagues have looked at what makes such collaboration successful. The first big issue is cultural differences between academia and industry. A survey of academics indicates that they work with industry primarily to advance their research. Only a minority of them – although this is an important group of academic entrepreneurs – work with industry because they are motivated by financial gain.

This finding suggests that collaborative projects should contain both a commercial and academic element to satisfy the incentives of both partners. Firms cannot necessarily expect academics to conduct outsourced research delivered in short time frames. Rather, the value of having academics involved

is often to test new ideas and use research laboratories as 'skunk works' for projects that are not yet mainstream but potentially highly promising.

The second big issue is intellectual property. In general, the more that the cost of a collaborative project is borne by the industrial partners, the more likely it is that they will control any intellectual property arising from it. Academics are usually happy with these arrangements as long as there are opportunities for scholarly publications.

If public funding is provided, the issue is more complicated and universities legitimately seek to claim some ownership. But many firms see the administrative burden and cost of intellectual property protection as a major barrier to university collaboration.

Projects should contain both a commercial and academic element to satisfy both partners

Some companies and universities are experimenting with 'open intellectual property regimes.' For example, the Structural Genomics Consortium, part-funded by pharmaceutical companies

including GlaxoSmithKline, illustrates how industry can benefit from academic work without necessarily owning property rights in all the outputs. Such experiments are currently confined to pre-competitive research, and it remains to be seen how they will develop.

What they suggest is that it is often difficult to put a monetary value on basic research. Hence the costs and inconvenience of patenting have to be traded off with the benefits of research that leads to breakthroughs in both science and innovation. ■

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Firms often involve academics to test new ideas

The future's bright for emerging electric car technologies



Car society: time for a revolution

Concerns for the environment, fuel costs and the global economy are driving real changes in the car industry

THE GLOBAL CAR industry is on the brink of a revolution in technology that will rewrite the rules on how cars are designed, built, sold and used. That is the premise of a book by Dr Peter Wells of the ESRCs Centre for Business Relationships, Accountability, Sustainability and Society (BRASS).

According to Dr Wells, this revolution is based on an approaching 'perfect storm' of environmental concerns, rising fuel costs, tough economic conditions, technological developments and changing consumer expectations. The existing industry, with its giant car factories over-supplying the market with millions of identical models, will be unable to cope with the pace of change.

Despite the vast size of the old style industry, few players make worthwhile profits. In 2008, the US 'big three' car firms were all pushed to the verge of bankruptcy, with General Motors and Chrysler requiring government bailouts.

Despite the vast size of the old style industry, few players make worthwhile profits

The long-term viability of these corporations, and their ability to meet the growing need for more sustainable transport solutions, is increasingly being questioned.

Electric cars have been touted as 'the future' for decades. But in Britain they have struggled to escape from the shadow of the Sinclair C5 debacle in the 1980s. Once an electric car was a way

of moving an expensive and heavy battery slowly and not very far. This is what allowed the internal combustion engine to drive the first electric cars out of the market early in the 20th century.

Now, a century later, the tables are turning. Advances in battery technology are giving electric cars a realistic range of over 100 miles and, in the case of the Tesla supercar, a top speed of 125mph.

In technological terms, the future is arriving, but are there businesses that can produce electric cars and make a profit?

What the industry needs, says Dr Wells, is more imagination from both consumers and producers: "Imagine buying a car like you buy mobile phone services. Or a car that has been through several lifecycles before it reaches you. Imagine never having to own a car at all, but being able to dial one up when you need it. Imagine the silence of cities when all the cars are electric. The benefits of electric cars are there for all to see."

The BRASS researcher believes that the car firms that will be the success stories of the future will be those that capitalise on emerging technologies to develop new types of car and new ways of marketing them.

Although the practical obstacles and risks for these ventures are significant, the potential



rewards for the company that delivers reliable, convenient and cost-effective electric mobility to the mass market are huge.

The potential flexibility of electric vehicle production also holds the promise of a much greater variety in vehicles, which can be matched to people's needs, budgets, lifestyles and location.

The idea that electric cars can reduce the environmental burden is not a new one. The idea that electric car factories could create vehicles that are better suited to customers and generate more money for investors is much more exciting.

Dr Wells concludes: "The answers lie in radical new business models. Businesses have to come up with better ways of giving us the mobility we crave without costing us the earth – literally. A century of tradition is crumbling, and in its place somebody somewhere is going to create the new Google or Facebook of the car industry." ■

The Automotive Industry in an Era of Eco-austerity: Creating an Industry as if the Planet Mattered

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www.e-elgar.com/bookentry_main.lasso?id=13835



Public sector workers are more likely to have a pension than private sector employees

Public sector pensions

Public sector employees' earnings and pension accrual eclipsed private sector workers in the first half of the 2000s

IN RECENT YEARS, public sector employees have benefited from both faster average earnings growth and higher average pension accrual than their private sector counterparts. According to ESRC-supported research at the Institute for Fiscal Studies, in the first half of the 2000s, a measure of remuneration that includes earnings and pension accrual grew 1.1 percentage points a year faster in the public sector than in the private sector.

In the public sector, defined benefit (DB) pensions – those where pension benefits depend on length of service and a measure of salary – are the norm.

But private sector employees are more likely than their public sector counterparts to have defined contribution (DC) pensions – those where pension benefits depend on contributions made to a fund.

After controlling for differences in sex, age and education, the research finds that public sector employees are around 50 percentage points more likely to be a member of a DB pension – and over 30 percentage points more likely to have any kind of pension – than those in the private sector.

Because of differences in the generosity of the schemes available, even among pension members, the average value of an extra year of pension entitlement is also higher in the public sector than in the private sector for both DB and DC pensions.

As a result of both the higher membership and higher value of accrual in the public sector, on average across all employees, the value of an extra year's pension accrual was 16 per cent of earnings more in the public sector than the private sector in 2005.

This difference is higher than the 14 per cent of earnings difference in 2001. The divergence was mainly caused by the continuing shift away from DB pensions

to less generous DC pensions, and therefore a decline in the average value of pension accrual, in the private sector that was not matched in the public sector.

Over the same period, average current earnings grew faster in the public sector than in the private sector – so the faster growth in average pension accrual was not offsetting lower

pay growth. Indeed, average earnings in the public sector grew 0.8 percentage points a year faster than in the private sector.

The research estimates that had the 2007 reforms to public sector schemes affecting new entrants been implemented between 2001 and 2005 and applied to all public sector employees, then on average this would have fully offset the faster growth in pay. A further reduction in the generosity of these schemes is likely following Lord Hutton's review. ■

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The average value of an extra year of pension entitlement is higher in the public sector

Ringfenced:
business
tax will drop
despite public
sector cuts

Alamy

Why cut business taxes?

Tax on corporate profits is being reduced from 28 per cent to 24 per cent. Is this a good idea?

DESPITE PLANNING THE harshest cuts to public spending in living memory, the coalition government has announced a reduction in the tax rate on corporate profit from 28 per cent to 24 per cent. The tax cut will be phased in over several years and by the end of this Parliament will cost nearly £3 billion a year.

Why has the government not resisted the urge to show such support to business? Indeed, why did it not aim to generate much-needed tax revenue by instead raising the tax rate on profit? ESRC-funded research led by Professor Michael Devereux, director of the Oxford University Centre for Business Taxation, has been exploring these questions.

He first puts the reduction in context. In 1995, Britain's tax rate on corporate profit was 33 per cent, which was then the tenth lowest rate of the 27 countries that now form the European Union. By 2009, despite having already lowered the rate to 28 per cent, Britain's ranking had slipped to 20th.

This happened because Britain was overtaken in a race to reduce taxes on profit. Multinational companies locate their activities in the most favourable environment, which depends on many factors, including wages, regulation – and taxes. By lowering taxes, countries make themselves more attractive to inward investment. Evidence suggests both that location decisions depend on taxes, and that countries compete for such investment.

This sounds like bad news. To attract or keep investment in Britain, the government is being forced gradually to reduce the taxes that it could otherwise levy on businesses located here. Other governments are doing the same. Overall, businesses are profiting from lower taxes at the expense of everyone else, which does not seem fair.

Professor Devereux says that there is some truth in this view, but we need to be more careful in thinking about taxes on business. Most people would agree that businesses should pay their 'fair share' of tax. But what does that really mean?

A business is, in the end, just a collection of people: shareholders, creditors, directors, employees, customers and suppliers. Any tax on the profit earned by a business must ultimately be borne by these people. Judging whether a tax on 'business' is fair requires looking through the legal entity that is the business to ask which individuals are worse off as a result of the tax.

It may seem that the answer is the shareholders: after all, they receive the profit, and if profit is reduced by taxation, then they must receive a lower amount. This would be true if the profit level were fixed, but it is not.

Economic theory has a counter-intuitive explanation of the effects of tax on profit.

According to this view, the required after-tax rate of return that a business must earn is fixed on the world market. This is because investors – such as fund managers who look after people's savings and pensions – can invest in a huge number of assets.

A fund manager will require, say, a ten per cent return from investing in company X if she can earn at least ten per cent by investing in other assets of comparable risk. But suppose that company X faces a 50 per cent tax rate. Will the fund manager be prepared to accept a return of only five per cent after tax? Not if the other opportunities to earn ten per cent are still available. She will continue investing in shares in X only if the after-tax rate of return stays at ten per cent – which means that the before-tax rate of return has to be 20 per cent.

Company X may be able to achieve a pre-tax rate of return of 20 per cent, but only by cancelling projects that it expects to earn between ten per cent and 20 per cent – or by shifting them to other countries with lower tax rates. This means it will invest less and probably employ fewer people at home.

But then who bears the tax burden? Not the shareholders – they still get their ten per cent. The company might be able to raise its prices to pass the tax onto its consumers. But the opportunity to do so could be limited by competition from foreign companies that do not pay the 50 per cent tax. So it is more likely that the company would have to reduce costs, particularly wage costs.

Of course, the real world is more complicated than economic theory. But there is evidence that a significant share of taxes on corporate profits is ultimately passed on in lower wages, rather than reducing shareholders' returns. Unfortunately, neither theory nor evidence reveals the extent to which the effects on wages are borne by the higher paid or the lower paid.

Where does that leave things? Reducing taxes on profit is almost certainly beneficial for investment in Britain – and that is

beneficial for employment and growth. The potential cost is that it may make the tax system less fair. This would be the case if the taxes were borne by the better off. But although there is evidence that a significant part of the cost is borne by the labour force, ultimately it is not clear whether that represents a fair

distribution of the tax burden.

Professor Devereux concludes that in this case, it is probably not a good idea to rely on taxes on corporate profit to ensure a fair tax system. This would be better achieved by taxing individuals directly, based on their income, wealth or spending. ■

Reducing taxes on profit is almost certainly beneficial for investment in Britain

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Gift Aid it: getting more money to charities

Withdrawing the rebate for higher rate taxpayers would raise charitable income

IS THE CURRENT Gift Aid scheme the most effective way for the government to support donations to charities? Not according to research by Professor Kimberly Scharf of the University of Warwick and Professor Sarah Smith of the ESRC Centre for Market and Public Organisation. Their study suggests that total charitable income would increase if more of the tax relief on donations was channelled directly to the charities rather than given as a rebate to higher rate taxpayers.

Gift Aid is the main way for charities – and donors – to get tax relief on donations. Charities can claim basic rate tax on taxpayers' donations – so £1 given out of net-of-tax income becomes a 'grossed-up' donation of £1.25.

In addition, higher rate donors can reclaim a tax rebate equal to the difference between their marginal rate and the basic rate on the grossed-up donation; so someone



Gift Aid it: tax relief on donations raised £4 billion for charities last year

with a marginal rate of 40 per cent can reclaim 25 pence for every £1 given out of net-of-tax income.

The current system combines a 'match' incentive, the government augments donations made to charity with tax relief at the basic rate, with a US-style rebate incentive for higher rate taxpayers. Last year, charities received more than £4 billion in

Three quarters of donors would not change their donations in the absence of a rebate

gross donations through Gift Aid, at a cost of more than £1 billion in tax relief.

The research suggests that total funding to the sector – donations plus tax relief – would increase if more of the tax relief went to the charities as a match rather than to higher rate taxpayers. The reasons are fairly straightforward. First, only a third of higher rate donors reclaim the rebate, although, not surprisingly, donors of bigger amounts are more likely to reclaim.

Second, donations are not very sensitive to the rebate. In general, withdrawing the rebate would be likely to trigger reduced donations among higher rate taxpayers who currently reclaim. Some donors are likely to react strongly, in which case the individual charities that they support may lose out. But nearly three out of four donors indicate that their donations would be unchanged.

Overall, higher rate reclaimers would not reduce their donations to compensate for withdrawal of the rebate, while charities would benefit from the increase in tax relief. Any reform has potential risks and associated costs. But on this evidence, reform could mean more money for charities with no additional cost. When public finances are tight, that may be a very attractive option. ■

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Bigger charities becoming more dominant

Different sized charities are growing at different rates

BIGGER CHARITIES HAVE grown more than smaller charities since the mid-1990s, but it is not necessarily the very biggest charities that have enjoyed the highest income growth. These are the findings of research by Peter Backus of the ESRC Research Centre for Charitable Giving and Philanthropy, and Dr David Clifford of the ESRC-funded Third Sector Research Centre.

There are around 170,000 active charities registered with the Charity Commission in England and Wales. Around half of these are small, with an annual income of less than £10,000. There are a few hundred very big charities with an annual income of more than £10 million.

The researchers examine trends in the shares of total charitable income accounted for by the top one per cent and top ten per cent of charities. The results suggest that there has been little change: income was very highly

concentrated in both the top percentile and the top decile in 1995, and it remains so today.

But trends in income shares only tell part of the story, since both the number of charities and their total income have increased significantly. So the researchers go on to examine the growth rates of the set of charities that have existed since the mid-1990s, relating income growth to initial charity size.

Initially bigger charities have grown more than initially smaller ones. Organisations with an income of at least £500,000 in 1998 had a higher median (average) growth rate over the following decade than those that were initially smaller. This is true both for the whole set of charities and for charities classified as social service organisations.

These findings are consistent with the idea of a 'professionalisation' of the charitable sector, but not necessarily a 'Tesco-isation', where the

initially very largest charities would have the highest growth rates of all. For the whole set of charities, the initially biggest did grow fastest. But for social service organisations, the initially 'big' charities in general but not the initially 'biggest' in particular had the highest growth rates.

These results are relevant to government plans for the 'Big Society', which rest in part on the ability of smaller, community-based charities – as well as the bigger voluntary bodies – to thrive and grow. Some people are concerned that the biggest charities are becoming more dominant, marginalising innovative methods adopted by smaller charities, which they argue are often better able to respond to local needs. ■

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Hostile takeovers

Simon Deakin asks if we need a new regulatory regime

THE TAKEOVER OF Cadbury by the US food manufacturer Kraft in 2010 raised questions about the way hostile takeover bids operate in Britain. Why are British companies so vulnerable to takeover – and what if anything can be done about it?

The basic principle of takeover regulation in Britain is one of shareholder sovereignty: shareholders, not the board, decide the outcome. Under the City Code on Takeovers and Mergers, the board has a duty to give advice to the shareholders on the financial merits of the bid. But it is not the board's job to 'defend the company'.

Under the City Code, the bidder must inform employees of the target company of its intentions with regard to the running of the company. But these loose statements of intent are not legally binding. Kraft was no more obliged to keep Cadbury's factories running after the bid than Cadbury was before – and Cadbury had proposed to shut the factory that Kraft went on to close, contradicting statements Kraft had made during the bid.

British labour law imposes few constraints on redundancies, which is one reason why acquiring companies know they can proceed fairly quickly to an asset sale (and consequent job losses) after a takeover goes through, something they often do to pay down their debts. The position is different in many other European Union countries, where job security legislation and 'co-determination' laws (which give employees rights in corporate decision-making) pose real restrictions on downsizing.

The role of hedge funds and other 'arbitrageurs' that bought Cadbury shares in the course of the bid by Kraft was pivotal in tipping the scales in favour of the bidder. The hedge funds were taking a risk that the bid would go through, which other investors were less able or willing to take. If the bid had failed, the hedge funds would have suffered large losses. They would argue that the risk justified their high returns.

The former chairman of Cadbury initiated a debate following the sale to Kraft by arguing that shareholders who buy into a target company after a bid is announced should have no part in the subsequent decision on whether to accept the bid. Such a reform would deter speculation and would probably dampen bid activity. It could also help to encourage a longer-term perspective on the relative merits and demerits of mergers.

Defenders of the status quo would see such a reform as severely qualifying shareholders' property rights. There are very



Kraft closed Cadbury's Keynsham factory despite assurances they would keep it open

few precedents for this in recent British law or practice, but the position is different elsewhere. In the US, for example, most listed companies have 'poison pills' written into their corporate by-laws (the equivalent of the articles of association of a British company).

Poison pills generally allow the board to dilute the holding of a hostile bidder, for example, by issuing shares to a friendly third party. This makes bids more expensive and can act as a meaningful deterrent. Delaware law requires the board to waive the poison pill once the sale of the company becomes inevitable, which will be the case if a rival bidder appears. Otherwise, the board can take the interests of workers and other 'stakeholders' into account when deciding to recommend against acceptance of a bid.

Had Cadbury been a US company, it probably would have had a poison pill in place, and the board could lawfully have triggered it in the case of the Kraft offer as no rival bid materialised. Had Cadbury been based in continental Europe, co-determination and worker protection laws would have limited Kraft's options post-bid. In the absence of both co-determination and poison pills, British companies are uniquely vulnerable to takeover bids.

It is hard to see this changing in the near future. The Takeover Panel, which is responsible for the City Code, is there to protect the interests of shareholders, and they did very well in the Kraft-Cadbury takeover. There is no political appetite for the introduction of continental European style labour laws into

Britain. If company law were changed to allow companies to adopt poison pills, few would do so in the face of likely opposition from institutional investors.

Another reform that has been mooted is granting ministers the power to intervene in takeover bids to preserve jobs and management skills in companies of strategic importance to Britain. But ministers seem to be reluctant to take powers that could be seen as implying micro-management of companies.

An alternative route would be to strengthen the law on directors' duties. Section 172 of the Companies Act 2006 requires boards to act in such a way as to promote the success of the company when taking strategic decisions. This provision should enable boards to 'just say no' to bids that they consider opportunistic.

As things stand, the law is vaguely drafted and cannot be effectively enforced. There is a strong case for amending the Act to make it clear that the board's duty under section 172 prevails over the Takeover Code. It should also be more straightforward for shareholders and others, including employees, to take remedial action against a board that fails in this duty. ■

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