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ERADICATING CHILD POVERTY IN BRITAIN: WELFARE REFORM AND CHILDREN SINCE 1997

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THE INSTITUTE FOR FISCAL STUDIES
WP01/08

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3 May 2001

This paper was drafted for a conference on UK welfare reform and presented in Seattle, November 2001. We are grateful to Mark Wardell of HM Treasury for help with a number of figures. Mike Brewer acknowledges support from the ESRC Centre for the Microeconomic Analysis of Fiscal Policy at IFS. Material from the LFS and FRS, made available by the ONS through the ESRC data archive, has been used by permission of the controller of The Stationary Office. Neither the ONS or the ESRC Data Archive bear any responsibility for the analysis or interpretation of the data reported here. We are grateful to Mark Wardell of HM Treasury for help with a number of figures, and comments from Michael Wiseman, Robert Walker and Tom Clark for comments on earlier drafts. This paper was drafted before Budget 2001, and so does not discuss the measures announced then.

An updated version of this paper can be found in "The Welfare We Want? The British Challenge for American Reform", edited by Robert Walker and Michael Wiseman, Bristol: The Policy Press, May 2003.

Executive Summary

Over the past 20 years the incidence of relative poverty among Britain's children has tripled. These changes are related to increased earnings inequality, growth in the number of single (lone) parent households, and an increased share of households with children with no working adult. The Labour Government has responded by adopting as a policy objective ending child poverty by 2020. Initial steps toward this end include increasing direct financial support to families with children, creating financial incentives for work for parents, adopting more intensive case management for the welfare caseload, and ameliorating the long-term consequences of the deprivation poverty brings. The Working Families' Tax Credit (WFTC) is the centerpiece of the financial support innovations but there is a broader swathe of welfare reforms which has received less attention. Overall, the U.K. system provides more generous support to the lowest-income families than is available in the U.S., and recent reforms have directly reduced child poverty. For most households, the reforms have reduced marginal benefit deduction rates and increased incentives to work. Preliminary evidence suggests the changes have had greatest effect on single parents. Continued progress requires the adoption of a more specific procedure for defining and measuring child poverty.

Eradicating Child Poverty in Britain: Welfare Reform and Children since 1997

Mike Brewer and Paul Gregg

‘‘Our historic aim will be for ours to be the first generation to end child poverty.’’
(Tony Blair, Beveridge Lecture, 1999)

Perhaps the most ambitious commitment made by the current U.K. Labour Government is its stated intention to eliminate child poverty within a generation—defined as 20 years. In this paper we review the concerns that led to adoption of this goal, and we summarize the welfare reform strategy developed to achieve it. We explore in more detail the elements of the strategy that directly increase families' incomes and compare various components with their equivalent in the U.S. We present micro-simulation evidence on the likely first-round effects of the financial changes and the limited statistical evidence on program effects that are currently available. We then look at the future developments that the Government has announced or has proposed but not yet implemented. The paper is concluded with a short discussion of what we see as the strengths and weaknesses of the Labour program.

BACKGROUND

Labour's child poverty initiative is motivated by the general rise in inequality in the U.K. over the last twenty years and in particular the deterioration in the circumstances of Britain's children relative to other groups. The Prime Minister's pledge to end child poverty has not been formally translated into a specific numeric target, as there is no official standard poverty definition in the U.K. However, the government currently produces a range of indicators covering relative incomes, absolute incomes, deprivation, and worklessness, all of which are related to child poverty (Dept. of Social Security, 2000b). The most commonly used U.K. standard, and the preferred indicator of poverty in the European Union, identifies as poor those households with incomes (adjusted for household size) less than 60 percent of the national median income. Income is adjusted ("equivalised") for household composition[1] and is calculated before and after subtracting housing costs. Special attention is accorded housing costs because of problems posed by regional variation and comparing expenses for homeowners and renters. Using the after-housing-costs benchmark, 4.2 million (33 percent) of Britain's children were living in relative poverty in 1998. This was up from 1.7 million (14 percent) in 1979. In 1998, this benchmark corresponded to annual disposable incomes after deducting housing costs of £8,717 and £10,289 for a couple with (respectively) one and two children. In 1999, the official U.S. poverty standards for the same families were $13,423 and $16,895.

The Changing Economy

The situation facing children is in part the product of a number of changes in the British social economy over the past two decades that have affected the ability of working-age adults to secure incomes above poverty levels. Four are particularly important: a growth in workless households, an increase in earnings inequality, a reduction in earnings mobility, and an increase in the wage reduction that accompanies unemployment spells. While evidence on these trends has accumulated since Labour policy was originally formulated, the changes were already apparent when the main policies were being formulated both before and after the 1997 general election. The importance attached to this information is apparent in a number of HM Treasury publications, in particular HM Treasury (1997), which analyzed developments in the labor market, and HM Treasury (1999a), which focused on poverty dynamics and life-chances.

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[1] The McClements scale is used to for household size. The scale uses a couple with no children as a reference household, and adjusts incomes of households with different compositions. There is no agreement on what the right equivalence scale should be. As is the case for the U.S. poverty line, the main advantage of the McClements scale is consistency: the U.K. Government and academics have used it for over 20 years (these issues are explored further in Banks and Johnson, 1993).

Workless Households. Britain has one of the highest employment rates among developed nations, with 75 percent of working age adults in work (broadly comparable to the U.S.). This aggregate employment rate has changed very little since 1979. Nevertheless, the share of households with at least one working age adult but no person employed has grown sharply. Between 1979 and 1999 the incidence of worklessness among this group of households more than doubled, increasing from 8 to 17 percent (Gregg and Wadsworth, 1996 and 2000b). Over the same period, the number of households where all adults are in work has increased. Gregg and Wadsworth (2000b) show that about a quarter of this change is due to a shift in household structure toward more single adult households. The rest is due to a polarization of work among households of a given size, producing both more workless and more fully employed households.

Earnings inequality. While income in the United Kingdom is more equally distributed than in the U.S., earnings inequality has been growing. Among developed nations over the period 1979 to 1995, the U.K. was second only to the U.S. in the absolute increase in the ratio of the 90th earning percentile to the 10th (OECD, 1996). Male wage inequality continued to grow in the U.K. after 1990, but at a slightly slower rate than in the 1980s. Since 1996 wage inequality has changed little (Tables A28 - A33, Office of National Statistics, 2000; for more detail and interpretation, see Machin, 1999 or Gosling, Machin and Meghir, 2000).

Earnings mobility. Among those employed in consecutive years, the extent of mobility up and down the earnings distribution fell sharply between 1978 and 1994. For example, 29 percent of men in the second lowest earnings decile in 1979 were still there a year later. By 1988, this measure of the persistence of earnings had risen to 37 percent (Dickens, 1999, p. 218).

Cost of Job Loss. Men flowing onto unemployment-related benefits return to work on lower wages than in their previous jobs. They also remain on lower wages for a sustained period after returning to work. Nickell et al (1999) define the "permanent cost of job loss" as the gap between pre-unemployment wages and the wage between 2 and 3 years after the unemployment spell. They estimate that between 1982-86 and 1992-97 that this permanent cost of job loss rose from 11 percent to 20 percent for prime age men. Gregg and Wadsworth (2000a) uses the series of short panels contained in the Labour Force Survey to look at the relative wages of people returning to work after a spell of out of work (unemployment or inactivity). Real wages in these "entry jobs" grew by 20 per cent less than those for other workers with similar observable characteristics between 1980 and 1997. This gap was partially explained by rising returns to job tenure and increased concentration of the entry jobs in low pay industries. What is more, job loss is not evenly distributed across the labor force: rather, it falls disproportionately on the lower paid. The lowest paid tenth of men are twice as likely to be not earning a year later than those in the middle of the earnings distribution (Dickens, 1999). So low-paid workers are more at risk from job loss, and over the last twenty years the wage penalty accompanying job loss has increased

Taken together, the rise in earnings inequality, declining wage mobility, the close link between job loss and low earnings, and a growing polarization of work across households suggest that lifetime earnings inequality may have risen even faster than the inequality evident in conventional cross-sectional measures. In addition, reforms to taxation and welfare benefits over this twenty-year period made the system less progressive (Johnson and Webb, 1993). As a result, the secondary redistribution of income through the tax and benefit system has diminished. These developments contributed to the general increase in inequality and poverty, but the growth in poverty among children has been especially marked.

Poverty and Worklessness in Households with Children

Over the last twenty years, children have replaced pensioners as the poorest group in U.K. society. While average incomes of the elderly rose in real terms, even among the poorest fifth, the poorest fifth of children in 1996 were in households with incomes no different in absolute terms than those reported for the corresponding group in 1979. Figure INCDIST shows how incomes for households containing children in the U.K. have fallen relative to others, such that a large spike has formed in the income distribution below the relative poverty line.[2]

[Figure INCDIST about here]

In the late 1990s, this relative poverty during childhood was almost evenly split between in-work poverty—where there is an earner in the household—and workless poverty– where there is no working adult present. In 1996, nearly 1 in 5 children lived in households where no adult worked, up from 7 percent in 1979 and 4 percent in 1968 (Gregg, Harkness, and Machin, 1999). Ninety per cent of these children were in the poor households that make up the bulk of the observed spike in Figure INCDIST. The U.K. is way out of line with other developed nations with respect to the numbers of children living in workless households: Twenty percent of children in the U.K. lived in workless households in 1996; in the country with the next worst record, Ireland, it was 15 percent, and in all other European countries it was 11 percent or less (OECD, 1998, p.12). In the U.S., working poverty is more common, and even before the current emphasis on getting people off welfare, only 1 in 10 children lived in a household where no adult worked (OECD, 1998 and Dickens and Ellwood, 2000).

Around a quarter of children living with two parents were in poverty in 1996, up from 1 in 10 in 1979, and they made up just under 60 percent of children in relative poverty (Gregg, Harkness and Machin, 1999). Over the same period, there has been a marked shift in the proportion of children living with a lone parent from around 10 percent to 22 percent. Poverty rates for these children has also risen: from one in three to two in three over the last twenty years. This sharp rise in poverty rates was driven both by a decline in employment among lone parents and an increasing propensity not to live with other relatives. In 1979, under 40 percent of lone parents lived in a workless household. This rose to peak at over 60 percent in the early 1990s, but has fallen back somewhat since. Considered together, the rise in the number of lone

[2] Kernel density techniques take a moving window of a certain width rather than the discrete windows used in a histogram (£10 was used here). This gives a smoother profile than a histogram, and can sometimes help make

parent households, the growth in the number of workless couples, and an increase in the likelihood of lone parents to be workless all contributed to the growing number of children in workless households.

Comparative studies suggest that the U.S. has greater levels of poverty on a within-country relative income measure, but on an absolute measure —like the U.S. official poverty line — the U.K. has greater poverty amongst children because living standards are lower. For example, on a common relative poverty definition (50 percent of mean income before taxes and housing costs, adjusted for family size as in the U.K.) Dickens and Ellwood (2000) estimate that the U.S. whole-population poverty rate rose from 25 percent in 1979 to 32 percent in 1999, while in the U.K., it rose from 11 percent to 26. But Bradbury and Jantti (1999) estimate that 29 per cent of U.K. children were living on incomes below the U.S. poverty line in 1995, compared to an estimated 19 per cent of U.S. children. When compared to poverty for other groups and to child poverty in other European countries (Jenkins et al, 2000), the poverty of British children appears to be more persistent—those poor today are more likely to be poor tomorrow than is true elsewhere.

The Impact of Deprivation

The use of a poverty measure based on relative income presents both advantages and problems. Among the problems, perhaps the most serious is that rising living standards and rising poverty rates can occur simultaneously. To ameliorate this problem, the U.K. and European literature on poverty also regularly looks at direct measures of deprivation that accompany low income (an example is Gordon et al, 2000). Indeed, the Irish government has recently adopted an official poverty measure that incorporates both relative low income and measured deprivation (see Nolan and Whelan, 1996, for the theory, and Callan et al, 1999, for the practice). There has been a growing acceptance among U.K. policy makers of the proposition that childhood deprivation has longer-term consequences, and this was probably crucial in the assembling the political will to address childhood poverty. That children growing

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patterns clearer. Cowell et al. (1996) give greater detail and the picture for the U.K. population as a whole.

up in deprived households and communities do less well in terms of life chances has long been documented, but such cross-sectional correlations may reflect a range of possible causal linkages. More recently, a literature has emerged that suggests that financial deprivation has an identifiable impact on educational attainment, wages, employment rates and other social outcomes in adulthood even after controlling for child ability and aspects of family background.

The U.K. literature relies mainly on the birth cohorts of the National Child Development Survey of 1958 and the British Cohort Study of 1970 (Gregg and Machin, 2000a, 2000b; Hobcraft, 1999; Hills, 1999, contains a useful summary). These surveys follow children from birth through to adulthood, giving a wider range of individual child and family characteristics than is common in other available evidence. However, these studies do not control for any residual unobserved family or child heterogeneity, so the estimated impact of financial deprivation may still be biased upwards. It is also not possible to tell conclusively whether the effects of deprivation identified by the studies—some of which relate to childhoods in the 1960s—are associated with relative or absolute deprivation. Perhaps as influential was the U.S. evidence that child-based interventions can make a difference to child outcomes for a range of deprived children. Evidence that the Head Start program (see Currie and Thomas, 1995) or the Abercedarian Project (see Ramey and Ramey, 1998) made substantive differences to child development suggests that, whatever the causal origin, educational disadvantage among deprived children is malleable by policy intervention.

This all has meant that the primary social agenda for the U.K. government has become tackling childhood deprivation. The Government is interpreting poverty not just as a manifestation of financial inequality, but as a factor creating material deprivation and inhibiting child development and educational attainment. Thus, the anti-poverty agenda is part of a wider Opportunity Agenda (see HM Treasury, 1999a) which aims to reduce the incidence and severity of states or shocks that have long-term adverse repercussions for individuals (this is commonly called “scarring” in the U.K.). This is why poverty here—although no specific target has been defined in the Government’s commitment to eliminate it—is not a simple relative income measure but a clear sense that childhood, for some, is an unfulfilling and damaging experience due to of a lack of financial resources in a household. The Government is, therefore, ultimately hoping to reduce income inequalities, but is also looking to reduce educational inequalities and a range of other damaging influences that affect children as they mature into adults.

THE STRATEGY

The policy response to child poverty and its consequences has three main components: (1) an increase in direct financial support; (2) a reduction of worklessness in households with children; and (3) the amelioration of long-term consequences.

1. Raise direct financial support for families with children, targeted on—but not exclusive to—low-income families

The most immediate and obvious response to observed low incomes in many families with children is to increase the net transfers available through the tax and benefit system. Up to and including the March 2000 Budget, an extra £7.2 billion (around £1000 per family with children in the U.K.) a year has been earmarked as increased financial support for families. Around a third of this increased expenditure for children has had the sole goal of reducing the relatively low incomes experienced by the poorest children. However, in much of this agenda there are multiple goals for most policies, and so resources have not exclusively been focused on the poorest.

These extra resources have been delivered through both expanded tax credits and cash transfers. The tax credits include the Working Families' Tax Credit, the Childcare Tax Credit, and the Children's Tax Credit. Increased transfer payments have come in Income Support benefit rates for children (these are mainly paid to workless families) and in the universal Child Benefit. The details of this package are discussed extensively in the next section. This child-specific support has been buttressed by increased general support for low earners. A National Minimum Wage (NMW)—Britain's first—was established in 1999. Reforms to the National Insurance scheme (roughly equivalent to the Old Age, Survivors, and Disability Insurance programs in the U.S.) lowered costs for low-wage workers and their employers. The starting rate of income tax was lowered from 20 to 10 percent which increases further take-home earnings in low-skilled entry-level jobs. The fact that the NMW was set with a much lower rate for youths

(£3 per hour instead of £3.60p for adults aged 22+) means that it is more effectively targeted on adults, where the relationship between low earnings and low household income is stronger (Stewart, 1999).

2. Reduce the number of children living in workless households

The second part of the strategy is to reduce the numbers of workless families with children. Or—in terms of Figure INCDIST—to reduce the size of the spike that occurs someway below the standard poverty line. This part of the strategy contains elements designed to improve the financial returns to employment, a reform of welfare administration to develop case management of the welfare dependent population, and improvements in childcare opportunities.

The reform of tax and benefits described above was not neutral in its impact on the financial attractiveness of employment. The package was deliberately slanted toward increasing the net gains from employment, or, in the jargon, to "making work pay." The reforms to the structure of the WFTC generally increased support for full-time or better-paid part-time work. For lower-paid, part-time lone parents, the improved incentives come mainly through the increased support for childcare costs in the Childcare Tax Credit. More details are given in the next section.

The New Deal employment strategy involves the development of a case management approach for welfare recipients. This was already partially developed for those claiming unemployment-related benefits in the U.K., but has been extended substantially under the New Deal framework. Nearly all welfare participants are now to be contacted by a Personal Adviser to establish if they want to work or participate in a program to improve job-readiness. The New Deal for Lone Parents and the New Deal for Partners of the Unemployed are particularly relevant for families with children; these groups had previously been ignored in strategies to encourage employment. The accompanying symposium papers by Jane Millar and Bruce Stafford discuss the New Deals in greater detail.

The National Childcare Strategy aims to create childcare opportunities for all those wishing to use them. Such opportunities are most often missing in low-income and low-employment areas. Out-of-work parents, and especially out-of-work loan parents, identify the absence of available and affordable childcare as a major barrier to increasing employment (Finlayson and Marsh, 1998; Shaw et al, 1996). The Childcare Tax Credit should help with the affordability of childcare, but the availability of reasonable quality childcare is very patchy in the U.K. So far the strategy consists of: a guaranteed half day place in a pre-school for 4 year olds (run by state schools who provide full-time schooling for 5 to 7 year olds), Early Excellence Centres and Neighbourhood Childcare Centres providing subsidized childcare in some of the poorest communities and encouragement for schools or Local Authorities to run After School Clubs and holiday play schemes.

3. Reduce incidence and severity of scarring factors from childhood and early adulthood

The third major arm of the strategy is to try to reduce the impact of deprivation on educational attainment, and to limit the carry-over of social problems to adulthood. There is a diverse range of initiatives targeted at key life-stages or events, generally originating from the Social Exclusion Unit (1998) attached to the Prime Minister's Cabinet Office. These cover teen pregnancy, children leaving social care, and homelessness among the young. In addition, a failure to connect to stable employment during the teenage years has been identified as causally leading to higher unemployment and lower wages in adulthood (Gregg, 2000, and Arulampalam, 2000). The New Deal for Young People aims to eliminate long-term youth unemployment, and to improve matching with sustained employment among youth. Bruce Stafford provides more details in his symposium article. Here we focus those directed at low educational attainment.

On international assessments of comparable reading and math abilities among adults, the U.K.—along with the U.S.—has a high variation in standards and a large number of adults with low levels of literacy and numeracy (Layard, McIntosh and Vignoles, 2000). Schools with high levels of child poverty among their pupils underachieve on school-leaving exams and generally have fewer pupils staying in education after the minimum leaving age of 16. To what extent this underachievement is due to the teaching or the attendant problems the children bring with them remains controversial. Income itself can only be partially responsible for this low achievement, and, therefore, while improving incomes may help reduce this deficit, it also makes sense to address it directly. Sure Start, school attainment in poor areas and Educational Maintenance Allowances (EMAs) make up an attempt to tackle this deficit from birth through to the end of the teenage years.

Sure Start. Sure Start is perhaps the most important of these initiatives so far. In origin it is loosely motivated by the U.S. Head Start program (Currie and Thomas, 1995), but there are large differences in the details. It is targeted on children aged 0 to 4 living in the most disadvantaged communities in the country. It aims to promote physical, social, and emotional development of children, and hence to make them more ready to learn by the time they enter into school. So far Sure Start programs operate in some 200 poor communities, but there are well-developed plans for expansion. These do not always overlap with the childcare centers mentioned above, but overlap and co-ordination of these quality childcare programs is increasing as they expand and they are increasingly acting as a coordinated intervention.

Low educational qualifications on leaving school. Successive governments have developed an extensive series of tests to assess child development through the education system. These are undertaken at ages 7, 11 and 14. Final examinations on leaving secondary school (the General Certificate of Secondary Education, always referred to as GCSEs) are undertaken at 16. These tests are increasingly used to assess the value-added by a school, and to highlight under-performance. Schools have regular inspections by Government-appointed inspection teams, and failing schools may be closed or have their senior teaching staff replaced. Local Authorities are also assessed for the support structures they supply, and, again, failing areas may lose local control and be replaced by private-sector management consortia. So pupils, schools and Local Authorities are all placed under a near continuous assessment regime. One of the key aims of this is to raise standards of achievement among the poorly performing tail of U.K. pupils and schools. This is being supported by extra financial resources directed at children with greater learning needs rather than explicitly focused on poverty.

Educational Maintenance Allowance. The exit from full-time compulsory education at age 16 produces a sharp discontinuity in education patterns between the third who cease full-time education and the two thirds who normally go on until at least age 18. Those dropping out are disproportionately those with fewer qualifications and those from less well-off families. Educational Maintenance Allowances—means-tested cash payments to children who continue in full-time education—are being piloted in a number of more disadvantaged districts. They are designed to raise participation, retention and achievement in post-compulsory education. Four different variants are being piloted with the maximum weekly payment ranging from £30 to £40 per week subject to full attendance, plus retention bonuses each term (semester) and a final achievement bonus.

The pilots are currently in the second of four years, and the evaluation of their results will focus on data collected on two cohorts of 16 year-olds in the years after they leave compulsory education compared with areas that are not operating the Educational Maintenance Allowances. So far, the evaluation has focused on whether the Educational Maintenance Allowances has affected participation, but it will go on to assess the impact on attendance and course completion as data emerges. Ashcroft et al (2001) report that the Educational Maintenance Allowances increased participation amongst young people eligible for the full allowance—approximately one third of young people, with gross family incomes under £13,000—by around 7 percentage points. The increases in participation were lower for better-off young people eligible for less than the full amount, and the average effect over all young people eligible for some payment was an increase in participation of around 5 percentage points. More surprisingly perhaps, there appears to be no significant difference between paying the allowance to the young person or the mother.

The U.K. strategy towards child poverty contains a large number of elements aimed at addressing financial poverty, employment and the adverse consequences of childhood deprivation. The next section provides much greater detail about the financial-based reforms encompassing direct poverty alleviation and incentives to work.

FINANCIAL TRANSFERS TO FAMILIES WITH CHILDREN

The Working Families' Tax Credit (WFTC) has received the most press and analytical attention since 1998, but seeing it in isolation from the other reforms and increases in generosity of support for families with children is misleading. These changes combine to form a systematic overhaul of the structure of financial transfers to the 7 million families and the 13 million children in the U.K. Their inter-relationship is made clear in the Government's announced plan to merge all the major parts of financial support for children into a new integrated child credit in 2003 (HMT, 2000b), which we discuss more fully in the penultimate section.

Before the 1998 budget, support for children came from four sources: (1) a universal per child transfer (Child Benefit) normally paid to mothers; (2) extra payments in means-tested benefits (Income Support) normally paid to the household head in workless families; (3) a refundable tax credit for working families (Family Credit) paid to the mother; and (4) one of two related non-refundable tax credits available to an earner within a couple. Starting with the March 1998 budget, the Government has increased the generosity of all four of these, and all but Child Benefit have undergone substantial structural change.

The increases in the generosity of Child Benefit in the 1998 and 1999 Budgets together raised the real level of support by 27 per cent for the eldest child, with inflation-only increases for younger siblings. The increases in support for children in means-tested benefits has been focused on younger children: Between April 1997 and 2001, weekly payments for children aged 0-4 rose by £13.25 a week above inflation—a 73 percent real increase—and those with children aged 11-15 rose by £4.25 in real terms. The result is that financial support for children up to age 15 has been equalized—older children had previously received more generous support. This reform partly reflects recognition by the Government that poverty rates were higher among families with younger children, and partly it facilitates the move to an integrated child credit, with its emphasis on simplicity and transparency.

As in the U.S., Britain increasingly uses the tax system to target transfers to families with children. The U.K. has an individual system of income tax. Credits and allowances appear in a person's tax schedule. Employers use the schedules to assess and then deduct income tax directly from paychecks. Allowances are typically less generous than in the U.S., so people start paying income tax at lower annual incomes (see Gale, 1997, and Brewer, forthcoming, for more comparisons of the U.S. and U.K. tax systems). The new Children's Tax Credit is a non-refundable tax credit that replaces two mutually exclusive and equal-valued tax credits: the Married Couple's Allowance (MCA) and the Additional Person's Allowance (APA). The overall impact is that, since 1999, married couples without children have lost a tax break, and families with children, regardless of their marital status, have seen a tax break more than double in value. The MCA and APA were available to all taxpayers, but the Children's Tax Credit is withdrawn at 6.7 percent from people paying higher-rates of income tax (over £33,935 from April 2001), like the Child Tax Credit in the U.S.

The Working Families' Tax Credit (WFTC) was an evolutionary reform to the existing in-work benefit, Family Credit. It was announced in the Labour Government's first full budget in spring 1998, and became available to claimants from October 1999. The WFTC is available to families with children where any adult member is working 16 hours a week or more. It consists of a per-family element—the same for couples and lone parents—and per-child elements. There is a flat zone where the maximum award is paid, and the credit is phased-out beyond earnings of £92.90 a week at a rate of 55 per cent of after-tax income (this would be equivalent to a phase-out of 38 per cent of before-tax income for most WFTC claimants). (We are deliberately using the U.S. phrase; U.K. studies call the phase-out rate the "withdrawal rate" or the "taper.") For a person on the basic-rate of income tax and paying National Insurance, this adds up to a total marginal deduction rate of 69 percent, a rapid rate of withdrawal compared to the combined phase-out faced by EITC claimants.

WFTC differs in four major ways from its predecessor. First, it is more generous, as both the family and the child elements have been increased. For a family with one child, the WFTC is worth a maximum of £78.75 a week—or around $4,000 a year, substantially more than the EITC. Each additional child raises the maximum credit by £25.60 a week. But most of this increased generosity in the maximum value of the WFTC has been matched in the level of out-of-work support, and so has by itself made little difference in the financial gain from moving from welfare to work. Second, and more importantly for improving the financial reward to work, families can earn more before support is withdrawn. The maximum weekly earnings before withdrawal starts was raised from £80 a week under the old Family Credit system to £92.90. Third, the phase-out rate was lowered from 70 to 55 percent of net of tax income. These three changes have increased support for those in full-time or better paid part-time work (i.e. earning more than £92.90 a week) and extended eligibility to in-work support to a large number of families. Lastly, the WFTC helps with childcare costs though a new Childcare Tax Credit, which pays parents 70 percent of childcare costs up to a (generous) maximum of £100 a week for 1 child or £150 for more than 1 child. The Childcare Tax Credit is restricted to households where all parents are in paid work, but lone parents are the prime beneficiaries to date. This represents a substantial increase in generosity of support for childcare costs than the regime under Family Credit, which only offered a childcare cost disregard rather than a direct cash payment.

The effect of these four changes is shown in Figure BUDCONa&b, which shows the previous (1997) and post-reform (the system as of March 2001 plus the indicative value of the Children's Tax Credit at the time of writing) support packages for a couple with one child. What is plotted is the increment in support from all four sources that comes, at each level of earnings, from having the child. The increased generosity of the WFTC over the previous in-work benefit accounts for £2.7 billion of this £7.2 billion reform package total, with £2.5 billion going on the child payments in means-tested and universal benefits, and £1.8 billion on the Children's Tax Credit (see HMT, 2000a).

[Figure BUDCONa&b about here]

The impact of the increased generosity of the WFTC and the Children's Tax Credit is muted for those with medium to high rents. Low-earning renters are eligible for rent support known as Housing Benefit (owner-occupiers normally get no housing support). Housing Benefit is phased out as income rises, but at a faster rate than WFTC—65 percent, and starting at lower income level. All low-income households (not just renters) can also apply for rebates for the local taxes in the U.K., which are assessed against property values. This rebate—Council Tax Benefit—is administered alongside Housing Benefit, and phased out at an additional 20 percent. Unlike the Earned Income Tax Credit, WFTC counts as income when calculating Housing

Benefit or Council Tax Benefit, and so some households with children can be on multiple phase-outs. Under Family Credit, the maximum marginal deduction rate (that is the combined effect of taxes and benefit phase-outs) could reach 97 percent. However, the increased generosity of the WFTC compared to Family Credit has floated many households claiming in-work support off Housing Benefit and Council Tax Benefit, and reduced the incidence of multiple phase-outs. This has virtually eliminated—or at least loosened—the worst of the poverty traps.

The effect of the multiple phase-outs, and the effect of the increased generosity in WFTC is shown in Figure BUDCONHBa&b—the range of incomes (or rents) over which people are on both WFTC and Housing Benefit phase-outs has been sharply reduced. This comes at the cost of those on medium to high rents losing much of the increased value of WFTC in reduced Housing Benefit. One third of recipients of the old Family Credit system also received Housing Benefit—the rest were either non-renters, or had rents low enough or incomes high enough to preclude support. But families with children where no adult works are much more likely to be claiming Housing Benefit.

[Figure BUDCONHBa&b about here]

Comparison with the U.S.

When the U.K. Government first announced that it was interested in reforming in-work support, it said it would examine "the advantages of introducing a new in-work tax credit for low-paid workers. It would draw upon the successful experience of the American earned income tax credit, which helps reduce in-work poverty" (Hansard, 2 July 1997). Even now, there is a strong political resonance between the WFTC and the EITC: In the words of the respective political leaders, both support "hard-working families" and "reduce child poverty." A direct financial comparison between the WFTC and the EITC (see Brewer, forthcoming, and Appendix A) suggests that the U.K. system is substantially more generous, but this comparison can be misleading because the WFTC reduces entitlements to other benefits, whereas the EITC represents truly additional income. But what is less often realized is that the structure and administrative details of the WFTC are quite different from the EITC, and almost wholly related to those that already existed in its predecessor, Family Credit. For example, although the tax authority in the U.K. (the Inland Revenue) administers the system, the WFTC has almost no direct connection to the rest of the tax system, unlike the EITC, and it does not operate as an annual tax rebate. The size of the award is instead assessed on expected weekly earnings for new jobs; for claimants with stable jobs, it is calculated by looking at the past four paychecks (seven if paid weekly). The WFTC is then paid at the same rate for 6 months, regardless of any changes in income (there is more detail in Appendix A).

This desire to get money to claimants quickly—rather than waiting for the end of the tax year to pay the award—evident in the WFTC design is primarily motivated by two concerns. First, most taxpayers in the U.K. have their income tax correctly withheld by employers, and so do not file a tax return. Second, people entering work on low wages would be worse off in work without the WFTC because the relatively high level of out-of-work benefits compared to the U.S. This means that the "real-time" work incentives are stronger than those provided by the EITC (Walker and Wiseman, 1997; Brewer, 2000).

The WFTC and the EITC are not the only ways that the U.K. and U.S. governments support families with children. In both countries, children are recognized in the benefit system, by in-work refundable credits, and by non-refundable tax credits or extra tax deductions or allowances. However, the vagaries of perception and political economy mean that these support systems are often presented from very different perspectives, and in consequence are difficult to compare. In Figure COMP we summarize the two systems by comparing the full budget constraint—the relationship between gross income and income of taxes and benefits and welfare payments—for families with children in the U.K. in 1997 and March 2001 plus the indicative Children's Tax Credit (before and after the implementation of the reforms discussed above) with that in the U.S. in 2000. The U.K.'s system of financial support for children was broadly in line with that in U.S. at lower incomes prior to the current reforms, but the reforms have made it substantially more generous. It is also more redistributive among families with children, with higher net tax rates at higher incomes than the U.S. The U.S. system has been necessarily simplified: These figures do not include state taxes, state EITCs or Medicaid; we include Food Stamps; and we have assumed the TANF system operating in Florida, a relatively low-benefit state (Committee on Ways and Means, 2000, p. 384). (We choose Florida partly because the state seems to include the median voter.) Housing support and help with childcare costs are ignored in both countries.

[Figure COMP about here]

Figure COMP gives a representation of the total budget, but Figures KIDSUPa&b show the supports specifically dependent on children by calculating the cash difference in the budget constraints of a single person and a live-alone lone parent with 2 children.[3] In the U.K., financial support for children falls in cash terms as income rises, apart from the short phasing in of the non-refundable children's tax credit. This is not true in the U.S.: First, the phase-in of the EITC gives a range where support increases with income at the lowest incomes. Second, after the EITC has been phased out, the value of the child exemptions and the head of household filing status increase with income. A striking feature of the U.S. system is the trough after the EITC has been withdrawn and before the tax allowances and deductions increase in value (from around $50,000), discussed more in Ellwood and Liebman, 2000.

[Figures KIDSUPa&b here]

THE IMPACT OF THE REFORM PACKAGE

Structural Change

The reform package reduces child poverty, changes marginal deduction rates, and increases incentives to work.

[3] So, for example, it does not show the full award of Food Stamps for a 3 person household, but the difference between a 1 person and 3 person household. The same applies for the U.K., except that we have assumed that the U.K. introduces an in-work credit for people without children, as announced in HMT, 2000b (so the picture is an underestimate of the position now). It is the approach used by Ellwood and Liebman (2000), who look at the tax treatment of U.S. families with children, and in Battle and Mendelson (2001), who compare systems of support in the U.K., U.S., Australia and Canada.

1. Direct reduction of numbers of children below the poverty line

Figure BUDGAINS shows which families have benefited the most from the extra money directed towards families with children in the past four years. (Figure BUDGAINS does not analyse all budget measures; see Myck (2000) for a more comprehensive discussion.) The use of relatively high phase-out rates for in-work and means-tested benefits means that the beneficiaries are heavily concentrated in the poorest households. Households in the bottom two income deciles see disposable incomes rise by over 7 percent whereas families in the top three deciles gain by less than 1 percent. Of course, the general focus on children in successive budgets means that these households are still gaining relative to households without children.

[Figure BUDGAINS about here]

The expected impact on relative poverty is relatively uncontentious, although the amount of income transfer actually realized is difficult to estimate. At the time of writing, the latest official data are for 1998/9, pre-dating the major reforms, and therefore of little use. Micro-simulations from two different tax and benefit models project that measures up to those in the March 2000 budget will move over 1 million children out of relative poverty compared to a system where benefits were only increased in line with prices (Piachaud and Sutherland, 2000, and HM Treasury, 2000a). Figure BUDDIST, drawn using the Treasury's tax and benefit model, compares the situation in 1998 (prior to introduction of the measures addressed here) with a simulation of the picture after the measures introduced up to and including April 2001. The figure does not include any changes in the distribution of pre-tax incomes: The shift in the poverty line is entirely due to the substantial transfers to households in the past three Labour budgets. These projections all imply that initial effect of the extra transfers to households is to move the hump in the income distribution for children to the right faster than the poverty line.[4]

[4] The Treasury's model estimates the effect of different tax and benefit systems on the pre-tax and benefit income distribution in 2000. The estimate should therefore not be taken as a forecast change in the poverty rate, but as an estimate of what the tax and benefit reforms will achieve over-and-above any changes in the poverty rate due to

But, as pre-tax incomes will have risen—and probably grown more unequal—over the same period, it is likely that the actual decline in the poverty rate will turn out to be lower.

[Figure BUDDIST about here]

The gap between the peak of the spike and this poverty line has nearly been halved, but so far, only the leading edge of the spike has crossed the line. This leading edge of the spike is mostly made up of working families, and so the poverty reduction to date is mostly among the working poor. This suggests that further increase in financial support for children will do more to reduce the numbers with observed low incomes, because these increases reach beyond the working to the dependent poor. The reform package also has the consequence of spreading the hump somewhat. But these simulations do not allow for any behavioral changes from the reforms, and so do not capture the effects of any changes in work effort that might result.

2. Marginal deduction rates

Marginal deduction rates for working families have also changed as a result of the WFTC reform. The reduction in the headline phase-out rate from 70 percent to 55 percent and the fall in the number of families entitled to rent support have reduced the number of families on very high marginal deduction rates. But the increased generosity of WFTC has increased the total numbers on any form of benefit phase-out. Before the WFTC was introduced, around 750,000 households had marginal deduction rates of over 70 percent, and 130,000 had rates over 90 percent (see Table 1). The WFTC reduced these numbers to 250,000 and 30,000 respectively, but the numbers on marginal deduction rates of 60 percent or more rose by nearly 200,000, to just under a million. This may be an acceptable tradeoff. However, if the WFTC continues to expand further up the income distribution, the terms will rapidly deteriorate.

[Table 1 about here.]

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changes in the pre-tax income distribution. The incomes presented are equivalised for family size, and the model estimates 60 percent median income to be around £170 a week for the reference family of a couple with no children (or a lone parent with two children).

The rates in Table 1 are above those in the U.S. because of the higher phase-out rates used in the U.K. But there is a large discontinuity in the budget constraint in the U.K. as families become eligible for WFTC at 16 hours work a week, so work incentives are not universally worse in the U.K. In fact, both countries seem to have good financial incentives for lone parents to do some work—assuming full take-up of all entitled benefits—but poorer incentives for lone parents to increase earnings beyond part-time or minimum-wage jobs (Brewer, 2000).

3. Improved incentives to work

The WFTC, the Childcare Tax Credit, and the Children's Tax Credit all combine to increase the financial returns to working rather than being on welfare. The intention is to induce entry into work, and so further reduce child poverty as a reduction in the number of children wholly or nearly-wholly supported by the state is probably vital if the numbers in child poverty—given the use of a relative definition—are to be reduced. We look first at the gain to taking a job and then the effect of increasing earnings once in work.

Table 2 shows how the reforms have altered the financial gain to work—the difference in zero-income position on benefits and in-work income after taxes and benefits— for some benchmark families. (These calculations ignore in-work costs, but we focus on the change in the gain to work, so this omission is not too problematic.) The reforms have slightly improved the financial gain to work at 16 hours a week, but have had more of an impact on the incentive to do full-time work, particularly for lone parents (first row). The Childcare Tax Credit supplement produces a large improvement in the (net of childcare costs) gain from moving to work for a lone parent paying £50 a week for childcare. £50 a week childcare costs is slightly higher than the average of those currently claiming the Childcare Tax Credit. The negative aspect of the reforms is that a second earner in a family where the primary worker earns around £200 a week has seen a sharp drop in the financial incentive to work. Such a person had the highest return to full or part-time employment in 1997 (apart from a lone parent with no rent and no childcare costs: a rare item), but in the 2001 scenario is closer to the other groups. The first wage in this stylized two-earner family is sufficient to get the family off Housing Benefit, so housing tenure makes no substantial impact here.

Table 2 also shows the relative gains of taking full or part-time work. The relative incentives to take full-time work have increased for all groups, mainly because of the lower phase-out rate, but this shift is particularly marked for workless couples. Averaging across the population of workless families with children, adults who now take a job at realistic entry wages and hours will be able to keep an average of 5-6 percent more of their gross earnings than case under the pre-reform system (HMT, 2000b).

[Table 2 about here.]

There has been a debate in the U.K. as to whether these changes in financial incentives will cause people to change their behavior. Blundell et al, 2000, simulate the impact of the introduction of the WFTC (not the whole reform package) using a structural labor supply model. They predict that the WFTC will reduce workless households with children by just under 60,000 (perhaps 100,000 children). They also suggest that there will be some offsetting reduction of labor supply by women with working husbands.[5] The U.K. Government's estimates are that the total package of reforms will encourage around 80,000 extra parents to enter work, a little more than twice the estimate in Blundell et al., 2000 for the WFTC alone (see HMT, 2000b). These estimates use elasticities derived from data on labor market transitions using the methodology laid out in Gregg et al. (1999). But comparisons for the WFTC alone suggest the two methodologies give very similar results (Blundell and Reed, 2000).

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[5] The authors have benchmarked this model against labor supply estimates derived from past reforms to in-work benefits in the U.K. (Blundell, 2000 reviews this evidence) and believe it to be consistent. The paper cited focuses solely on the WFTC reforms, which may prove to be a significant restriction, since the lower phase-out rate for the WFTC means that more of the income gains from the tax reductions introduced by the Government now feed through into net income gains for families compared to the old Family Credit.

Early Evidence

The WFTC has been in operation for a year now, and the first evidence of its impact is beginning to emerge. As of August 2000, there were 1.1 million claims for WFTC, 230,000 more than for its predecessor in summer 1999, although it is not clear from administrative data how many of these new claims were from previously workless families (discussed by Blundell and Brewer, 2000). The Spring 2000 Labor Force Survey (LFS)—administered on average 6 months after the introduction of the WFTC in October 1999—shows a dramatic decline in the numbers of children living in workless families: Between spring 1999 and spring 2000 this rate fell from 17.3 percent to 15.8 percent.

Table 3 explores this evidence using a simple difference in difference methodology. There has been a strong employment recovery over the last few years in the U.K. Between spring 1996 and 1999, the aggregate non-employment rate fell by 0.7 percentage points a year. It continued to fall between 1999 and 2000, but at a slightly lower rate. The reduction in workless households with or without children looks very like the aggregate pattern prior to 1999. Since then—coincident with the introduction of the WFTC—there has been a sharp increase in the rate of decline for households with children. On an unadjusted difference-in-difference basis, Table 3 suggests that the WFTC and associated changes have already reduced the number of workless households with children by half a percentage point, or around 40,000. On a per child basis, the change since the introduction of the WFTC has been more dramatic.

[Table 3 about here].

The bulk of the change has been among lone parents. Lone parents in the U.K. have for a long time had very low employment rates. From the mid 1980s to the early 1990s, employment rates for lone mothers were broadly stable at just above 40 per cent, even though over the same period, employment among mothers with working husbands rose sharply (Desai et al., 1999; Blundell and Hoynes, forthcoming). Since 1993 the numbers of lone parents living in workless households has started to fall. The decline in lone parent workless households between 1996 and 1999 (penultimate row of Table 3) was over a percentage point a year. In the last year, however, there has been a sharp 3 percentage point fall.

We use the LFS to investigate this improvement in employment among lone parents further. Following Eissa and Liebman (1996) we use single (live-alone) adults without children as a comparison group to (live-alone) lone parents, and look at how employment rates among those with similar age and education are performing in the labor market. We compare the pre-reform period 1997-99 with the post-reform 1999-2000 period (1996 data with weights consistent with those used in subsequent years had yet to be re-released at the time of writing). Table 4 suggests that the raw differential in increased employment rates among lone parents since the introduction of the WFTC is still significant when we control for the age of child and use single adults of a similar age and education as a comparison group. The results suggest that a combination of the buoyant labor market and an older profile of the children drove the improving employment rates of lone parents in 1997-99. Since 1999 however, there has been acceleration in employment growth for lone parents coincident with the policy shift that is not consistent with employment growth among the childless with similar characteristics. Indeed, the adjusted results are quite similar to the unadjusted differences. Hence it appears that lone parents have had an exceptional increase in employment rates over this period and this could reflect responses to financial incentives, increased advertising that occurred when the new policy was implemented, or some combination of both.

[Table 4 about here.]

FUTURE DIRECTIONS

All three of the main areas of policy development described in section 2 continue in development. Two particular policy proposals, for expanded case management and greater system integration, would profoundly change the picture of the U.K.'s welfare system.

ONE, and the Expansion of Case Management in the Welfare System

ONE (a name, not an acronym) is a tag used by the Government to describe the unification of administration systems for different out-of-work working-age benefits. In practice, this means that, over time, all benefit claimants will get regular contact with a personal advisor (case manager), where the regularity varies according to which benefit people are on. So far this is only compulsory for the unemployed; disabled workers and lone parents have voluntary programs under the New Deals. This is changing; in the future all claimants will have a compulsory "work-focused interview" at regular intervals. Here, the personal advisor asks about a person's desire to work and the inhibiting factors. Claimant groups will have different job-search requirements, but similar support systems will be available to all, whatever benefit they are on, if they want them. This reform places work at the heart of the welfare administration process for all groups, whereas currently the unemployed are clearly given a higher priority. It also means that benefit advisors will not have implicit incentives to push people onto other benefits. All groups will have readily available job-search support systems. The case management will not just help with job search, but will cover issues of transition in the benefit system and access to care services for dependants as well.

This development follows from the New Deal framework of contacting a wide benefit groups to discuss, promote and support a transition into employment (see the paper by Stafford for a discussion). The main difference is that this will be embedded routinely in the benefit administration, and attending the "work focused interview" is compulsory. It falls a long way short, though, of compulsory job search or time limits on welfare receipt.

An Integrated Child Credit

The integrated child credit is another unifying reform, but one affecting the tax and benefit system rather than the administration regime. The aim is to pull together all of the financial support for children that is currently paid through welfare payments, in-work benefits and tax credits into a single instrument, with the same rules and administration. This integrated child credit has many more similarities with the Canadian Child Tax Benefit than with the U.S. system. Payments in respect of adults in Income Support and the WFTC will remain outside this system, and, at the same time as the integrated child credit is introduced, in-work support will be extended to adults without children, probably with restrictions to full-time employment and an age limitation of over 21 or over 24 for the childless.

A pictorial representation of how the benefit system could change with the advent of the integrated child credit is shown in Figure ICC.

[Figure ICC about here]

The three support systems that are pulled together into a new single system remain nominally distinct from the universal Child Benefit, but in practical terms—who receives the payment, and how it is paid—they will be identical. Neither the value of the credit, nor details of how it will be administered had been announced at the time of writing. If it were based on the current payment structures, it would mean a per-family payment (with a maximum value of around £442 a year) and a per-child payment (with a maximum value of around £1,500). The extra payments for childcare costs maybe included too. It would then be partially withdrawn at moderate incomes (£5-15,000 pa) at 38 percent of gross income, and fully withdrawn at higher incomes (over £35,000) at 6.7 percent of gross income.

This system will have a number of new features. First, all payments will be paid to the mother (or the main care-giver). Under the current system, this depends on which benefit is being paid and even how the payment is being made. Second, income uncertainty at the time of transitions into and out of work will be reduced, as there will be a stable platform of financial support for children across the welfare-to-work divide, rather than the uncertainly (and possible delay) of moving from out-of-work benefits to in-work benefits. Third, payments will be assessed against family income throughout, presumably on a constant definition of income. This represents the most significant step towards joint assessment for families with children since income tax became individualized in 1990. The way it responds to changes in income and circumstances—much of which remains undecided at the time of writing—will also be crucial (see Brewer, Myck and Reed, 2001, for more details of the background to the reform and some of the options).

CONCLUSION AND ASSESSMENT

While the U.K. Government's strategy contains many of the main elements of U.S. welfare to work agenda—such as increased financial incentives and case management of the welfare caseload to support transition into work—it also has substantial differences. The most striking are:

- Levels of welfare support for those not in work—as well as those in work—are rising substantially.

- There is no time-limiting of welfare support nor a requirement to seek work for lone mothers (sanctions only apply to those claiming unemployment benefits who do not meet their responsibilities to look for work and accept appropriate job offers).

- The strong emphasis on tackling poverty and its consequences for children.

At some stage the government will have to declare its position on what it means by elimination of child poverty. Elimination of poverty on a high relative income measure is almost impossible. The best European Union countries, Sweden, Denmark and Finland, have child poverty rates (on a 50 percent of mean income before housing costs basis) of a little under 5 percent (Bradbury and Jantii, 1999). Measurement error and lumpiness of income over the short windows used to assess income in the U.K. data will always leave some people below such a benchmark.

The Government has a number of sensible ways forward. It could assert that such imprecise data means that an estimated child relative poverty rate of 5 per cent is consistent with its intention to eliminate child poverty. Alternatively it could focus on a measure of material deprivation or some combination of a relative income and material deprivation measure, as used by the Irish government. A reliance on relative income will require large resources to be committed to supporting children, and child support systems to rise in line with median incomes thereafter. This is difficult, but not impossible, as many European countries, especially in Scandinavia, have not seen the substantive rise in relative child poverty rates over the past 2 or 3 decades experienced by the U.K. (Micklewright and Stewart, 2000). It is clear from Government publications however (e.g. HMT, 1999b or DSS, 2000b), that the intended target is larger than a simple financial measure. As a result, it is likely that the measures ultimately adopted to assess success will include some indicators of material well-being.

The strategy is, however, clearer than the target. The Government has substantially raised financial support for families with children. Increased payments have been focused on low-income families, whether they are working or not, but all families with children have gained something under the Government's package of reforms. Work incentives have risen, especially for full-time work, and those lifted out of poverty to date are much more likely to be working. Increasing the financial rewards for work at low wages is part of a wider strategy to reduce the number of children living in workless households. This part of the strategy would appear vital if the costs of eliminating childhood poverty are not to prove prohibitive. Here there are some early signs of improvement, with the number of children in workless households down from 19.4 percent in 1996 to 15.8 percent in spring 2000—and this improvement happening disproportionately after the WFTC came into effect in late 1999. There have also been substantial reforms to the way welfare is administered to support transitions into work. The most important is the development of a case management approach, with all claimants having a personal advisor. The final part of the strategy is to reduce the extent to which children from the poorest households and communities do less well in terms of development and education. This involves a mixture of extra resources and focusing the machinery of government and service delivery on out-turns among the poorest children. All elements of this strategy are evolving, and further steps have already been announced or proposed.

The intention is commendable, and the strategy coherent, but the scale of the task so large that many argue that it is unachievable. Some cynics suggest the Government has little intention of achieving it. The central problem is the large financial transfers required to reduce poverty on a relative income basis, especially if recent reductions in worklessness do not continue. The increased work incentives are certainly not substantial enough alone to drastically reduce the numbers in such workless households, and hence the strategy relies heavily on the reforms to welfare administration and increased childcare availability to facilitate moves back to work. Increased generosity of support in and out of work may actually reduce the desire for work through an income effect, as life without work becomes more tolerable at these higher income levels. This may mean that there is growing pressure to adopt compulsion for lone parents and partners of workless men to search for and accept work. However, time-limited welfare payments to the workless, or the application of sanctions to those who do not comply to compulsory requirements, may create a small group in acute poverty and undermine a claim of having eliminated child poverty. Increased generosity of support will also mean that the high withdrawal rates cover an ever-expanding section of the population. This could be reduced by greater use of the universal, or near universal, parts of the child support system, but at a large extra cost.

In addition, there are problems establishing exactly what the impact of financial resources are on child development outcomes, and even more problems designing and implementing successful interventions. In mainstream policy areas, Britain has not developed as strong an experimental and evaluation culture as the U.S. Nor has it developed systematic mechanisms by which evidence influences policy on the ground. This becomes all the more difficult where policy allows for significant local inputs and choices.

On a more up-beat note, if interventions and reduce financial distress lead to fewer teen pregnancies or people with very low levels of literacy, then fewer parents in the next generation will suffer as acute problems earning and supporting their families. This intergenerational transmission aspect of deprivation is very important in government thinking. The ambition of this program will be perhaps surprise American readers, and it seems unlikely to us that such ambition would be ever attempted in the U.S. It is perhaps interesting, however, to think briefly about whether it should be.

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Appendix A. Detailed comparisons of the Working Families' Tax Credit and Earned Income Tax Credit.

	Working Families Tax Credit (as of June 2000)	**Earned Income Tax Credit (2000)**
Eligibility		
Eligibility	Must work more than 16 hours a week, have dependent children (under 16 or under 19 and in full-time education), have less than £8,000 capital. Couples need to claim jointly; need not be married. Extension to those without dependent children proposed alongside an integrated child credit.	Must have positive earnings in past year and annual investment income under \$2,350. Married couples need to file a joint tax return, unmarried couples file separately. Parents need to have a "qualifying" child (either theirs or their spouse's, or any other child that was cared for all year). "Children" are under 19 or under 24 and a student, or permanently and totally disabled. Where a child potentially qualifies two unmarried adults for EITC, only the adult with the highest income can apply (this includes multiple tax unit-households).
Structure		
Value of basic credit	Credit is weekly. Basic credit of £53.15 plus possible 30 hour credit of £11.25 plus credits for each child at £25.60 or £26.35 for 16-18s. Childcare tax credit is supplementary to this.	Credit is annual and is a fraction of annual income up to a maximum level of \$353/\$2,353/\$3,888 for families with no, 1, or more than 1 children.

Tapering	Beyond threshold of £91.45, tapered at 55 percent.	Phase-in threshold applies a 7.65% /34%/40% credit (for no, 1, more than 1 children) to income until maximum credit reached. Beyond threshold of $12,690 ($5,770 for no children), tapered at 7.65%/15.98%/21.06% so that runs out at $10,380/$27,413/$31,152.
Interaction with other parts of tax and benefit system		
Definition of income	Net income (i.e. income after income tax and national insurance). Self-employed: same definition of "income" as for other tax liabilities.	Gross earnings or "modified adjusted gross income" if "modified adjusted gross income" is higher and claimant is on the taper ("modified adjusted gross income" is income minus standard deductions for tax purposes). Self-employed: same definition of "income" as for other tax liabilities.
Exclusions from the definition of income	Child Benefit, Statutory Maternity Pay, Attendance Allowance, maintenance payments, Housing Benefit and Council Tax Benefit awards	TANF & Food Stamps are not taxable.
Awards count as income for	Housing Benefit and Council Tax Benefit awards	Federal law prohibits EITC to be treated as income for purpose of Medicaid, SSI, Food Stamps and low-income housing. Since 1991, EITC did not count for AFDC assessment; States can now count EITC when determining TANF awards.
Assessment and payment mechanism		
Assessment	Assessed on average weekly income in "assessment period" prior to claim. Length of "assessment period" depends on frequency of claimant's earnings: 7 weeks for weekly payments, 8 weeks for fortnightly, 16 weeks for 4-weekly, 4 months for monthly payments. Estimated earnings	Assessed at year-end on past year's income.

	used for new workers.	
Payable	Weekly award fixed for 26 weeks (unless family status changes). Paid through wage packet unless non-earner in couple elects to receive it or if self-employed. Timing of payments aligned with timing of wages, so if worker paid monthly in arrears, credit will be paid monthly in arrears. Non-earners paid fortnightly.	Annual award is a refund on annual tax liability with any excess paid as a lump-sum. Families have to file by April 15 each year. Up to $1,418 can be paid in advance through the wage packet for claimants that have federal income tax withheld from wages. Few elect for this option.
Paid to	Couples decide who receives it. If couple cannot agree, then Inland Revenue will probably pay to the main carer.	Married couples who claim the EITC have to file a joint tax return. Their EITC credit reduces the joint tax liability. They nominate who receives the payable part of the credit. See "eligibility" for other rules on who can claim in non-married couples.

Source: Brewer (forthcoming).

Table 1. Number of families facing high marginal deduction rates before and after the reforms

Thousands of families	Before the 1998 budget	After the 2000 budget	Difference
100% and over	5	0	-5
90% and over	130	30	-100
80% and over	300	210	-90
70% and over	740	250	-490
60% and over	760	950	+190

Source: from HM Treasury, 2000a.

Notes: A marginal deduction rate is the percentage of the marginal pound of income that is lost in taxes and withdrawn benefits or tax credits.

Table 2. The effect of the reforms on the financial gain to work for parents with children

	Gain to work (£)			
	16 hours		35 hours	
	1997	2001	1997	2001
Not on HB				
Lone parent	57	60	96	115
Couple with children	30	33	65	82
Couple with children, 1 earner working 35 hours/week @ £6/hour	44	30	102	65
Single person	13	13	64	70
With HB				
Lone parent	31	32	51	68
Couple with children	14	14	30	35
Single person, no children	6	7	25	30
With childcare of £50/week				
Lone parent	15	48	81	100

Notes: Table measures difference between zero-income benefit income and income after taxes and benefits in work. Assumes 2 children under 11 and full take-up of all entitled benefits, hourly wage of £4.20. Childcare costs of £50 a week is slightly more than the average of those lone parents currently claiming the Childcare Tax Credit. Both tax and benefit systems have been indexed to 2000 prices.

Source: authors' calculations based on TAXBEN model.

Table 3: Annual Changes in Employment Rates among Live-Alone Lone Parents 1997-99 and 1999-2000

Period	Raw Annual Changes	Adjusted for comparable single adults and age of youngest child
1997-1999	1.598	0.004
1999-2000	3.138	1.807
Difference	1.540	1.803

Note: Column 3 is the difference in employment growth rates between comparable lone parents and single adults with in the two periods. They have been estimated from probit equations of employment status controlling for year, age 18-24, 25-34, 35-44 (45+ as the base), qualifications of degree level or equivalent, A level but below degree, O level or equivalent and below O level (no qualifications is the base). Gender and gender and age, qualification interactions and dummies for age of youngest child being 0-1, 2-4, 5-10 and 11-14 are also included (15+ as the base). The marginal effects reported are the transformed coefficients on a year/lone parent interaction for the two periods.

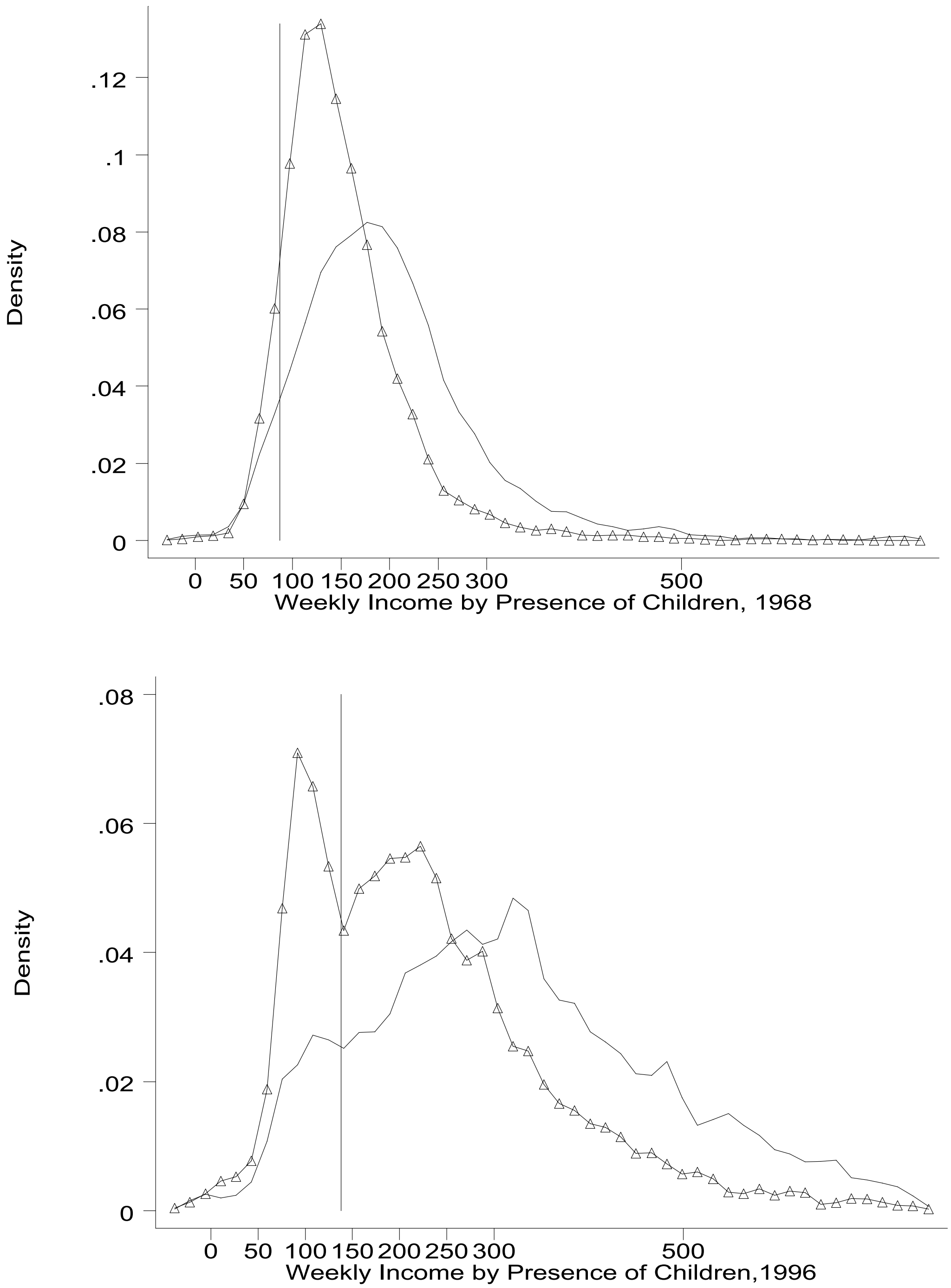
Source: Labor Force Survey.

Table 4: Differences of Trends in Household Employment Patterns Before and After the Introduction of the WFTC

	(1)	(2)	(2)-(1)
Percentage point change (per year in	1996-99	1999-2000	
Non-employment race	-0.7	-0.6	0.1
Workless Households with:			
No Children	-0.5	-0.4	0.1
Children	-0.7	-1.2	-0.5
Children in Workless Households	-0.7	-1.5	-0.8
Lone Parents Households	-1.3	-3.0	-1.8
Couple with Children 0.1	-0.6	-0.5	

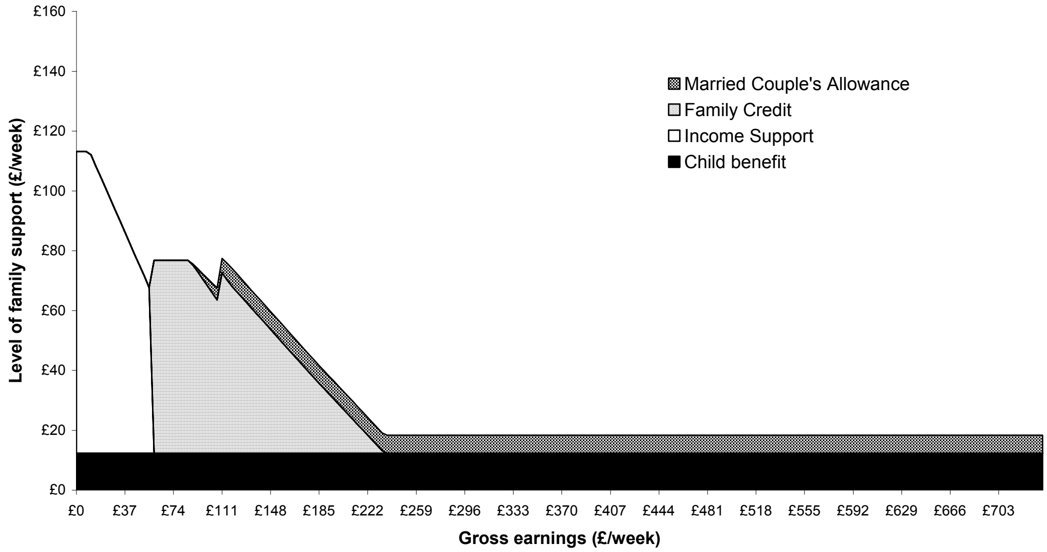
Source: Office for National Statistics, 2000.

Figure INCDIST: Kernel Density Representation of Income Distributions of Households With and Without Children 1968 and 1996 (£1996)



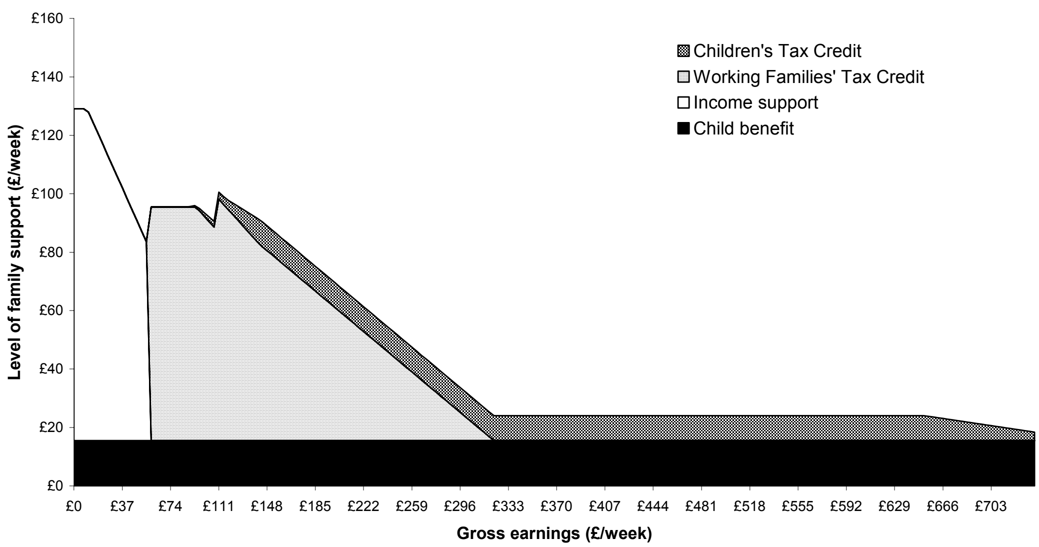
Source: Family Expenditure Survey. Vertical lines are poverty cutoffs at 60% median income after housing costs equivalised for family size. Figures exclude pensioner households.

Figure BUDCONa. Pre-WFTC system of support for families with children



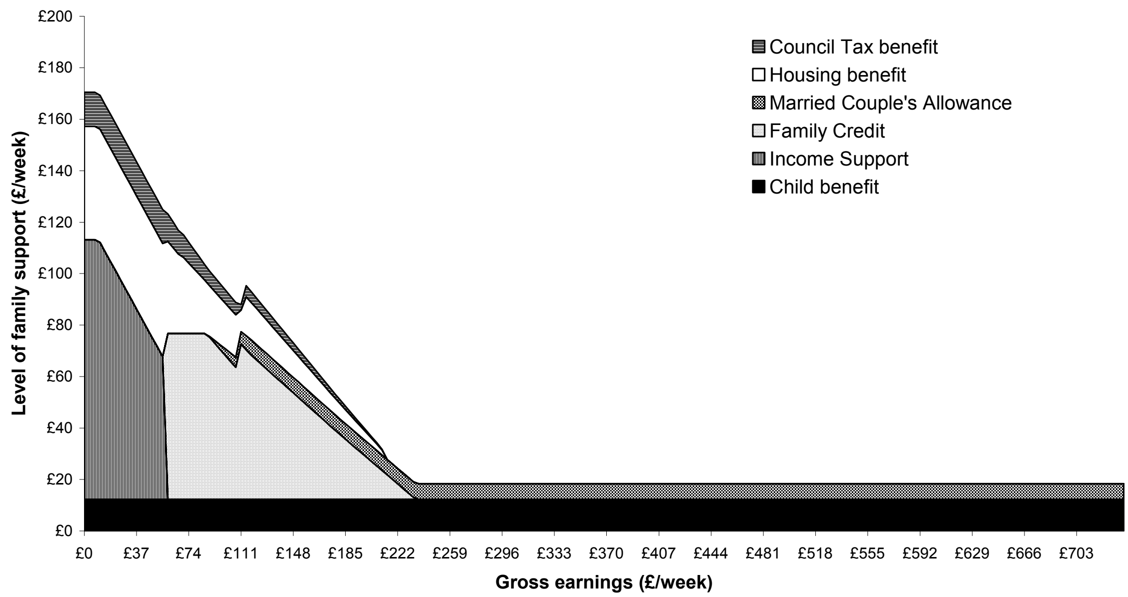
Note: Assumes entitlement for WFTC reached at £59.20, or 16 hours work at the minimum wage. Values uprated to 2001-2 prices.

Figure BUDCONb. System of support for families with children after the major reforms



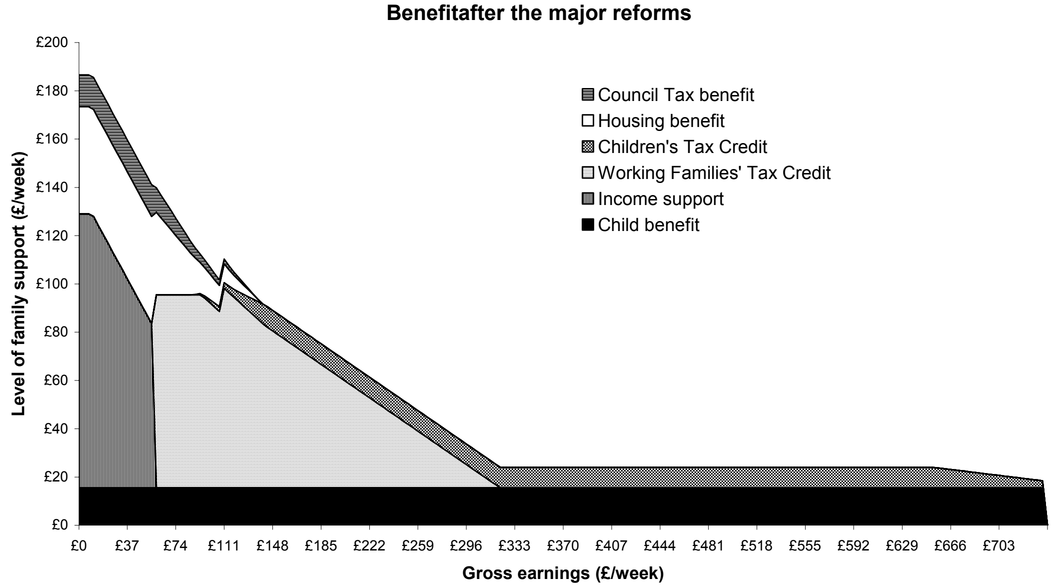
Note: Assumes entitlement for WFTC reached at £59.20, or 16 hours work at the minimum wage. Uses the tax and benefit system as of March 2001, plus the indicative value of the Children's Tax Credit at the time of writing.

Figure BUDCONHBa. Pre-WFTC system of support for families with children with Housing Benefit



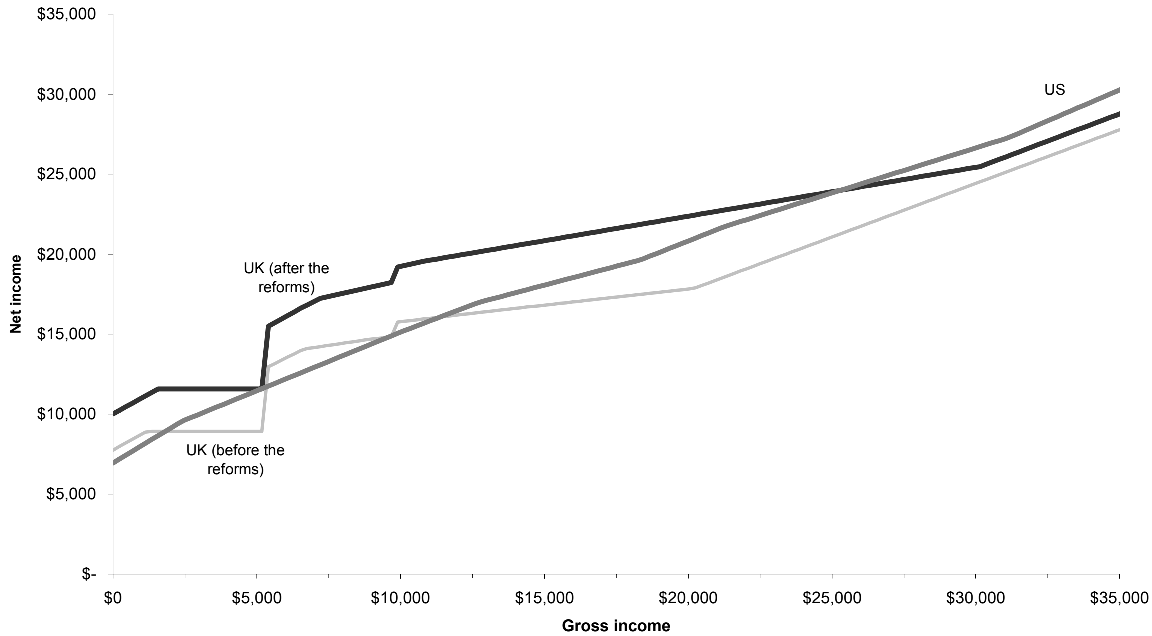
Note: Assumes entitlement for WFTC reached at £59.20, or 16 hours work at the minimum wage. Values uprated to 2001-2 prices.

Figure BUDCONHBb. System of support for families with children with Housing Benefitafter the major reforms



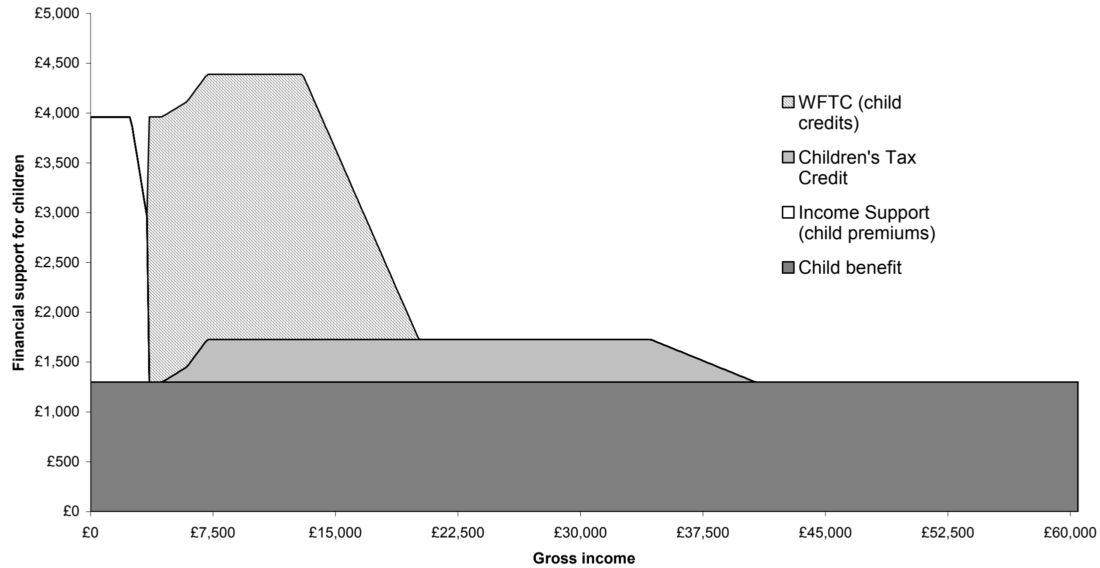
Note: Assumes entitlement for WFTC reached at £59.20, or 16 hours work at the minimum wage. Uses the tax and benefit system as of March 2001, plus the indicative value of the Children's Tax Credit at the time of writing.

Figure COMP. The budget constraint for a lone parent, 2 children, in the UK and US



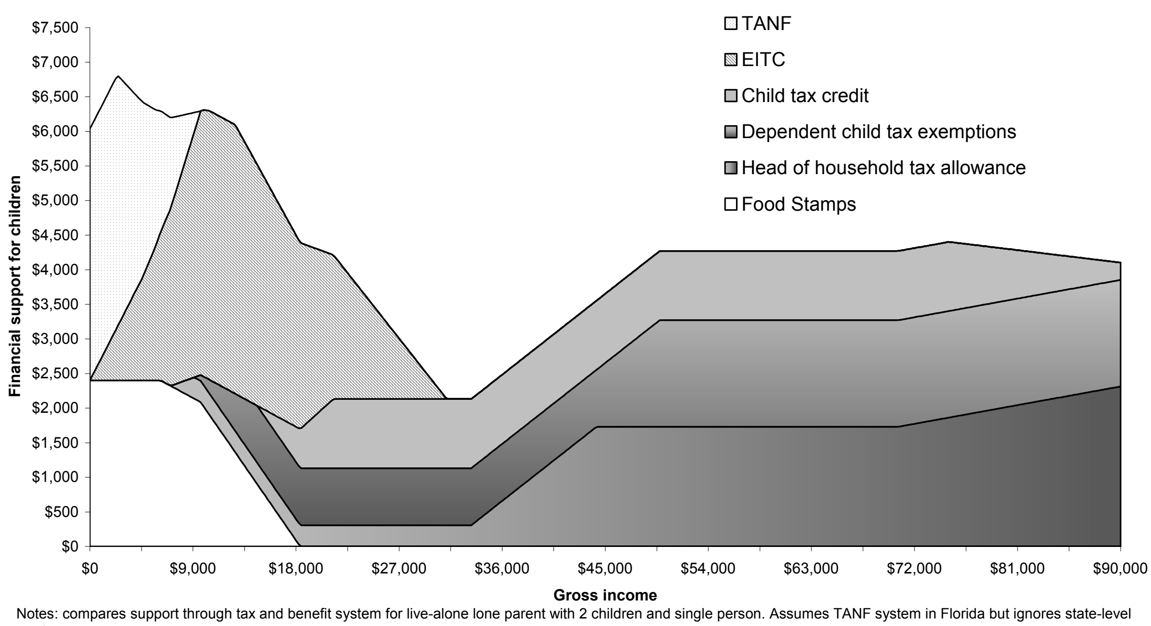
Note: Assumes live-alone lone parent, 2 children under 11. Does not include housing or childcare support or costs. UK lone parent has wage of £4.20. All values converted at £1: $1.50. Does not include state-level taxes or EITCs. Assumes Florida's TANF system. "Before the reforms":system as of April 1997. After the reforms:

Figure KIDSUPa. Support for children in the UK, after the reforms



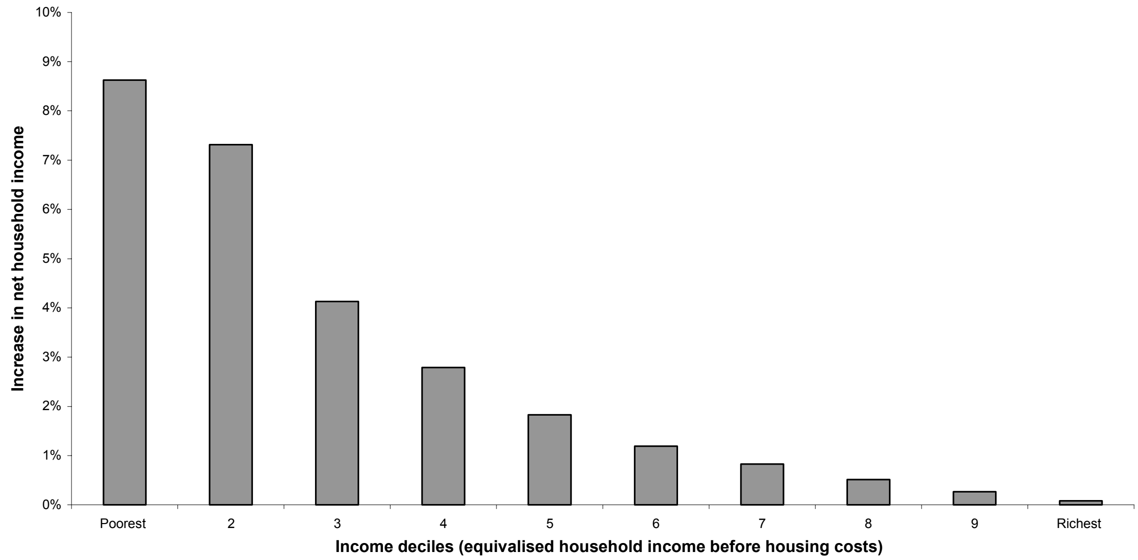
Notes: compares support through tax and benefit system for live-alone lone parent with 2 children and single person. Uses March 2000 tax and benefit system plus indicative Children's Tax Credit, but also assumes an in-work tax credit available to those without children. WFTC eligibility begins at annual equivalent of 16 hours/week work at £4.20/hour.

Figure KIDSUPb. Support for children in the US, 2000



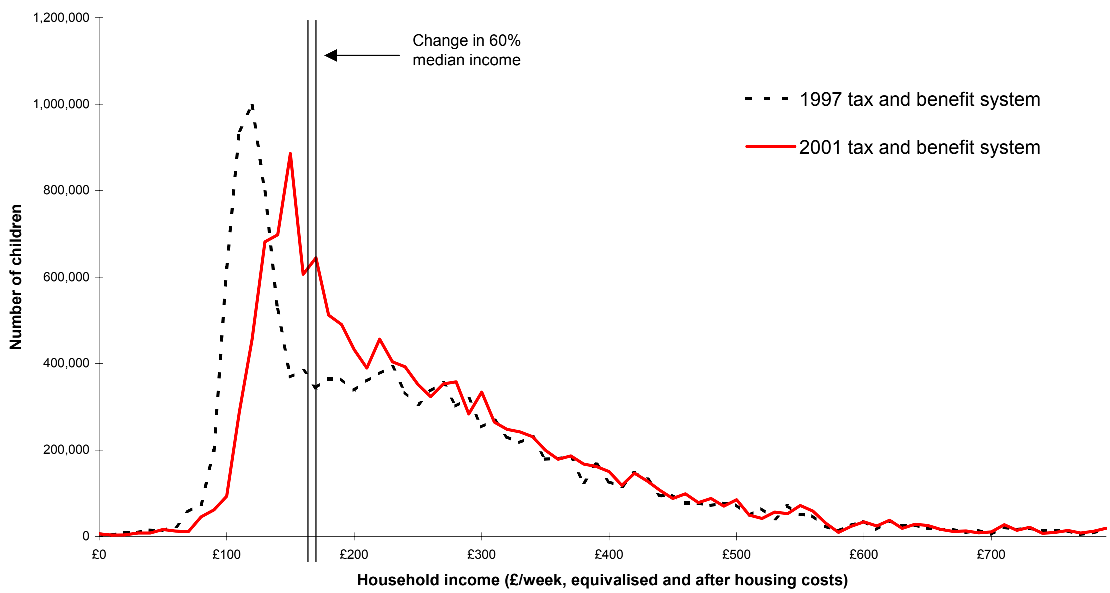
Notes: compares support through tax and benefit system for live-alone lone parent with 2 children and single person. Assumes TANF system in Florida but ignores state-level EITCs and taxes.

Figure BUDGAINS. Estimated Gains to Families with Children from Children's Budget Measures, 1997-2001



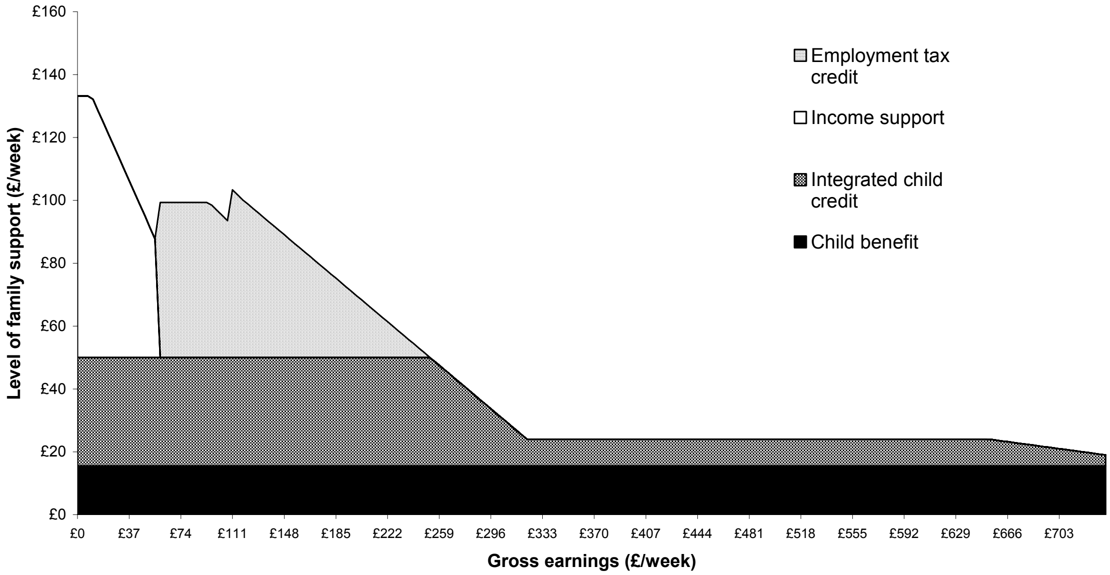
Note: shows impact of changes in Child Benefit, WFTC and Children's Tax Credit on income of households with children
Source: calculated using TAXBEN, the IFS' tax and benefit model, and drawn from Brewer, Myck and Reed (2001).

Figure BUDDIST. Distribution of children in the UK income distribution before and after the reforms



Note: Shows modelled impact of reforms on the estimated 2000-1 income distribution for families with children. Assumes full take-up of benefits and tax credits.
Source: figures provided by HM Treasury.

Figure ICC. The new integrated system of support for families with children



Note: Assumes entitlement for employment tax credit reached at £59.20, or 16 hours work at the minimum wage. Values deflated to 2001-2 prices.