



Human Development Report 2005

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A decorative graphic on the left side of the cover. It consists of a central circular hub with a black dot in the middle. The numbers '2005' are arranged around the hub: '2' and '5' are on the left, '0' is at the bottom, and '1' and '5' are on the right. Several thick, colored lines radiate from the hub: a black line pointing up-left, a yellow line pointing up-right, a light green line pointing right, and a dark green line pointing down-right. There are also two large, stylized arrows: a light green one pointing right and a dark green one pointing down-right.

The Links between Income Distribution and Poverty Reduction in Britain

Goodman, Alissa and Andrew Shephard. 2005.

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Child poverty and redistribution in Great Britain

Alissa Goodman and Andrew Shephard, Institute for Fiscal Studies, London

1. Background

The 1980s was a period of rapidly increasing income inequality in Britain, accompanied by growing numbers of individuals falling into relative income poverty. While child poverty rates - in at least the two previous decades - had been very similar to those of the rest of the population, it was over this same period that a pronounced gap began to emerge: overall poverty rates were rising but child poverty rates were increasing by an even greater amount.

Throughout the early 1990s when the growth in inequality halted, the relative position of families in the income distribution did improve, although by the time Labour came to power in 1997, child poverty still remained significantly higher than for many other population groups, and than that experienced throughout the 1960s and 1970s.

No doubt aware of this, in March 1999 the Prime Minister announced the Government's commitment to eradicate child poverty within a generation. The first target that the Government set itself was to reduce relative child poverty by a quarter of its 1998 level by 2004. Following this original announcement, there have been substantial increases in financial support for families with children, which together with increases in employment amongst parents, has led to large falls in relative child poverty rates at a time of growing economic prosperity.

While the government now appears broadly on track to meet its first child poverty target, considerable progress needs to be made if we are to work towards the recently defined 2010 target of halving child poverty, and then on towards the ultimate goal of "eradicating" child poverty in 2020. Although the government has not explicitly stated what needs to be achieved for child poverty to be considered to be eradicated, it is likely to involve considerable further reductions in relative income poverty amongst families with children. Such reductions are no doubt a challenge for even the most redistributive of governments.

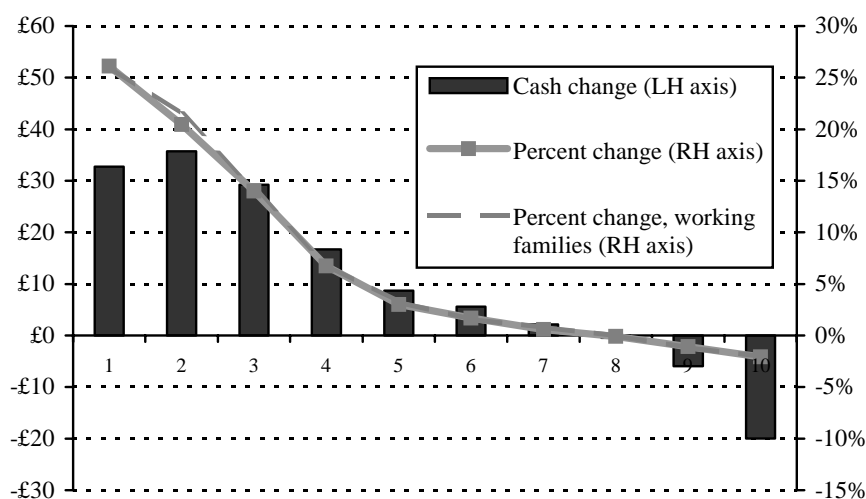
2. The policy context

The current Labour Government has substantially increased the amount of state financial support for families with children. A large proportion of these additional resources have been channelled through in-work benefits and tax credits, which boost the incomes of low-earning working families with children and improve incentives to work. Additionally, the Government's desire to reduce child poverty has led it to increase out-of-work income by almost the same amount as it has increased the incomes of those who are working, and this has reduced the incentive for some parents to work.

While it is very difficult to say exactly what effects these changes to the tax and benefit system have had upon child poverty, Figure 1 attempts an intermediate step by estimating the impact of changes in personal taxes and benefits between April 1997 and

April 2004 on the incomes of families with children. The figure has split the 7 million families with children in Britain into ten equal-sized decile groups according to their equivalised income, with the first decile group containing the poorest 10 per cent of families, and tenth decile group containing the richest 10% of families. It shows the average proportional gain in income in each decile group separately for all families, and then just families with at least one worker.

Figure 1. Average gains in incomes of families with children from personal tax and benefit reforms, 1997 – 2004



Source: Brewer and Shephard (2004), “Has Labour Made Work Pay?”

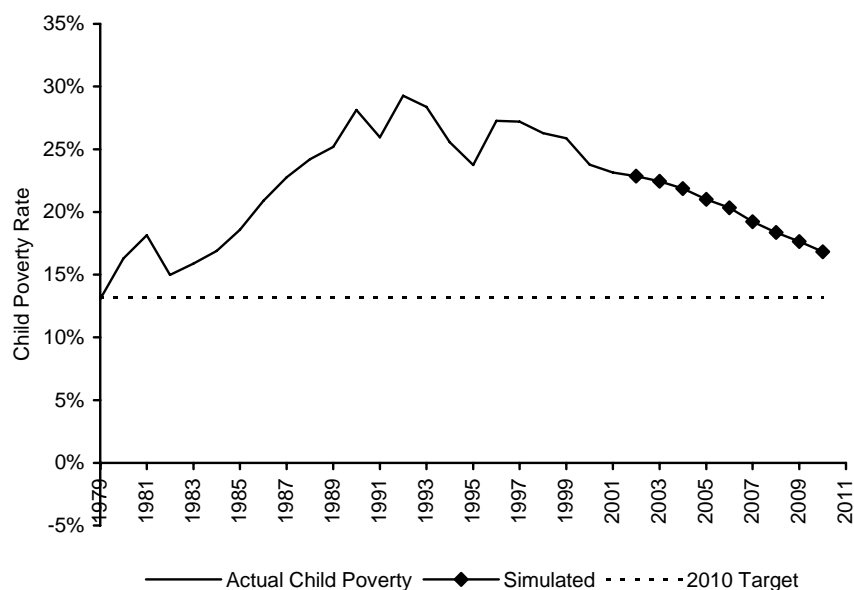
Given the Governments reliance upon means tested support, it is unsurprising to see that the figure shows that the tax and benefit reforms of the present government have been extremely redistributive within families with children, with the average proportional gain being inversely related to family income. The gains for the poorest families have been substantial, with the incomes of the poorest fifth of families with children rising by over twenty percent as a result of the reforms.

The proportional changes in income across the distribution can be divided among working, and workless families. In doing so, we find that proportional gains amongst low-income families with someone in work are very similar to the gains amongst low-income families with no-one in work (we conclude this because the two lines showing proportional gains are almost coincident). As was discussed above, this has largely come about because Labour’s desire to reduce child poverty substantially required it to increase benefits for families with children who do not work, and it did so by almost as much as it did for low-income working families.

3. The future

As discussed in Section 1, the relatively large reductions in relative child poverty achieved in recent years will prove to be just the start of a much more significant downward trend in child poverty if the targets for halving child poverty by 2010, and eradicating it by 2020 are to be met. Figure 2 illustrates the scale of the future task, by simulating the path that relative child poverty would take if we suppose a complete reversal in the strongly pro-rich pattern of annual income growth seen over the period 1979-1990 (while Thatcher was prime minister) in each of the 8 years from 2002/03 to 2010/11. Such a sustained pattern of strongly pro-poor income growth would result in a steady decline in relative child poverty, but further improvement in the position of low-income families with children would be required to meet the Government's 2010 target. Meeting the target will need to be brought about either through redistribution (taxes and benefits), changes in working and employment patterns amongst parents, or as suggested by this simulation, more fundamental changes to the underlying distribution of earnings and income.

Figure 2. Simulated child poverty, with reversal of historical 1979-1990 growth patterns



Notes: A child is defined as living in poverty if their household income is below 60% of the contemporaneous median income. Income is calculated using net household equivalised income, before housing costs have been deducted. Incomes are equivalised using the Modified OECD equivalence scale. This definition is that used for the Government's official target for child poverty (defined by relative low-income) for 2010/11. An additional target will also be set defined by material deprivation and relative low-income.

The "Simulated" child poverty line shows the path of relative child poverty when the incomes of each centile group in the 2002/03 population are simulated to grow at an imposed rate for each year between 2002-03 to 2010-11. The growth rate imposed is that of the average annual income growth between 1979-1990 of the centile group at the *opposite end of the income scale* to the centile group in question. The Simulated path hence illustrates how child poverty would change if the pattern of pro-rich growth taking place under Thatcher were *reversed*. For example, the real average annual income growth of the 10th and 90th centile groups between 1979-1990 were 0.4% and 3.7% respectively. In our simulation, the 10th percentile is given real income growth of 3.7% per year over the next 8 years, whilst the 90th percentile sees just 0.4% real growth per year over the same time. All demographic and other features of the population are held

constant. Sources: Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

4. Why does this matter?

The British government's choice to target low incomes has been motivated by a large literature, both from Britain and around the world, showing the links between low income and/or social class to many other aspects of childhood deprivation, including enforced lack of commonly perceived necessities, poor health (including mortality, morbidity, accidents, teenage pregnancy), poor educational attainment (including cognitive score trajectories, school exclusions, length of schooling, qualifications obtained). Such findings are bolstered by further evidence on intergenerational income mobility, which highlights that such deprivation tends to persist across generations. Although these well-established associations do not imply causality, the aim of policy is clearly to reduce the negative effects associated with growing up in poverty, as well as to alleviate low income itself.