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REDUCING CHILD POVERTY IN BRITAIN: AN ASSESSMENT OF GOVERNMENT POLICY 1997–2001*

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The reduction and eventual elimination of child poverty has become one of the central objectives of the new Labour Government in Britain. Measures to achieve this by changing taxes and benefits and promoting paid work are described. Their effects are assessed using a micro-simulation model. The policy changes will achieve a significant reduction in child poverty but it will remain in 2001 substantially higher than in 1979 and much higher than in most European nations.

The new Labour Government in Britain has made the reduction of child poverty one of its central objectives. In March 1999 the Prime Minister said: 'Our historic aim will be for ours to be the first generation to end child poverty .... It is a 20 year mission' (Walker, 1999).

The purpose of this paper is to describe the initiatives taken up to, and including, the 2000 Budget and to weigh them up in terms of their potential impact.[1] The UK government's overall strategy of welfare reform has the aim of ensuring paid work for those who can, security for those who cannot. The principal measures to reduce child poverty may be conveniently divided into three categories:

1. Policies to alter income levels directly through the tax and benefit system. The aim is to provide direct financial support to all families, recognising the extra costs of children, while targeting extra resources on those who need it most.
2. Policies to promote paid work. The aim is to ensure that parents have the help and incentives they need to find work. Paid work is seen as the best long-term route to financial independence for families.
3. Measures to tackle long-term disadvantage. The Government is attempting to reduce the number of teenage pregnancies. Through the Sure Start programme it is providing support for parents of children aged under 5 in disadvantaged areas; through the National Childcare Strategy it is aiming to provide good quality and affordable childcare in all areas. It is attempting to

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[1] Policy initiatives are summarised in Department of Social Security (1999*a*). Background analysis is set out in the HM Treasury series on *The Modernisation of Britain's Tax and Benefit System,* which is available at www.hmtreasury.gov.uk.

raise basic standards of literacy and numeracy and tackle exclusions from school and truancy.

The focus of this paper is on those policies with the most direct and immediate bearing on child poverty by altering income levels directly. We also consider the role of welfare-to-work policies in poverty reduction and the extent to which changes in tax and benefit policies have made it more worthwhile both to move off benefit and into work. First, the extent of the problem of child poverty is set out and the causes are discussed briefly. Then in Section 2 policies designed to raise incomes directly are described and their impact is analysed using micro-simulation modelling. In Section 3 the impact of the measures to increase paid work is assessed. Finally, some factors affecting the prospects for child poverty are discussed.

1. The Extent and Causes of Child Poverty in Britain

Poverty is defined in most academic and recent government analysis as an income level below half the national average; this is the definition used here. The growth in the extent of child poverty in Britain is shown in Table 1. The figures for 1997/8 are given both before housing costs (BHC) and after housing costs (AHC). For comparability over time, the AHC figure is the most useful and it shows that over the period since 1979 the number of children in poverty has tripled.[2] Recent comparative figures compiled by Bradbury and Jantti (1999) show that the United Kingdom has the third highest proportion of children in poverty out of 25 nations and the highest of any European country.[3] The rate is more than twice that in France or the Netherlands and over five times that in the Nordic countries.[4] Table 1 shows that about two thirds of the poorest children are in families without a full-time worker and the biggest absolute increase is in single parent families, most of whom are not in paid work. But rapid growth in child poverty also occurred in families with one or two children and a full-time worker. Thus, the analysis of child poverty points to not one but a number of causes: there are more children in workless households and there are more children in 'working poor' households.

Nearly one in five children in Britain now lives in a household where no one is in paid work – double the proportion in 1979 and four times the proportion in 1968 (Gregg *et al.*, 1999). This growth is the result of three principal changes. First, the number of lone parent families has risen; most are headed by women and most of these women are not in paid work. Second, unemployment levels have not fallen to the levels of the 1970s. Third, male inactivity rates have risen substantially; this has been most marked for men aged 50 and over but among men aged 25–49 the proportion economically inactive rose

[2] Most of the analysis in this paper uses the BHC definition so that changes in Housing Benefit are captured.

[3] Tables 3.3 and 3.4.

[4] For a broader picture of the well-being of UK children in comparative perspective, see Micklewright and Stewart (1999) and UNICEF (2000).

Table 1

Children in Poverty, by economic status of the family, 1979 and 1997/8 (thousands)

	In poverty			All children	
	1979 AHC	1997/8 AHC	1997/8 BHC	1979	1997/8
One or more full time workers					
– self employed	250	500	450	1,300	1,600
– employee, 1 or 2 children	70	460	310	6,900	5,100
– employee, 3 or more children	160	460	350	3,200	2,200
Others					
– single parents	280	1,830	1,200	1,000	2,500
– couples with children	680	1,140	1,000	1,500	1,500
All (millions)	1.4	4.4	3.3	13.8	12.9

Notes: Poverty = Below 50% of mean equivalised income level after housing costs (AHC) and before housing costs (BHC).
Sources: 1979 – Department of Social Security (1998); 1997/8 – Department of Social Security (1999*b*). Figures for the two years are not fully comparable because they use different data sources.

from 1.9% in 1979 to 7.6% 1998 (Gregg and Wadsworth, 1999) so that inactivity is now a more prevalent cause of worklessness than unemployment.

The growth in the number of poor children in working households is attributable according to the Treasury to two main changes (HM Treasury, 1999*a*). First, the increase in inequality of earnings: the wages of men in the top decile group grew over the last two decades at twice the rate of those in the bottom decile group. Second, more working households now rely on part-time work which is often insufficient to lift the household out of relative poverty.

2. Policies to Alter Income Levels Directly

By April 2000 the main changes to the system of taxes and benefits *for children* introduced or planned by the new Labour Government were the following:[5]

1. Working Families' Tax Credit (WFTC) was introduced in October 1999. This tax credit, normally to be paid through the pay packet, replaces Family Credit which was a means-tested benefit paid direct to families. The tax credit, like Family Credit, is withdrawn according to income. WFTC is more generous with a higher maximum payment and a lower taper. To qualify a person must work 16 hours a week or more, have a dependent child and not have capital of more than £8,000. The credit is larger if a parent does paid work for 30 hours a week or more.

2. Child Benefit is a universal benefit paid for each eligible child without any test of means and not subject to income tax. Since the 1997 it has been

[5] All monetary amounts are in £ sterling. At the time of writing £1 equals approximately €1.60 or US$1.60.

increased in real terms by 29% for the first child and 5% for second and subsequent children.

3. Children's Tax Credit will be introduced from April 2001. This tax credit, which is a replacement for the Married Couple's Tax Allowance and the corresponding tax allowance for lone parents, is to be paid to a parent in all families with children aged under 16, except that it will be withdrawn from higher rate tax payers.

4. Income Support (IS) is the means-tested safety net available to unemployed, sick or disabled families and to lone-parent families. This and other associated means-tested benefits are being increased for families with children, particularly for those with children under 11.

As well as specific child-related changes other general measures, such as changes to income tax and the introduction of the minimum wage, also affect families with children. Not all the changes have had a positive effect on incomes: another decision was to abolish special benefits for lone parents. It is to the net effects of all the changes that we now turn.

2.1. *The Distributional Impact of the Policy Changes*

To carry out our own quantitative exploration of the impact of Labour's policy on child poverty, we make use of POLIMOD, a static tax-benefit model, to simulate the effect of tax and benefit changes on household incomes. This model uses representative household survey micro-data to calculate taxes and benefits before and after policy reforms.[6] Similar exercises – with differences in coverage, period, emphasis and assumptions – have been carried out by Immervoll *et al.* (1999), the Institute for Fiscal Studies,[7] Piachaud and Sutherland (2000) and by the government itself (HM Treasury, 1999*b*, chart 5.1). The present analysis is distinguished by its attempt to capture the effects of all the main policy changes and commitments since the Labour government came to power in 1997 that are feasible to model in this way. The policy changes that are simulated include those that reduce the incomes of families with children, as well as those designed to increase them. In addition, we offer detailed breakdowns of the effects of the combined changes. We examine losses as well

[6] See Redmond *et al.* (1998) for more information. Our analysis is based on Family Expenditure Survey (FES) data for 1994/5 and 1995/6 updated to 1999/00 prices and incomes. To model the immediate affect on incomes POLIMOD calculates liabilities (or entitlements) to income tax, National Insurance contributions, child benefit, Family Credit (FC) or Working Families Tax Credit (WFTC), Income Support (IS) – including income-related Job Seekers Allowance and pensioners' Minimum Income Guarantee, Housing Benefit (HB) and Council Tax Benefit (CTB). Otherwise, elements of income are drawn from the recorded values in the FES dataset.

We attempt to capture the effects of non- take-up of means-tested benefits (FC/WFTC, IS, HB and CTB) by applying the take-up proportions estimated by the Department of Social Security (DSS, 1999*c*). For example we assume that some 20% of lone parents do not receive the FC (or WFTC) to which they are entitled, and 15% of people of working age do not receive the IS to which they are entitled. In general we assume that take-up behaviour is not affected by changes in the size of benefit entitlements.

We model the effect of the minimum wage by assuming that all hourly earnings below the relevant minimum are brought up to it and that working hours do not change. Resulting changes in earnings then affect tax and benefits.

[7] See www.ifs.org.uk/budgets.

as gains, focus separately on children in lone parent and two-parent families and on children with parents in and out of paid work, and explore the sensitivity of reductions in poverty to changes in the poverty line.

We start with policy rules as they existed in April 1997 and uprate their values to April 1999 using the Retail Prices Index (RPI). This is the *counter factual* – the policy we assume would have prevailed had Labour not come to power.[8] The policy changes that are modelled are listed in detail in the Appendix. They include all those that were announced between April 1997 and April 2000, whether or not they were operational in the year 1999/00. New policy is set in terms of 1999/00 prices. The changes that we explore include those specifically targeted on children, discussed in the previous Section. We also model some general changes to income tax (including rate reductions, the abolition of relief on mortgage interest and allowances for couples and lone parents) and National Insurance contributions (alignment of earnings thresholds with income tax thresholds), as well as the introduction of the minimum wage, adjustments to benefit rates (apart from price indexation), the introduction of an annual fuel allowance for pensioners, and the increase in capital thresholds for pensioners on Income Support.[9]

Our estimate of the revenue cost to the government of the combination of these changes is £7.5bn per year (in 1999/00 prices).[10] The effects on the distribution of household incomes are shown in Table 2. To rank people we used household income after tax and benefits (without deducting housing costs) and equivalised using the McClements scale.[11] An indication of the income levels that correspond to the decile points is provided in the first two columns for two specific family types.[12]

The third and fourth columns of Table 2 show the mean percentage change in household disposable income in each decile group for all persons and just for children.[13] Many of Labour's policy changes have been targeted directly at families with children and this is reflected in a percentage increase in house-

[8] Uprating is applied to all monetary values, not just elements of the tax-benefit system that are subject to statutory uprating or are traditionally uprated every year. We use the Rossi index (RPI less housing costs) for means-tested benefits.

[9] There are two important aspects of policy relating to children that we do not include in our analysis: the childcare tax credit associated with the Working Families Tax Credit, and changes to Child Support. In both these cases we believe that uncertainty about behavioural responses would make model estimates misleading or unreliable.

[10] The overall increase in gross earnings due to the minimum wage is estimated to be £1.7bn per year, making the total increase in net household income £9.2bn per year.

[11] Our choice of equivalence scale is due to our wish to reproduce, as far as possible, the HBAI methodology to make our results comparable with government figures. HBAI uses the McClements equivalence scale which gives much lower weight to the costs of children aged under 5 than most other equivalence scales. This results in an understatement of the prevalence of low income and poverty in families with very young children compared with analysis using other scales. The McClements scale allows 0.61 for the first adult (head), 0.39 for a spouse of the head, 0.46 for any other second adult, 0.42 for a third adult and 0.36 for subsequent adults. The child scale is 0.09 (age 0–1), 0.18 (age 2–4), 0.21 (age 5–7), 0.23 (age 8–10), 0.25 (age 11–12), 0.27 (age 13–15) and 0.36 for any children aged 16 or over.

[12] These are BHC incomes, out of which housing costs must be paid.

[13] Children are defined as aged under 16 or under 19 if in full-time secondary level education and not married.

Table 2

The Distributional Effects of Labour's Policies

Decile group*	Weekly household disposable income at decile point: 1 parent, 1 child†	Weekly household disposable income at decile point: 2 parents, 2 children‡	mean % change in household income§: all persons	mean % change in household income§: children	% of all children in households whose income: increases	% of all children in households whose income: decreases
bottom	108.20	186.05	8.4	12.3	82	17
2nd	131.38	225.91	8.8	13.9	97	3
3rd	155.69	267.70	6.4	10.8	97	3
4th	183.20	315.01	4.5	6.6	96	4
5th	214.57	368.95	3.1	4.2	98	2
6th	251.23	432.00	2.5	3.1	97	3
7th	294.14	505.78	1.8	2.1	94	5
8th	348.71	599.60	1.4	1.8	91	9
9th	451.75	776.80	1.0	1.2	82	18
top	–	–	0.3	0.4	64	35
All	–	–	2.4	4.3	91	9

Notes: * Ranked by equivalised disposable household income using April 1997 policy in 1999/00 prices. Household income is weighted by number of individuals and equivalised using the McClements scale.
† Child aged 6.
‡ Children aged 4 and 8.
§ These columns show the average change in household income for all people and for children. The differences between the columns reflect the fact that some households do not contain children.
Source: POLIMOD

hold income which is 80% higher for children than for people in general. With the exception of the bottom decile group which includes a disproportionate number of losers, a clear gradient is evident: lower income households and the children in them gain more in proportional terms.[14] Fig. 1 illustrates the effect for children. Under pre-Labour policy children are concentrated in the lower parts of the income distribution. The effect of the reforms is to move households with children up the distribution, although most of the movement is within the bottom half. The proportion of children in the poorest 30% of households falls from 38% to 31% whereas the proportion in the bottom half falls from nearly 60% to just 57%.

The great majority of children (91%) are in households that gain from the reforms. However, some are worse off and although the majority of these are in better off households, some 2.3% of all British children are not only worse off following Labour's policy reforms, they are also in the poorest 10% of households. As shown in the final column of Table 2, nearly 1 in 6 children in households in the bottom decile – 300,000 children – are worse off as a result of the reforms. These children tend to be in households not in receipt of

[14] As with all such estimates, this pattern will be sensitive to some extent to the chosen equivalence scale. Furthermore, in common with all other analysis based on survey data, all the POLIMOD estimates in this paper are subject to sampling error.

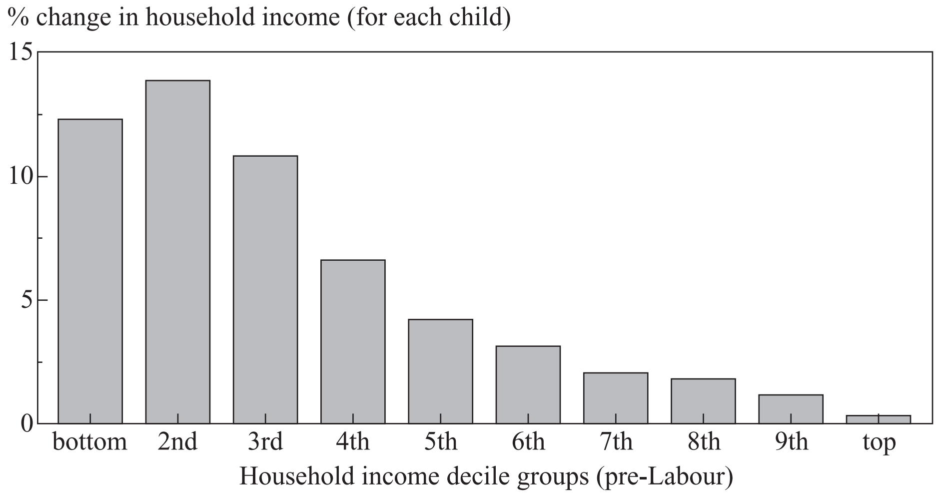

Fig. 1. *The Distributional Impact of Labour's Policies on Children*

Income Support (IS) who lose mortgage interest tax relief, or in households in receipt of IS with children aged over 11, who lose lone parent benefit and premia.[15]

2.2. *Reduction in Child Poverty*

Our particular concern is children living in poverty and the extent to which Labour's policy can reduce the prevalence and severity of this experience. The starting point of our analysis is the statistics on Households Below Average Income (HBAI) produced by the government (DSS, 1999*b*).[16] We would like to be able to answer the question: how many fewer children will be counted as poor in these statistics once the package of Labour's policies that we have modelled has taken effect? The household income variable used for ranking in Table 2 has been deliberately defined to be as similar as possible to that used in the HBAI statistics, using the 'before housing costs' (BHC) measure. We believe that this income concept is to be preferred over the AHC alternative for the analysis of changes in tax and benefit policy. An AHC measure does not include changes in Housing Benefit (HB) and would, for example, not capture reductions in HB entitlements following the introduction of WFTC. There are some minor departures from HBAI methodology due to the fact that we must

[15] In practice, lone parents who received lone parent benefits in 1997 will continue to have their combined child benefit and lone parent benefit payment protected in cash terms. We model the long-term effect of the structural change.

[16] For a description of these statistics in the context of targets for poverty reduction in the United Kingdom see Atkinson (1998).

simulate taxes and benefits in order to evaluate changes in the rules that govern them.[17]

Using 50% of mean equivalised household income as the poverty line, Table 3 shows that, under April 1997 policy, there are 19.1% of all people and 26.3% of children below the line and counted as poor. Introducing Labour's policy changes as described above reduces the overall poverty rate to 14.8% and the child poverty rate to 17.0%. The latter reduction of 9.3 percentage points corresponds to 1,230,000 children. This confirms the government's own updated figure of 1.2 million.[18] For simplicity, at this point, we do not re-calculate the poverty line following the impact of policy on incomes.

Table 3 shows the effects on children in one- and two- parent families

Table 3

Poverty Rates Before and After Labour's Policies

		Children		
	All persons	All	One parent	Two parents
All households				
Poverty rate, April 1997 policy (%)	19.1	26.3	42.5	21.8
Poverty rate, Labour policy (%)	14.8	17.0	24.4	14.9
% point difference	4.3	9.3	18.1	6.9
Net number removed from poverty	2,480,000	1,230,000	510,000	720,000
Moved out	2,520,000	1,240,000	520,000	720,000
Moved in	40,000	10,000	10,000	0
Households with paid worker(s)				
Poverty rate, April 1997 policy (%)	7.4	11.4	15.7	10.8
Poverty rate, Labour policy (%)	5.0	6.9	10.8	6.4
% point difference	2.4	4.5	4.9	4.4
Net number removed from poverty	870,000	420,000	50,000	360,000
Moved out	890,000	420,000	50,000	360,000
Moved in	20,000	~	~	0
Workless households				
Poverty rate, April 1997 policy (%)	39.4	60.0	57.4	62.2
Poverty rate, Labour policy (%)	31.8	39.8	32.0	46.3
% point difference	7.6	20.2	25.4	15.9
Net number removed from poverty	1,610,000	820,000	470,000	350,000
Moved out	1,630,000	820,000	470,000	350,000
Moved in	20,000	~	~	0

Notes: The poverty line is 50% of mean equivalised (BHC) household income. Numbers of people are given to the nearest 10,000. Rows and columns may not add due to rounding.
~ indicates less than 5,000.
Source: POLIMOD.

[17] FES data are updated to 1999/00 levels of prices and incomes in order to evaluate contemporary policy changes. In addition, there are some differences which arise because some components of income (taxes and benefits) are simulated rather than using values recorded in the survey data. The main effect of simulating the tax and benefit components of income appears to be to narrow the income distribution to some extent. There are also a few conceptual differences which are introduced in order to capture all the changes in policy on which we focus – notably the change in mortgage tax relief which is not included in HBAI BHC income. More detail on these sources of difference is available in Mitton and Sutherland (2000).

[18] HM Treasury (2000), Box 5.1. It is worth noting however, that the Treasury estimate uses an AHC measure of income and takes 60% of the median as the poverty line. We examined the implications of using 60% of the median. In the case of the BHC income measure used in this paper, 60% of the median is only very slightly lower than 50% of the mean (99.1% of the value).

separately. Children in one-parent families are over-represented among the poor, making up 35% of poor children but only 22% of all children. The policy changes reduce the child poverty rates in the two groups by different proportions: by over two-fifths in one-parent families and just under a third in two-parent families.

Table 3 also breaks down the changes in poverty rates for children by whether or not they live in a household with any paid workers. It shows that the package of policy changes is slightly less effective at reducing child poverty in workless households than in households where someone is in paid work (the reductions in poverty rate are 34% and 39% respectively). For children in one-parent families, the policy package is most effective where the parent is not in work. However, for children in two-parent families the opposite is the case: poverty reduction is lower in workless households (25%) than in households where someone is in paid work (40%).

As well as a clear and substantial reduction in child poverty, we can see that some 10,000 children in one-parent families find that their incomes are reduced such that they move *into* poverty. In addition it is clear from Table 2 that some who are in the bottom decile and already in poverty are pushed deeper into it.

The impact of policy changes on the number of poor children is important but so too is the reduction in the *extent* of poverty. The size of the child poverty gap, which is defined as the total shortfall of household equivalised income for each child below the poverty line,[19] is reduced by slightly less in proportional terms than the headcount of poor children. We find that the policy changes bring a 31.7% reduction in poverty gap, compared with a 35.5% reduction in child poverty rate.

Moving a child from just below to just above the poverty line has the same effect on the poverty headcount statistic as moving a child from the depths of poverty to a level of family income way above poverty levels. Fig. 2 examines *how far* Labour's policies have moved poor children, as well as how many of them are moved across the line. It is a transition matrix which divides children into groups with household income before and after Labour's policies (i) above 55% of the mean, (ii) between 50% and 55%, (iii) between 45% and 50%, and (iv) below 45% of the mean. The bottom left-hand corner of the figure (shaded cells) shows the children who are moved across at least two thresholds by the policy changes: children moved from the poorest 'below 45%' group to at least over 50% of the mean, and children moved from below 50% of the mean to above the 55% threshold. Of all children counted as poor (below 50% of the mean) before the policy changes, 806,000 or 23% are moved significantly in this way.

Our use of 55% of the mean as the top threshold in this analysis should not be taken to indicate that we judge incomes at this level to be adequate or acceptable. For a lone parent with two children aged 4 and 10 the 50% mean poverty line (BHC) is £161.02 per week. The 55% line is £177.12 and the 45%

[19] Thus the gap is weighted by the number of children affected in each poor household.

After	Before: below 45%	45–50%	50–55%	above 55%	total
below 45%	1,389	7	0	0	1,395
45–50%	664	172	7	0	1,845
50–55%	308	430	180	4	922
above 55%	67	431	646	8,882	10,026
total	2,427	1,040	833	8,886	13,186

Fig. 2. *Numbers of Children in Households with Income in Ranges in Relation to Proportions of the Mean: Before and After Labour's Tax-Benefit Reforms*
Thousands

Notes: Shaded cells indicate children who have been moved significantly out of poverty.
Source: POLIMOD

line is £144.92 per week. For this family, our 'significant move' represents at least an addition to income of £16.10 per week. However, even at 55% of the mean, income is lower than the minimum considered to be 'low cost but acceptable' by the Family Budget Unit (Parker, 1998) for a family of this type (£185.16).[20]

2.3. *Sensitivity to Shifts in the Poverty Line*

Another way of assessing the robustness of the prospective reduction in child poverty is to consider the effect of a rising poverty line. By the time all the policy measures that we consider have taken effect, the poverty line will have shifted along with average incomes. We do not attempt to forecast what this shift will be; many factors may be involved. Their combined effect will be observable when the official HBAI figures for 2001/2 are published (probably in 2003/4). However, it is possible now to calculate the direct effect on mean household incomes of the tax and benefit changes and the introduction of the minimum wage, and to allow the poverty line to shift accordingly. The 50% mean poverty line after Labour's policies is 2.4% higher than the poverty line

[20] We have uprated the January 1998 figure of £173.22, which assumes no work costs or alcohol expenditure, to 1999/00 prices.

before their introduction. Table 4 compares, for the fixed and shifting poverty line,[21] (i) the reduction in the child poverty rate, (ii) the reduction in the child poverty gap and (iii) the proportions of poor children making significant moves out of poverty.

The reduction in poverty shown by all three measures is naturally lower with a shifting poverty line. The child poverty rate falls to 18.7% with the shifting line, instead of 17.0% with the fixed line, indicating that 1 million children (instead of 1.23 million) are removed from poverty. The child poverty gap falls by 25% instead of 32% and the proportion of poor children who move significantly out of poverty is 16% (560,000) instead of 23%.

Overall, the Labour policy changes considered thus far will by 2001 reduce child poverty by between one-quarter and one-third, depending on the measure used.

3. Policies to Promote Paid Work

The government's objective is to increase paid work as one way of reducing child poverty. The strategy rests on two key components: helping parents return to, or find, paid work and making work pay. There is a combination of 'sticks' and 'carrots' to persuade parents that it is worthwhile to take up paid work. The only group for whom there is currently direct sanction are those registered as unemployed; lone parents will be obliged to discuss training and employment but, as yet at least, benefits are not conditional on compliance,

Table 4

Child Poverty Before and After Labour's Policies

	All	One parent	Two parents
Poverty rate, April 1997 policy (%)	26.3	42.5	21.8
Poverty line: fixed			
Poverty rate, Labour policy (%)	17.0	24.4	14.9
% reduction in poverty rate	35.5	42.6	31.7
% reduction in poverty gap	31.7	26.1	34.2
% poor children *significantly moved** out of poverty	23.2	24.1	22.8
Poverty line: shifting†			
Poverty rate, Labour policy (%)	18.7	27.7	16.2
% reduction in poverty rate	29.1	34.8	26.1
% reduction in child poverty gap	24.5	18.9	27.1
% poor children *significantly moved** out of poverty	16.1	16.2	16.1

Notes:
* 'significantly moved' means that household income rises from below 45% of the mean to at least 50% of the mean *or* rises from below 50% of the mean to at least 55%.
† 50% of the mean shifts up by 2.4%.
Source: POLIMOD.

[21] Note that estimates of this type may be particularly sensitive to sampling error. See Pudney and Sutherland (1994).

once the discussion has taken place. The main carrot is the Working Families Tax Credit (WFTC) which is aimed at make low-paid work more attractive and, alongside the minimum wage, guarantee a minimum income to those in paid work. The WFTC is intended to ease the unemployment trap (a lack of any significant gain in net income as a result of taking a job) and ease the poverty trap (the high marginal effective tax rate due to income tax, National Insurance contributions, and withdrawal of means-tested benefits). However, this inevitably involves widening the poverty trap, increasing the earnings band over which marginal effective tax rates are high (but not as high as before). As this extension up the earnings distribution occurs, the numbers involved increase rapidly. Thus the WFTC will reduce the number facing marginal effective tax rates of 80% or more, but it will increase the number facing marginal deductions of over 65%.

How far have the tax-benefit policy changes and the introduction of the minimum wage served to make paid work more financially attractive? Fig. 3 shows some calculations that illustrate the unemployment trap and the poverty trap for two family types (lone parents with one child and couples with two children), using standard government assumptions about housing costs and other circumstances that affect benefit entitlement. The increases in the gain from earning due to Labour's policies (reductions in the size of the unemployment trap) are significant for some but the gains themselves remain modest in size. In the case of lone parents, those earning around £100 per week would find that the return to working was *lower* under Labour policy than under policy that existed before the 1997 election. This is due to the combination of the abolition of lone parent benefit and the interaction between WFTC and Housing Benefit and Council Tax Benefit.[22]

The calculations in shown in Fig. 3 can also be used to show the impact of the policy changes on the poverty trap. For example, an increase in earnings of £50 per week for a lone parent earning £100 would result in a net gain in income of £15 per week under pre-Labour policies. This is an average marginal effective tax rate (AMETR) of 70%. The corresponding marginal rate under Labour policies is 40%. However, the AMETR for the same increase at an earnings level of £250 is 32% pre-Labour, and 70% under Labour policies. A similar shifting of high AMETRs up the earnings scale occurs for couples. Calculating the marginal effective tax rate for a smaller marginal increase in earnings (£1)[23] shows that very high marginal rates on very low earnings are not necessarily a thing of the past. For example the lone parent in Fig. 3 working for 16 hours on the minimum wage would face the same marginal rate on an additional £1 per week – 85% – under pre- and post-Labour tax-benefit policies. The employee in the couple in Fig. 3 working for the minimum wage

[22] These calculations do not include the effect of child care costs, nor of the child care credit associated with WFTC. Clearly the child care credit can play a major role in making paid work financially viable. However, the gains from earning that we calculate are the *maximum* since they assume zero child care costs. In any situation where child care costs were not met in full by a credit, the gains from earning would be *smaller* than shown here.

[23] As in HM Treasury (2000), Table 4.2.

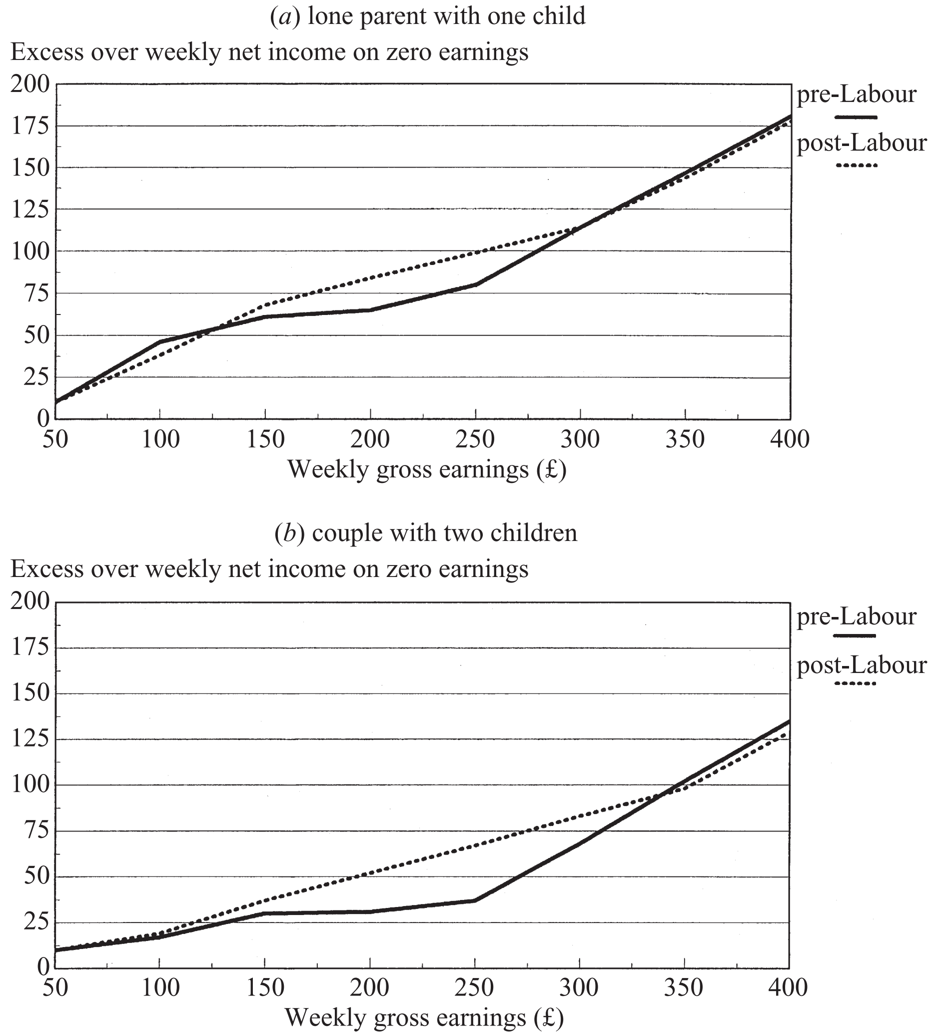

Fig. 3. *Gains from Earning Under pre-Labour and post-Labour Policies*

Notes: All figures £/week, rounded. The calculations assume children are aged under 11 and use assumptions for rent, council tax and hours of work (i) for lone parents from Department of Social Security (1999*d*), Table 1.2a and (ii) for couples from in HM Treasury (1998) Chart 1 and Table 2 (updated). Weekly hours are assumed to be under 15 for earnings less than £57.60; between 16 and 29 for earnings up to £108.00 and 30 or more for earnings of £108.00 or more.
Source: POLIMOD

for 30 hours a week would face a marginal rate of 96% under pre-Labour policies. This would fall to just 94% under Labour policies.

The new Labour approach has been to concentrate resources on the poor by means of greater selectivity and means testing. While child benefit has not been ignored, the increase in it is far smaller than in the means-tested element now operated through the Working Families Tax Credit. In the short- or medium-term greater targeting or selectivity is the most effective means of boosting the incomes of the poorest. But, in the longer-term, increased support for the poorest which is then rapidly withdrawn from those with more earnings, serves to widen the poverty trap – even if most of its extremes are smoothed out. There is a danger of creating a two-class world among families: poor families with no or low pay who receive large amounts of Income Support or Working Families Tax Credit and other families who receive little state support. If the condition of the poor families is improved but not that of other families on low or average incomes, then the incentive to self-help will inevitably decline. Thus, while the New Labour approach emphasises responsibilities and stresses the desirability of more self-reliance, its selectivity strategy may be undermining what it seeks to encourage.

How far these measures will increase paid employment among parents remains uncertain. Blundell *et al.* (2000) have estimated the effects of the WFTC on labour supply as modest: an increase in participation of 30,000, but they have not assessed the welfare to work measures. To illustrate the potential effect we have simulated a scenario in which parents not in paid work enter employment at the minimum wage for 16 hours a week (the minimum to qualify for WFTC). We assume that work entry does not occur if this would leave a child aged under 5 without a parent at home, or if the parent is a full-time student, on maternity or disability benefits or over pension age. Work entry on this scale would involve 1.4 million new jobs. It would take a further 0.42 million children out of poverty. Combined with the other Labour policies already analysed, poverty would be reduced by 1.65 million children, nearly halving the extent of child poverty (assuming no shift in the poverty line). This and other scenarios analysed in Piachaud and Sutherland (2000) make clear that increased paid employment would reduce child poverty but also that under any likely scenarios there would remain substantial numbers of families that would remain wholly dependent on state benefits which remain at levels below the poverty line.

4. Assessment and Conclusions: the Prospect for Child Poverty

The results of the micro-simulation of the policy changes announced up to April 2000 suggest that the number of children in poverty will fall by about 1.23 million – a reduction of about one-third. The prospects for parents' paid work are uncertain but the increase in employment together with the tax and benefit changes should result in a fall in child poverty of about one and a half million – or nearly one-half its current level. This seems a realistic forecast, but three aspects warrant attention.

First, those raised out of poverty tend to be pushed just above the line. This is most notably the case for the changes announced in the 2000 Budget. These added a few pounds at most to weekly income but managed to push a significant number of children over the line (Sutherland and Taylor, 2000). The result of all the tax-benefit changes in terms of poor children moved significantly out of poverty, if the poverty line is shifted following the rise in mean incomes, is a much lower reduction in numbers. It is more difficult and more expensive to tackle more severe poverty as well as ensuring that families have incomes significantly higher than poverty levels.

Second, our forecast depends on unemployment being kept down. As was stated in *The Changing Welfare State*:

> 'Sharp economic downturns and structural change lead to high unemployment and economic inactivity. This in turn can increase benefit caseloads dramatically. Such changes are not automatically reversed as the economy improves. If no action is taken, high levels of worklessness can persist for long periods. And persistent worklessness leads to poverty and social exclusion.' (DSS, 2000: p. 67)

Third, it is important to stress that, while child poverty will be substantially reduced, the extent of child poverty that will remain in 2001 is extremely high by post-war British standards and by European standards. Child poverty will still be over 50% higher than in 1979. If child poverty is to be abolished in a generation then it will not be enough to roll forward the policy initiatives taken so far. It will be necessary for poor families to earn more – which will require skills, childcare and jobs – and to receive more transfers from the state either in subsidies to low pay or social benefits – which will require more redistribution.

A significant start has been made towards ending child poverty in Britain. Most important have been redistributive measures favouring poor families, particularly working families. The promotion of paid work, assisted by declining unemployment, has contributed. Measures to tackle long-term causes such as educational failure and teenage births will over time make a contribution. Yet the measures so far taken leave much more to be done if the target of abolishing child poverty in a generation is to be achieved.

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Appendix: Modelled Changes in Tax and Benefit Policy Announced Between April 1997 and April 2000

Amounts are weekly and in 1999/00 prices and differences are expressed in real terms, unless otherwise specified. At the time of writing £1 equals approximately €1.60 or US$1.60.

Introduction of a *Minimum wage* of £3.60 per hour for employees aged 22 and over; £3.00 for employees aged 18–21.

Child benefit increased by £3.25 to £15 for first or only children and £0.40 to £10 for other children. Additional increases of £0.50 per family (and £0.35 for second and subsequent children) are due in April 2001. It is unclear whether these increases are in real terms on top of any indexation for inflation, or whether they include inflation increases. We have assumed the latter and deflated the nominal amount by an assumed rate of inflation of 2.25% (which is the Government's own forecast). Thus the real value of the increase is assumed to be £0.16 for the first child and £0.12 for other children, making the rates £15.16 and £10.12 in 1999/00 prices.

Lone parent benefit abolished (the 1997 benefit would have been £6.45 in 1999/00 in real terms).

Working Families Tax Credit (WFTC) replaces family credit. WFTC has a more generous starting point (by £9.35); a lower taper (55% instead of 70%); a higher adult credit (by £2.50), higher credits for children aged under 11 (by £12.65 per child) and children under 16 (by £4.35 per child) but lower credits for children aged 18 (£10.35 lower). (The childcare tax credit is not modelled.)

Income Support: family premium increased by £2.80; lone parent premium abolished (it would have been worth £5.15 in 1999/00); rates for children aged under 11 increased by £12.65, for children aged under 16 increased by £4.75 and those for other children aged under 18 by £0.40; rates for children aged 18 reduced by £9.35; and disability premia increased by £0.90 per person. The earnings disregard in Income Support and Job Seekers Allowance for lone parents, disabled and carers increases by £5 to £20 in April 2001. We have assumed that this is a real increase.

Housing benefit (HB) and *Council tax benefit* (CTB) changes to rates and premia match those for income support *except* that the real value of the 1997 lone parent premia (abolished) is £23.05 (HB) and £11.75 (CTB); there is no reduction in allowance for children aged 18 in HB and CTB.

Minimum Income Guarantee (MIG): the capital limits for MIG (Income Support for pensioners) are increased from £3,000 to £6,000 (so that income from capital less than £6000 per benefit unit is disregarded) and from £8,000 to £12,000 (so that pensioners with capital between £8,000 and £12,000 may be entitled to MIG assuming other conditions are met). Due in April 2001. Premia increased by £4.65 (single) and £7.45 (couples).

Capital thresholds in all means-tested benefits except MIG (and including WFTC) reduced in real value by 4.8% since 1997. (These have not been uprated since 1988.)

Winter fuel allowance: £150 per year for households containing a person over state pension age or in receipt of Income Support pensioner premium. (Assumed to be £2.88 per week.)

National insurance contributions: Class 1 employee contribution lower earnings limit (LEL) increased by £17 (to £83); upper earnings limit (UEL) increased by £50 (to £550); contributions on earnings below the LEL ('entry fee') abolished (worth up to £1.32 per week). *Class 2* (self-employed) contributions reduced by £4.55. *Class 4* (self-employed) lower profits limit aligned with the Class 1 LEL (a reduction of £61); Class 4 upper profits limit aligned with the Class 1 UEL (an increase of £50) and the rate of Class 4 increased from 6% to 7%.

Income tax schedule: introduction of a 10% lower rate on first £1500 of annual taxable income, including income from investments (replaces 20% lower band); standard rate reduced from 23% to 22%.

Married couples allowance (MCA) for couples both aged under 65 and *Additional personal allowance* abolished. (Under 1997 policy this was worth 15% of £1970 per year or £5.68 per week in 1999/00 prices.) *Age-related MCA* increased so that pensioner couples do not lose. Age-related personal allowances increased by £130 per year (age 65-74) or £200 per year (age 75+).

Mortgage tax relief abolished. (In 1997 the maximum annual relief was 15% of the annual interest on £30,000.)

Introduction of a *Children's tax credit*: this is for taxpayer families with children aged under 16. If either parent is a higher-rate (40%) taxpayer, the value of the annual credit is tapered at a rate of £1 for every £15 of income per year above the 40% threshold. The credit is to be introduced at the level of £8.50 per eligible taxpaying family when it is introduced in April 2001. We have made the same assumptions about inflation as with child benefit, making the real value about £8.31 per week in 1999/00.

Incapacity benefit is reduced by 50p for every £1 of occupational or personal pension income over £85 per week.

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