A credit to children

The UK's radical reform of children's benefits in an international perspective

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Contents

Foreword

This policy report is part of an international study of benefits for children in four countries, Australia, Canada, the UK and the US. A joint project by the Joseph Rowntree Foundation and the Caledon Institute of Social Policy, based in Ottawa, has undertaken the difficult task of describing each country's system in a common framework, and analysing similarities and differences.

The main international output of this work is a detailed description and analysis of the four systems, along with comparisons between them. It is being published by JRF and the Caledon Institute as *Benefits for Children: A Four-country Study,* edited by Ken Battle and Michael Mendelson, simultaneously with this report.

The Joseph Rowntree Foundation has been interested particularly in the lessons of international experience in this area for the UK's new Integrated Child Credit. In June 2000, it brought together leading international experts and UK officials in a seminar in London to discuss these implications. The present volume presents the issues that have emerged for the UK from this exercise. It has drawn heavily on the expertise and advice of the lead country experts, Ken Battle, Michael Mendelson, Daniel Meyer, Jane Millar and Peter Whiteford. But opinions, errors and oversimplifications remain the responsibility of the author.

1 Introduction: a new departure

Who pays for bringing up children? Families have always taken the main responsibility, but often with some assistance from communities or society as a whole. For the past century or so, the state has also entered the picture. In a number of countries, including Britain, it has helped to redistribute resources in favour of families with children. Most commonly, they have not had to pay as much tax as those without children. In addition, or alternatively, some or all families have received payments from the state, particularly in recent years. While such support has not been designed to transfer the primary financial responsibility for children away from families, it has acknowledged that all of society has a stake in raising the next generation, and that the state should therefore make a contribution.

In the past 20 years, the rationale for and nature of this commitment have taken on an important new dimension. The reason is the spread of child poverty. Post-war welfare systems had relied mainly on families receiving wages from work and insurance benefits in periods out of work to meet the basic needs of their children. Tax breaks might help at the margin, but often did not even reach lower income groups. But today, in Britain and many other countries, these systems have not been sufficient. Child poverty has spread and deepened, principally because of: a huge growth in the number of children living, often for extended periods, in families without work; a reduction in the relative pay of the poorest workers; and reductions in the relative benefit levels of people out of work. A growth in lone parenthood has been an important underlying factor, contributing to how many families have low or no income from work.

This growth in child poverty while societies grow richer has raised the stakes. Society must now consider not just an equitable amount to contribute collectively to the cost of bringing up the next generation, but how to avert the bitter social consequences of allowing a large section of that generation to grow up poor and feeling excluded from economic and social norms.

Part of the solution lies in addressing the root causes of child poverty, whether that means welfare to work, neighbourhood regeneration or other programmes that help families to help themselves. But, however successful such policies prove to be in combating exclusion, they are unlikely on their own to conquer poverty. A Beveridge-type world, in which work and insurance against non-working periods are the main pillars against poverty, looks as elusive as ever in countries where the bottom end of the labour market no longer provides sufficient rewards or stability to give such protection.

Implicitly accepting these arguments, a number of governments have been developing structures to protect more systematically the incomes of poor families, whether working or not. These anti-poverty measures are often superimposed on more general payments or tax reliefs that preserve the older principle of giving support to families with children regardless of income. Canada, Australia and the United Kingdom have strong similarities in that they are presently rationalising systems that have developed piecemeal in response to the above trends, and that combine targeted with more widely available support. The United States has some similarities to these countries, in particular in providing tax-delivered benefits for low-earning families, although a big difference is the lack of a safety-net programme for non-workers. All four countries presently put a strong emphasis on ensuring that benefits for children either help or do not hinder work incentives. The study on which this paper is based (Battle and Mendelson, 2000) therefore looks at Australia, Canada, the UK and the US.[1] (Other European countries are confronting similar issues, but in the context of very different structures for social protection and support for children; they are not covered in this study.)

In 2003, Britain will introduce an Integrated Child Credit (ICC), which aims to embody more systematically the policy hitherto pursued by a range of separate payments aimed at children. While it will not in itself necessarily change the structure of entitlements, it encapsulates the way in which the government presently looks at benefits for children, which is very different from 20 years ago. In principle, it is aiming to cover something close to the full cost of raising children to parents on low incomes, while paying lesser but still significant amounts to those on middle and on higher incomes.

The ICC will do two particularly radical things. First, it will provide for the first time a common means-tested benefit for poor families regardless of whether or not they are working. Second, it will make explicit that it expects this payment to meet the needs of children, and separate it from other means-tested payments meeting needs of poor families. (Although, as discussed later in this paper, separating family and child poverty is difficult if not impossible.) The idea of a specific payment for children is underlined by paying the Child Credit as a separate amount to the mother or main carer, and by keeping that payment stable for families who move in and out of low-paid jobs.

This report aims to analyse the UK's present situation and options in the context of the experience in Australia, Canada and the United States. The following chapter sets the scene by reviewing briefly the provisions and perspectives of each of the four countries. Chapter 3 then analyses a series of policy questions that need to be addressed in introducing the Integrated Child Credit in the UK, indicating where other countries' experiences can help us to think about the answers. Finally, the concluding chapter reflects on how these issues fit into the wider political and economic environment.

Note

1 This paper and the study on which it is based look primarily at what they call ‘benefits for children’, which are defined as financial transfers that families receive because they have children, whether in the form of direct benefits or tax reliefs or credits. Benefits in kind such as food stamps or free school meals are not directly included, but are referred to where relevant. Broader issues about programmes directed at children (e.g. health, education) are not addressed here. The study also did not look systematically at maternity payments or parental leave – designed to enable parents of young children to stay at home, rather than to add to resources available for children themselves.

2 Benefits for children in four countries: an overview

The following descriptions are not comprehensive: they pick out some salient features of each country's system and how they are being thought about and changed. A full description of benefits for children in each country appears in the comparative study published with this report (Battle and Mendelson, 2000).

Australia: a needs-sensitive system in search of simplification and incentives

Families in Australia receive:

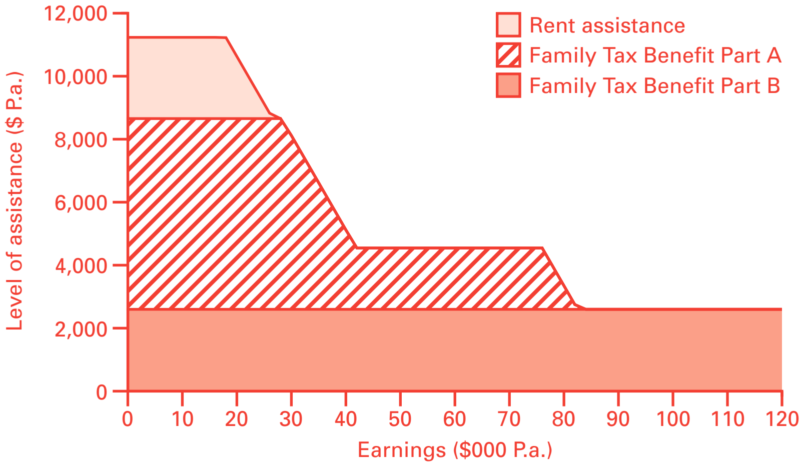
- A payment going to all but the richest 10–15 per cent, with a flat higher rate going to those on low to middle incomes (40–50 per cent of families) and a reduced rate for the rest. This 'Family Tax Payment Part A' is payable as a cheque to mothers, or can be offset against income tax liability. Those on the higher rate also get a rent allowance. Assistance is higher for older children (starting from age 13). A single system covers both families in work and out-of-work families receiving social assistance.
- A supplementary payment ('Family Tax Payment Part B') for families where there is a single earner, higher for those with children under five. This is paid regardless of the income of the main earner; where a second earner in a couple works, the payment is withdrawn once their income rises above a very basic level.
- An extensive system of income-tested assistance with child-care costs, paid mainly directly to service providers, but partly also directly to parents.

This system was introduced in July 2000, simplifying 12 earlier forms of assistance into three. It is the product of many years of evolutionary reform. From the 1970s onwards, the main thrust has been to get payments to mothers in lower income families, but without cutting out people on middle incomes. It is also notable that since the 1980s Australia has had the highest growth in poverty before tax and benefits of the countries in this study, but is also more effective at reducing poverty rates through the tax and benefits system (see Figure 5 later in this report).

Australia therefore now has a highly redistributive social welfare framework. It uses benefits rather than the tax system to pay money directly to those caring for children. There is already a high degree of integration between benefits for working and non-working families along comparable lines to that proposed in the United Kingdom.

Figure 1 shows that, even though most payments for children are means-tested, the schedule for withdrawing them as income rises is not severe. The maximum amount continues to be paid to households who are not the very lowest earners (in the family type shown, up to 70 per cent of average earnings). Assistance is then

Figure 1 Family assistance for single income couple, private renters, one child under five, one five to 12, Australia, post July 2000



Note: There is about A$2.60 to £1.00 at July 2000 exchange rates but, in terms of purchasing power, A$2.00 buys about the same as £1.00.

withdrawn at a rate of 30 per cent, so that only the minimum rate of 'Part A' payments is payable from around 120 per cent of average earnings.

However, the overall tax and benefits system – taking account not just of family payments – does create a fairly high withdrawal of earnings at the margin for low to middle income families. The new structure introduced in 2000 reduces the effective marginal tax rates for people in income bands where benefits are being withdrawn from 80 to 60 per cent, although at the same time it brings some newly eligible recipients into this 60 per cent rate from a previous income tax rate of 30 per cent. In addition, there are continuing interactions with the withdrawal of other forms of assistance (for example, assistance to youth), which can raise effective marginal tax rates to higher levels.

Canada: moving towards an integrated, broad-based benefit that is not part of 'welfare'

In Canada, families with children receive:

- From the Federal government, an income-tested but broad-based Canada Child Tax Benefit reaching eight in ten families, soon to grow to more than 90 per cent. The maximum benefit is paid at a flat rate to those on lower incomes. For those above about 46 per cent of average non-elderly family income, the amount is very gradually reduced until it disappears for families at 122 per cent of average family income. This benefit is administered through the tax system, and is based on the reporting of income that almost every Canadian adult must make to the tax authorities. The benefit is paid to taxpayers and non-taxpayers alike, by cheque or by electronic bank deposit.
- From provincial governments, a variety of new income-tested child benefit programmes that supplement the federal system

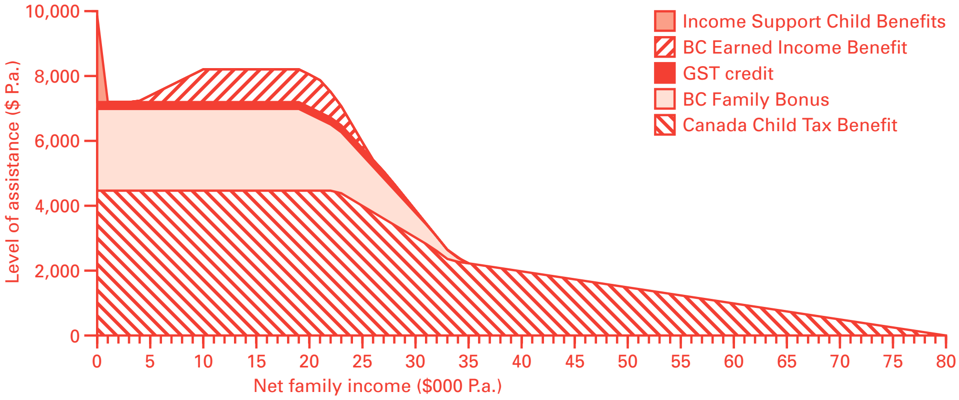
and are broadly in line with its structure. Provinces also provide social assistance (comparable to UK Income Support) at various levels for families without other means. The child element in this can be considerable. However, under the new National Child Benefit reform, increases in the federal Canada Child Tax Benefit are reducing and eventually replacing child benefits paid through provincial social assistance.

- There are in addition some smaller programmes, such as a credit delivered through the tax system to offset some of the costs of the value added tax (GST) for low income families and a lone parent non-refundable credit equivalent to the credit that a single earner in a couple would receive for a non-working spouse.

The present structure of child benefits, only in place since 1998, is the culmination of many years of reform. A regressive system based on a child tax exemption between the world wars was supplemented for all income groups after 1945 with the creation of a universal Family Allowances programme. From the 1970s onwards, benefits became more income-related, with the poor getting most, and in 1991 the richest were excluded. The most recent reform consolidated this targeted approach by increasing and equalising child benefits for poor families, although the system still serves the large majority of non-poor families and is beginning to improve benefits for them as well. The other big change was to begin the integration of provincial child benefits into the national system by allowing provinces to reduce income payments for children, now provided federally, if they reallocate the savings to other income programmes and services for low income families with children.

As Figure 2 illustrates, the federal tax credit for children (the bottom layer) is only withdrawn gradually as family income rises, even though various provincial benefits disappear sooner. Of the countries looked at here, this represents the most gradual rate of

Figure 2 oTal child benefits, couple with one child under seven, Canada (British Columbia)



Note: There is about C$2.20 to £1.00 at July 2000 exchange rates, but, in terms of purchasing power, C$1.80 buys about the same as £1.00.

withdrawal. The base benefit is withdrawn at a rate of just 2.5 per cent for families with one child and 5 per cent of net family income where there are two or more children; its maximum level is received by families with up to 46 per cent average income, and some benefit is received up to 1.2 times average income. (But families with low incomes also receive a federal supplement which is withdrawn more steeply between 32 and 46 per cent of average income.)

The present system has managed to strengthen the anti-poverty objective while at the same time beginning to improve benefits for the non-poor majority of families with children. It distributes benefits in a rational, income-based structure. By making benefits to children available to a large majority of families, it helps promote social cohesion and its anonymous administration through the income tax system avoids stigma.

However, the Canadian introduction of an integrated child credit is incomplete since the Canada Child Tax Benefit has not yet fully displaced provincial social assistance payments. To this extent, there remain the problems of stigma and social exclusion, associated with social assistance, which is assessed through a monthly needs test.

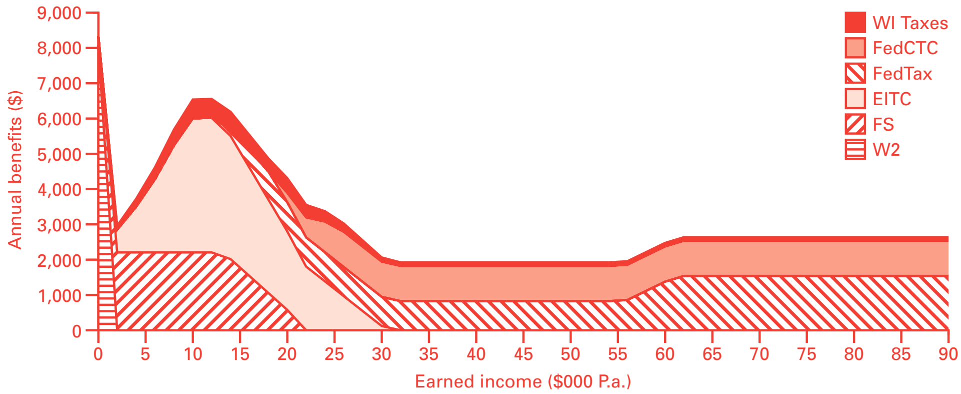
United States: a system centred on work incentives, not poverty relief as such

Benefits for children in the United States are provided primarily through the tax system. Families with children receive:

- A tax allowance of $2,750 per child, worth most to people paying the highest rates of income tax.
- A credit against income tax liability of $500 per child, worth the same to families on all tax rates.
- The Earned Income Tax Credit (EITC) if they work with low incomes. Initially, more earned income attracts a higher credit, until a maximum payment is reached; thereafter, the credit declines in value as income rises. The EITC is paid at a much higher rate to families with children than to others.
- Financial support while participating in welfare to work programmes, for example, those participating in an approved job placement. This varies by state, as do assistance programmes for parents who are not working.
- Food stamps, health benefits and other benefits in kind to poor families and individuals. Food stamps, while not strictly a cash benefit, are effectively equivalent to cash where the amount given does not exceed the amount that families would anyway spend on food.

Thus, there is no universal benefit for children in the United States. As illustrated in Figure 3, the tax system provides a level of support for all working families, which for the rich can be as high as for families on very low earnings. The situation for the latter varies greatly by state according to their welfare programme. The graph

Figure 3 Cumulative child benefits, two parents, two children, United States (Wisconsin)



Note: There is about $1.50 to £1.00, both in terms of July 2000 exchange rates and in terms of purchasing power.

shows Wisconsin, which gives more than average to those with no earnings (shown in the height of the left-hand 'spike') but withdraws it more quickly than many states once people are in work (shown by the steepness of the spike). But, in general, apart from those who qualify for out-of-work welfare programmes (which have become more restrictive since the mid-1990s), the families with the greatest aid are not the very poorest workers but those with modest earnings. This reflects the objective in the United States, which is not to relieve child poverty per se, but to encourage poor families to work. Up to a certain point, the more they work the more they are rewarded with federal payments through the Earned Income Tax Credit.

This system has developed and works reasonably well in the present period of unprecedented job opportunities. It relies heavily on the market generating sufficient paid work to support the poor. States vary in the emphasis they put on encouraging work compared to helping people who are not working, but the trend has been towards emphasis on the former. This leaves a system weak in providing for temporary unemployment or for income fluctuations while in work. In the case of the latter, annual tax-based assessments take a long time to respond to changing circumstances. None of this may matter too much in a boom, but it would raise difficult issues in a recession.

The United Kingdom: developing a targeted and universal system

Families in the United Kingdom receive, for each child:

- a flat-rate benefit as of right (Child Benefit)
- means-tested benefits if they are not working (as part of Income Support)
- means-tested tax credits if they are working but on low incomes (as part of Working Families Tax Credit)
- from 2001, an additional tax credit if they are working but not paying higher-rate tax (Children's Tax Credit).

In 2003, the government plans to integrate the last three of these into a single Integrated Child Credit while retaining universal Child Benefit. The idea is to create a more visible and rational system for providing a combination of universal and means-tested benefits for children. To understand this change, one may characterise the development of UK policy as follows.

- 1909–77: tax allowances make a social contribution to the cost of bringing up children, but provide most to higher-rate taxpayers and nothing to non-taxpayers.
- 1977–98: tax allowances replaced by child benefits providing a flat rate for everyone. These benefits remain significant, but they fall in real terms and are supplemented by means-tested payments to the growing numbers of families with no pay or low pay.
- 1998–2003: jump in both universal and means-tested payments, with biggest gain for low income working families, who get tax

credit rather than benefit. This unprecedentedly generous targeted help for the working poor is driven by the government's crusade to end child poverty using work as the central instrument. But the present government has also asserted a commitment to the wider support of families with children by reintroducing a credit for most taxpayers, not just poor ones. In contrast to the pre-1977 system, however, higher-rate taxpayers are excluded from this tax break, rather than receiving the most.

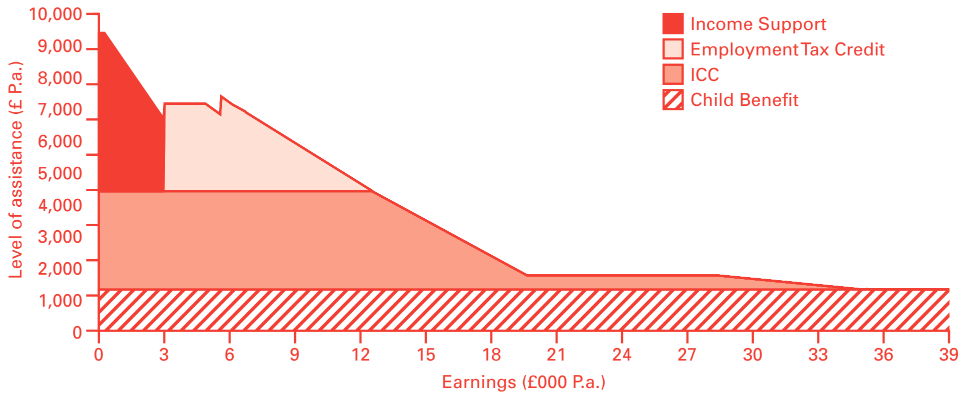
- 2003–: the new integrated credit makes means-tested child payments more visible and stable, like child benefit: paid to the mother or main carer, and stable rather than varying continuously with income.

Figure 4 shows how the structure of the ICC aims to combine targeting and universalism in a simple way. The bottom two layers, paid to the main carer, are supposed to be seen as allocations for spending on children. Every household with an income below a certain level will get the same amount, which will be comparable to the cost of bringing up a child. Middle income parents will get another flat amount and higher-earners a smaller sum (Child Benefit only), in both cases intended to contribute to rather than cover the cost of children. Only in relatively narrow income bands between these 'plateaux' of support will the Child Credit be reduced with earnings – for people not in these bands, it will be stable. Low income households will have other means-tested payments withdrawn more continuously (top layers on the graph), but this will not affect the amount assigned to children.

Thus, the present reform of benefits to children in the UK is based on new ways of thinking about the:

- *level* of support for children in low income families
- *stability* of this support across all no-earner and low-earner households

Figure 4 The Integrated Child Credit relative to other basic support, couple with two children (illustrative based on present entitlements)



Note: Only the bottom two layers on this graph show payments directed at children, which is the basis of the graphs for the other countries.

- *direction* of this support to the person most likely to spend money on children
- effects on *work incentives*
- level of support for *middle and higher* income parents.

Overlaying these aspects of who receives what are important issues about the design and delivery of the system. By moving to administration by the tax rather than benefits authorities, and creating greater integration across benefits for working and non-working families, the government hopes to reduce stigma. The ICC looks more like something for everyone than a welfare payment only for the poor.

However, in moving towards a tax rather than benefits model, two other key issues have arisen.

One is over *to whom* the credit is paid. The Working Families Tax Credit is in many cases seen in a male earner's pay cheque. This is in contrast to the benefit that preceded it, the Family Credit, which was a benefit paid to mothers. The new system is a compromise. The Integrated Child Credit element – representing stable support for the children – once again goes to the 'purse not wallet'. The Employment Tax Credit element – representing support for the adults in a household that encourages them to take low-paid work – appears in the pay packet.

The second issue is *when* the credit is paid and over what period it is assessed. This has not yet been resolved. The United Kingdom is inclined to assess and pay its benefits over rather short time periods, in order to make them responsive to rapidly changing needs. But this may now need to be traded off to some extent with the desire for the support system to occupy itself less minutely with people's lives, and to redefine the contract between state and client so that the latter feels less closely dependent.

These issues are discussed in more detail in the following chapter.

3 Eleven questions for the Integrated Child Credit – and how experience in the UK and elsewhere suggests they might be answered

The introduction of the Integrated Child Credit in the United Kingdom in 2003 will represent much more than a relabelling of tax and benefit entitlements. By separating out for the first time those elements of financial support for households that are aimed at children, the reform raises a range of issues around how this support can best be designed to meet children's needs. The new system is not being built from scratch. It will have to be sensitive to the present structure of entitlements. But its inception offers a unique opportunity to think about the *adequacy*, *structure* and *delivery* of the support that is offered to families with children. Most importantly, the challenge will be to ensure that it is seen as a just, clear and logical system to the general public who pay for it, and to the families who benefit from it.

In no country does the state try to provide a universal benefit to cover the full cost of children; at most, payments to middle and higher income groups partially offset such costs. But the adoption by Australia, Canada and the UK of substantial flat-rate payments to lower income families in and out of work will force them to confront issues of adequacy. Since these payments go to some families with no market income, their adequacy can be looked at in terms of their ability on their own to provide children with what they need to avoid deprivation.

The past three UK Budgets have gone some way towards bridging the gap between the sums that poor families receive to support their children and the actual cost of bringing up a child. But families living near the breadline would like to be able to depend for an adequate income on something other than the largesse of the Chancellor in last year's Budget. Identifying a payment specifically intended to cater for children may help to ensure greater stability to this help over the longer term. However, the experience of Child Benefit provides a mixed precedent. On the one hand, its popularity has certainly prevented it from being abolished when several Chancellors may have liked to; on the other, its value has not consistently kept up with prices, let alone average earnings and hence general living standards.

If the new Child Credit is to provide a more solid long-term support for poor families, it will need to be designed in a way that commands some form of consensus. If there is social agreement that it establishes at least a baseline of adequate family income, it will be harder for future Chancellors to undermine it. This raises a number of important questions over its design, not just related to its base level. The structure of entitlements will influence whether the Credit is viewed as a 'handout' to the poor or becomes part of a legitimate recognition of the cost of children (like Child Benefit) – and whether it is seen as supporting or undermining work incentives. The details of entitlements will also interact with delivery issues; for example, can a family-based means-test be delivered through an individual-oriented tax system? The following, then, are some key questions that arise around issues of adequacy, structure and entitlements.

Question 1: how generous a base income for poor children?

One of the most elusive tasks is to come to an operational definition of an income adequate to cover the cost of raising children.

Should governments:

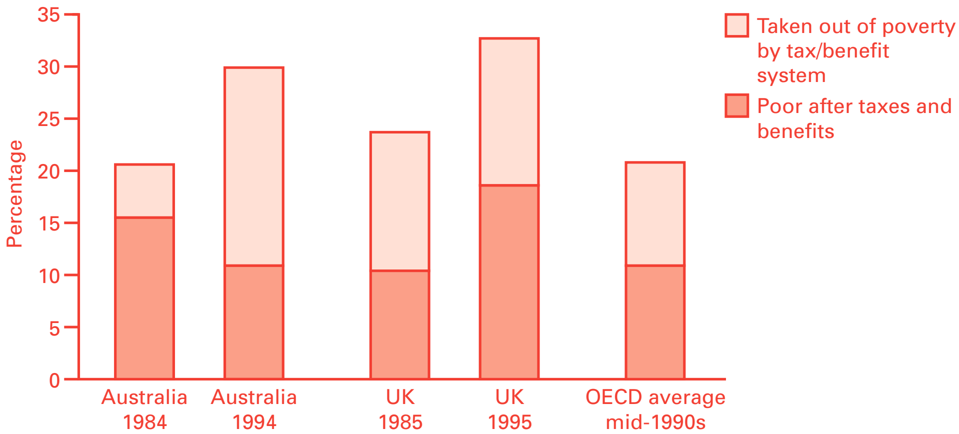
- Aim to bring as many children as possible above an arbitrarily defined poverty line? Or regard such a line simply as a reference point which can be used to measure success in terms of reducing the 'depth of poverty' (i.e. how far people fall below the line)? International experts at the JRF's seminar warned against focusing too much on how many cross the line. Clearly, if every child eventually crossed it, depth of poverty would stop being an issue. But, in the interim, it may be more desirable to alleviate the suffering of the very poorest than to move people who are just below an arbitrary line to just above it.
- Set a more meaningful target in relation, for example, to a budget standard? The Family Budget Unit calculated in 1998 that a couple with two young children on Income Support were £39.05 a week short of a budget that would buy goods and services that met their most basic needs (a 'low cost but acceptable' budget). Since this calculation was made, Income Support for this family has risen by £36.35, but about £12 of this represents inflation. So, in real terms, the shortfall has fallen from nearly £40 to about £15. This is encouraging progress in a short period. However, even meeting the basic budget standard may not in the long term be sufficient to allow families depending on benefits to live in dignity and free of debt.

Hence, any adequacy standard is likely to be determined as much by political and economic judgement as by an objective definition of 'how much is enough'. Box 1 illustrates how different political outlooks affect these standards in various countries.

Box 1 Setting adequacy standards

Research by John Veit Wilson (1998) for the Joseph Rowntree Foundation found that in various countries there is no single prevailing method for setting adequacy standards. The definition of adequacy is as much a result of political outlook as of social science methodology. For example, Nordic countries consider social equality to be important and aim to limit how far levels of living fall below the average; some other European countries express poverty rather in terms of exclusion from one's right position in highly unequal societies; in the United States, it is seen rather as lack of money to meet minimum needs.

Figure 5 Percentage of children in poverty before and after taxes and benefits



Source: Oxley *et al.* (1999).

However, recent international experience does also show that it is possible for financial support for children (rather than just parental employment patterns) to reduce substantially the number of children living below a poverty line, however arbitrary such a line might be. For example, in the past 20 years, Australia has been developing policies to deliver family benefits with similarities to those presently being developed in the UK. Figure 5 tells an interesting story, defining poverty as below half median household income. As in the UK, market-based inequalities in Australia rose sharply in the late 1980s and early 1990s, with the total number of children in poverty before taxes and benefits (total height of bars) ending well above the OECD average in both countries. In the UK, the tax and benefit system did not compensate for this change. But, in Australia, benefits for poor children were increased greatly, so that final child poverty actually fell, and ended close to the OECD average.

The introduction of the Integrated Child Credit is a useful moment for the UK government to clarify the basis on which tax and benefit policy is intended to underpin its anti-poverty strategy. While the Credit will not on its own lift every family out of poverty, its level could be linked explicitly to a set of assumptions about children's needs. The more explicit the basis on which this is done, the stronger the long-term commitment to an adequate Child Credit is likely to be.

Question 2: are we confident about the weightings given to different household members?

In 1998, the Chancellor announced that families on Income Support would receive the same allowance for every child, rather than £5 less for children aged under 11 than for those aged 11 and over. This was justified by research showing that older children do not necessarily cost more. It is easier to make such adjustments in the context of an overall increase, which does not create losers. That happened in 1998, and could potentially happen with further adjustments of relative payments, if the context of a rising priority of payments to children in a strong economy continues. At present, for example, Child Benefit is set at one-third lower for second and subsequent children than for the first child. But the research shows that the difference in *spending* on subsequent children is only about 10 per cent lower on average, and that there is no discernible difference at primary school age (although actual spending is not necessarily proportional to need) (Middleton *et al.*, 1997). The advent of a new system gives the opportunity to reassess these relativities, which has not happened on a general basis since the 1970s.

International experience indicates that there is no single clear 'answer' to how the relative cost of different family members should be taken into account. For example, the Canadian government tried hard to calculate this when designing its present system, but found that the variability among families in different circumstances made relative costs difficult to generalise. In particular, the cost of child care for families with young children was extremely variable. Its conclusion was that the important thing was for the system to be clear and reasonable, rather than foolproof. Australian child poverty initiatives in the late 1980s adjusted the relativities between children and adults, and raised the assistance levels for older children, going in the opposite direction to the UK recently. But this adjustment did not settle an ongoing debate about appropriate relativities. The conclusion for the UK may be that it should reassess the existing relativities on the basis of the considerable evidence now available, but accept that some judgement will need to be exercised. For the purpose of simplicity, it may adopt the principle of giving different weightings to different children only to the extent that there is a clear case for doing so, but otherwise regard the cost of each child as equal.

Question 3: can children be taken out of the welfare equation?

Separating children's payments from other support for families seems, on the face of it, to imply that the cost of children can be separated out from a family budget. Although researchers have estimated the extra cost of children (Middleton *et al.*, 1997), and looked at the ways income gets allocated within families (Goode *et al.*, 1998), in practice, it is hard to distinguish spending needs for different members of the family. One reason is that the cost of shared goods such as housing is difficult to apportion. Another is that the amount that poor families actually spend on children interacts with the amount they spend on adults. The research indicates that parents often make sacrifices in their own welfare to meet their children's needs.

Benefits for children in other countries take a range of approaches in this respect. Australia makes a single family payment taking account of family composition. The United States has a combination of general tax credits for children and a means-tested credit for low earners that is highest for families. Canada comes closest to the proposed UK's ICC, in putting support into a child tax benefit.

It would be misleading to regard child-oriented payment systems as implying that children's needs can be addressed completely independently of adults'. There are different ways of channelling resources to parents other than through child allowances – including, for example, the current family supplement in Income Support. Meeting parents' needs in the ICC could raise complex issues about the structure of the system, not just its adequacy; these are addressed under Question 7 below. But, whatever structure is introduced, parental spending should not be forgotten, and policy makers would do well to regard the welfare of children as closely tied into that of their parents.

Question 4: do we sufficiently distinguish short-term and long-term needs?

Ensuring that families have sufficient resources to buy basic daily necessities for their children is not the same as meeting some of their longer-term needs. Any household that experiences a drop in income may initially be able to cope, but finds things harder once they have to start replacing or repairing household appliances, carrying out repairs on their home or buying new shoes for their children.

Since the abolition of a long-term rate for means-tested benefits, the United Kingdom has not specifically acknowledged this distinction between immediate and longer-term needs.

Governments tend to be ambivalent about providing for longer-term needs of people receiving means-tested assistance. In the United States, in particular, there are strong efforts to deter long-term ‘dependency’ on welfare payments.

Yet, even if current efforts at welfare reform succeed in reducing the number of children in families outside work for extended periods, it will still be important to consider how well benefits meet longer-term needs, for two reasons. One is that some families are still likely to spend extended periods not working. The other is that families moving in and out of low-paid work may come to regard the ICC as the most stable part of their budget for spending on children. There is a case for designing this to be adequate to cover longer-term purchases, rather than relying on arbitrary mechanisms such as the Social Fund.

A related issue concerns the asset test, which is set at a low level in the UK by international standards. Australia’s assets test on family assistance was mainly designed to exclude the very wealthy, before it was abolished. In the United States, several states have relaxed the maximum level of assets for welfare claimants, and some have subsidised saving. In the UK, the ICC gives an opportunity to reconsider asset testing. A credit aiming to ensure that children in low income families have stable access to resources is not the same as a temporary benefit to help those with no income or assets through a difficult period. It may be possible to exempt the ICC from an assets test entirely, without doing so for Income Support or the Employment Tax Credit, so that some families with assets would have the ICC as their one source of income.

Question 5: what trade-off will society accept between targeted and general financial support for families with children?

Although none of the other countries under review has a ‘universal’ benefit like Child Benefit in the United Kingdom, all provide some form of payment to families with children to many better-off families. The recent reforms in Australia, Canada and the United Kingdom have all combined basic payments available to middle income families with higher ones available to poor families, under the same system. This has the obvious advantage of giving most citizens a stake in a system that nevertheless focuses on the needs of the poorest.

In looking to the long-term future of such a system, several issues arise. One is over the future of a truly universal system in an environment of scarce public resources. Until recently, an important debate in the UK was whether to ‘affluence test’ or to tax Child Benefit. The introduction of the Child Tax Credit, soon to be rolled into the ICC, would make it possible to move towards a system that gives something to people on middle incomes but much less to the richest. Since this element will not go to people paying higher rate income tax, one option would be for it gradually to replace Child Benefit, by letting the value of the latter wither.

However, such affluence testing is mainly symbolic. An issue that makes more difference to the Treasury and to recipients is the level and structure of benefits to middle income groups. Australia and Canada take somewhat different approaches. Australia gives a flat-rate Family Tax Payment to those on middle to higher incomes, worth about two-thirds as much as UK Child Benefit for the first child (measured in terms of purchasing power) and about a quarter of the full payment to poorer Australians. Canada, on the other hand, has no flat rate below the maximum; it tapers off maximum support very gradually, which avoids steep withdrawal rates, but is means-tested more continuously. Question 6 looks more specifically at mechanisms for withdrawal.

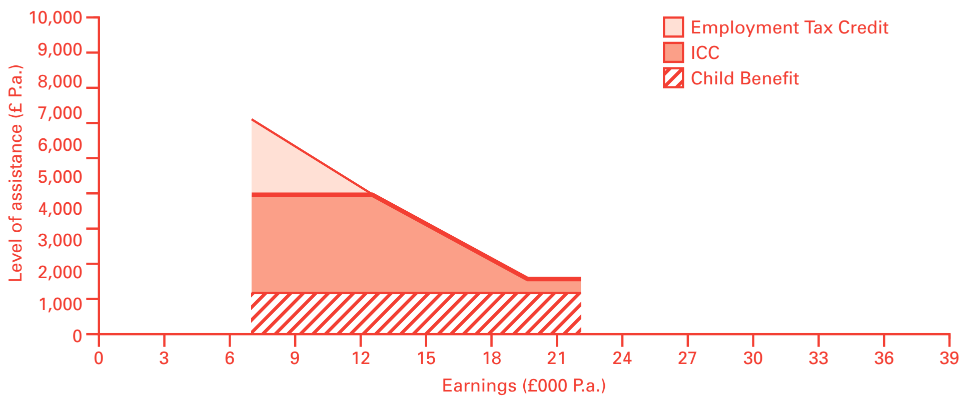
Question 6: what is the best way of withdrawing targeted assistance as income rises?

The introduction of means-tested payments to working families raises a fundamental dilemma about how to withdraw it with rising income. The more generous the support, the more effective it is in relieving poverty and providing an incentive to take work on a low wage. But the greater the generosity, the more problematic its withdrawal. Removing it rapidly with rising income creates a high effective marginal tax rate. More gradual withdrawal makes the rate less steep, but extends still relatively high withdrawal rates further up the income scale. In either case, the payment may remove children from poverty but make it harder for their families to rise above a just adequate net income. So the poverty trap gives way to an adequacy trap (known in Australia as the 'low income trap').

The challenge is to devise a system that simultaneously achieves government objectives in terms of targeting, avoids the worst disincentives and seems fair to recipients.

The Integrated Child Credit and similar mechanisms in Australia and Canada remove children's payments from some of the worst effects of the 'adequacy trap'. Figure 6 shows how in the United Kingdom, for example, these withdrawal rates would be structured under the ICC for low to middle income families. The overall withdrawal rate would be quite severe over a wide range of incomes. (The graph does not show the effect of taxation, national insurance contributions or loss of Housing Benefit, which would make the slope more severe.) But the bold line shows only the payments for children, going to their main carer; for these, people on low incomes receive a flat-rate amount and the taper begins

Figure 6 Basic support for couple with two children, UK (illustrative)

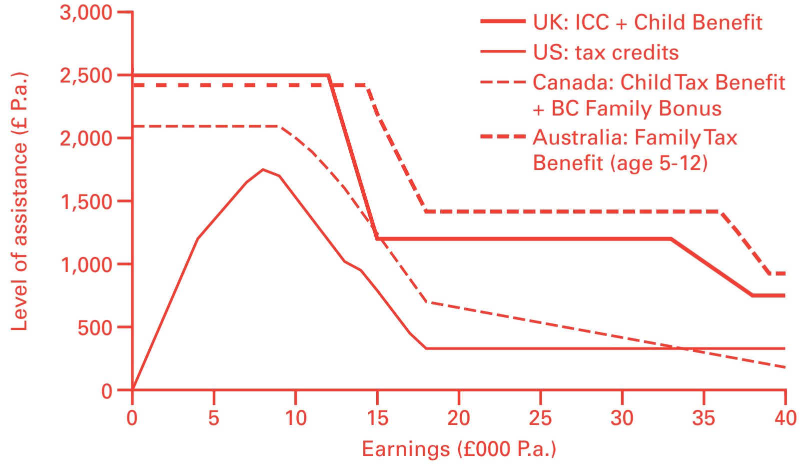


only at the point at which the Employment Tax Credit entitlement has run out.

Figure 7 illustrates the structure of the withdrawal rates of some principal children's benefits in all four of the countries under review. Any comparison of this type needs to be read with caution, since benefits for children have varying relationships with other features of the tax and benefit systems. But this graph shows, for the UK, Australia and Canada, how the most prominent benefits for children vary with income. In each case, these sums arrive as identifiable payments, rather than being lumped in with other benefits or combined with other elements to calculate tax liability (although that has recently become an option for child payments in Australia). The United States is a bit different, since the main benefits do come as credits built into tax calculations; for purpose of comparison, the two main such credits, the Earned Income Tax Credit and the Child Tax Credit, are shown in the graph.

It can be seen from Figure 7 that all countries make some use of 'plateaux' of support – payments that remain stable over an income range. The UK and Australia each have three plateaux, for low, middle and higher income groups, with steep withdrawal rates between them. Canada prefers to have a single plateau, for lower income groups, a relatively gentle slope (gradual withdrawal of

Figure 7 Benefits at different income levels for a lone-parent, one-child family



Note:
This *illustrative* graph shows the structure of the most prominent benefits for children paid to families in the four countries – and in particular those that go to the main carer. The examples are roughly the amounts paid to a lone parent, one-child family. The graph's purpose is to compare the ways in which countries withdraw these payments as income rises.
The common scale in UK pounds is based on purchasing power parities – rates of exchange derived from what can be bought with a currency unit. A common scale allows comparison across countries of the income levels at which benefits are reduced. But the figures give an imperfect comparison of the overall generosity of different systems, since the payments shown have varying relationships to other benefits, the picture varies with family type and it has not yet been decided exactly which payments will be put into the ICC. More detailed comparisons are made in the longer report (Battle and Mendelson, 2000).

benefits) for those on middle incomes and no benefits for the richest 10–20 per cent. The United States is the only country that does not give a plateau of support for children in lower income families. It actually increases support with income for the poorest working families, in order to provide an extra work incentive (encouraging these families to raise their earnings). When that incentive reverses, still on quite a low level of income, the withdrawal rate with rising income is not very steep: 16 or 21 per cent depending on number of children.

None of these models offers a perfect structure, and much will depend on a combination of what governments can afford, on historic patterns of entitlements and on political priorities in relation to the entitlements of certain groups. But, in setting a policy, the following considerations are relevant.

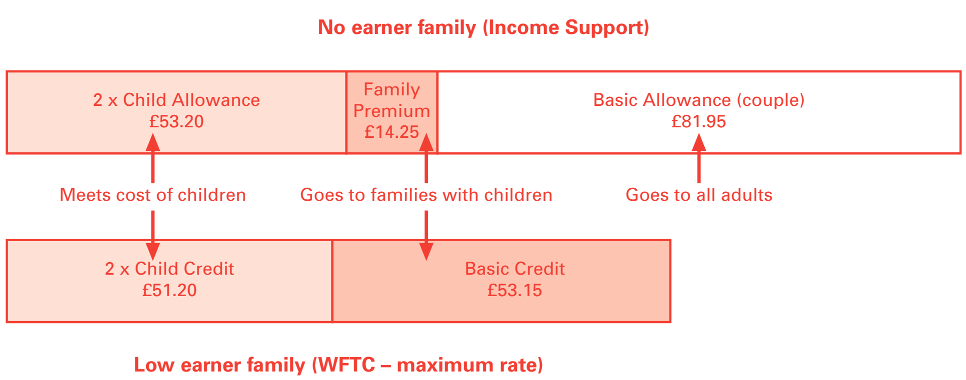
- The ‘plateau and cliff’ pattern is psychologically attractive. Most people at any one time are on a plateau and therefore know what they are entitled to, without having to understand the intricacies of the system, e.g. its tapers and income assessment periods.
- Nevertheless, having too steep a cliff between the plateaux can cause difficulties. It may encourage fraud and create surprises for those who ‘fall off the cliff edge’ by earning a bit more in a particular year.
- Such structures have a close and potentially interactive link with the shape of a country’s earning distribution. For example, the UK has a high number of lone mothers working part time and the Working Families Tax Credit gives them a large payment which is quickly reduced if they increase their hours. This system seems necessary to protect this group from poverty, yet may entrench a pattern of low earnings.
- Even at the points where there is a plateau in payments to children, there may be a sharp effective marginal tax rate for the household because of withdrawal of other benefits plus the imposition of income taxes. Yet, that does not necessarily destroy the value of a stable payment for children, especially where it does not enter the household through the same route – where it comes in as a cheque to the person caring for the children, rather than as an adjustment to the calculation of the pay packet. This effect is accentuated where the income for children’s benefits is tested infrequently; in Canada, the assessment is secure for a year. It is interesting that Australia, Canada and the UK have all decided to create a means-tested plateau of support for children for households whose total effective tax rate is quite high.

Question 7: how far can the ICC cover extra support for families?

As noted under Question 3 above, direct spending on children is not the only determinant of family welfare. At present, parents on low incomes receive payments that are not available to people without children, over and above child allowances. This applies to a 'basic' component of the Working Families Tax Credit and to a 'family premium' in Income Support. But, as Figure 8 shows, these family components are set at very different levels. Whereas a basic level of Income Support covers adults' needs whether or not they have children, the Working Families Tax Credit's basic component is for families only. The new Employment Tax Credit will change this and the neatest thing would be to create a common adult component, as in Income Support, with anything extra for families paid through the ICC.

But how much of the 'family' component should go into the ICC? Anything more than the £14.25 spent on the family premium would require the total level of Income Support to be raised. If the rest were to go into an employment credit for every working household with a low income adult, the employment credit would need to be nearly £40 to keep total WFTC entitlements the same. This might be more than the government wants to give, say, a single person in

Figure 8 Current UK entitlements



their 20s. The alternative is to have variable rates of employment credit for different categories of adult – with supplements, for example, for those with children or for those over 50. The advantage would be to target work incentives at those groups for whom they are a priority. The disadvantage would be that, having separated out extra needs of households with children in the ICC, the system would be taking extra account of them elsewhere. In principle, a higher employment tax credit could recognise the limitations in the potential earnings of families with children (especially with lone parents), while the ICC recognises the extra costs of children themselves. It would take skilful packaging to get this logic across to recipients and the public.

Whichever solution is used, it is worth noting that the Canadians have found that payments explicitly meeting the needs of children have psychological advantages. Their purpose is easy to understand and they are stable for people on low incomes. They can also be related to other support for children in poor families – for example, Canada's Child Tax Benefit is a passport to free prescriptions. In the UK, it may be worth considering whether the ICC rather than Income Support should define eligibility to free school meals, bringing children with low earning families into the system, and reducing the poverty-trap effect of withdrawal of in-kind benefits. (The United States has suffered from such effects in relation to free health care and food stamps.) Two alternatives would be to have a higher Child Credit for in-work families ineligible for free school meals, or to abolish free school meals entirely and take that into account in the ICC's level. It would be worth asking recipients which method they would prefer.

Question 8: can a system get money to people when they need it without meddling excessively in their lives?

Overseas observers looking at the British social security system notice first and foremost the degree of detail with which it gets involved in assessing people's needs.

This is particularly true in the time dimension. UK social security recipients have to report immediately any change in their circumstances, and their income and needs tend to be assessed in a much shorter reference period than in other countries. The Working Families Tax Credit and its predecessor, Family Credit, have started to get away from this practice by assessing income over an initial six-week period and not reassessing it for another six months. But it still looks very different in this respect from, say, the Earned Income Tax Credit in the United States, which is assessed at the end of each tax year as a deduction from tax in the following year.

There is considerable concern that moving towards longer assessment and payment periods could leave very poor people in some difficulty, if it meant that after a change in circumstances they did not quickly get enough money to cover their needs. But, having longer assessment and payment periods as a *norm* does not necessarily prevent supplementary assessments taking place where, for example, someone loses their job within the tax year.

However, the Integrated Child Credit offers a better opportunity than other parts of the tax and benefit system to create less frequent changes as people's circumstances alter. This is true, first, with respect to people moving in and out of low-paid work; the same value of credit will apply in both situations. Second, where someone in work receives the maximum credit, there is less concern that fluctuations in income should change his or her entitlements –

again because of the initial flat rate. In other countries, recipients have shown a clear preference for systems that pay a consistent amount over a long period, over those that are constantly varying with their needs. For example, in Canada, they have made it quite clear to the government that the one thing they would dislike most would be frequent reassessment, since that would make payments feel too much like welfare. The ICC is an ideal place to start to test the limits of this principle in the UK.

There are also other ways in which the UK system might start to become less fussy and precise. In the UK and elsewhere, there is a distinction between entirely rule-bound and more discretionary systems of entitlement, with the tax system falling into the latter and benefits into the former category. Applying more the spirit of the tax system could certainly be helpful in making administration flexible in terms, for example, of judging where particular needs warrant interim payments to those making new claims. This kind of sensitivity to the realities of people's lives can be especially important in the case of children, whose domestic living arrangements are not always simple – for example, in the case of those who split their time between the households of two separated parents.

Question 9: can a family-based assessment of entitlements be operated in the context of an individually assessed taxation system?

Some commentators in the UK warn that bringing a family-based means-test into the tax system will start to compromise the principle of independent taxation for individuals within a family. But international experience has shown that, through pragmatic approaches, this need not be the case.

It seems appropriate that child payments should be based on family, not individual income. Indeed, the one way in which this is not the case in the UK is rather illogical. The Child Tax Credit is tapered off for rich families when at least one person starts paying higher rate tax – a pragmatic approach which avoids submitting everyone to a family means-test. In Australia, a similar affluence test is based on family income.

Canada and Australia both use assessments of income for tax purposes to operate family means-tests for children's benefits. Even though income tax is imposed on individual incomes, there is nothing to stop the tax authorities from asking about a spouse's income, or matching tax records. In Canada, a quarter of a century's experience of using the tax system to deliver family-assessed social benefits has not caused major administrative difficulties or controversy, even though it sometimes produces technical inconsistencies.

But these systems rely on every adult filling in a tax return. The big issue for the UK is whether that would be feasible or desirable. For some time, it has been assumed that it would be an excessive burden. But need it be? A simplified tax form for those who are not presently obliged to fill one out could potentially prove less of a burden than the very complicated forms that people on benefits often have to complete at present. Most importantly, it would help break down the distinction between earners/taxpayers and benefit claimants.

Question 10: how will Integrated Child Credit interact with other benefits?

In Canada, where a hitherto separate system of provincial welfare support has often seemed to cut across the federal system, the need for a more integrated approach has been a major reform issue. The United Kingdom in principle has less conflict between different jurisdictions, but in practice the system still seems highly complex to users. Housing Benefit, for example, is set nationally but administered locally, and its withdrawal can overlap with that of other in-work benefits, causing steep effective withdrawal rates and a system whose net effect is not transparent.

Potentially, a downside of creating a new Child Credit is that it is a new element in the system for parents to understand. To help mitigate this problem, it would be useful to create direct links between the ICC and other parts of the system. In the present Treasury thinking, this would happen by matching up the income level at which the Employment Tax Credit stopped being paid with the level at which the ICC started to reduce with further rises in income. A useful aspect of this would be to avoid having to do two assessments; any family who qualified for either Income Support or the Employment Tax Credit would also automatically receive the maximum rate of ICC.

But, the real prize in terms of joining up the system would be to make Housing Benefit more closely linked to other in-work benefits and in particular to avoid a double taper. Is there scope for bringing housing elements into the ICC itself? Australia links eligible rent levels in its Housing Assistance to the number of children in the family – in contrast to Canada, where the eligible rent is restricted as a percentage of income regardless of family composition. In the United States, there is also no direct link. In the UK, the case for bringing family composition more directly into the Housing Benefit equation needs to be considered alongside other aspects of reforming the system. One way in which the growth of work benefits for families might help in the reform equation could be to give low earner families sufficient resources to bear a bit more of the variability in their housing costs. (Australia pays not more than 75 per cent of rent as an allowance, with a minimum contribution, but has higher income support levels than the UK.) Proposals to pay at least some Housing Benefit at a flat rate rather than linked directly to rent levels (Kemp, 2000) could hence potentially start with a children's element as part of the ICC.

Question 11: does the system make sense to its users?

One of the biggest challenges to recent reforms to benefits for children in different countries has been to ensure that the systems meet new and complex objectives, yet still seem comprehensible and logical to their users. The growth of the anti-poverty objective in the past 20 years, referred to at the beginning of this paper, has created a serious risk that public support for children will become stigmatised as part of a welfare system. But countries that have created an integration between targeted and more general benefits have emphasised that this danger can be greatly reduced by constructing a simple and clear system that does not seem to make its users into dependants of the state.

But another message that has come across strongly from overseas experience is not to assume that policy makers can work out how users will view the system, without asking them. Canadian officials believe that they have been able to develop gradual improvements partly by monitoring reactions to ongoing change and asking users about their preferences. The present intermediate period during which the Working Families Tax Credit is operating and the ICC is being planned represents an ideal time for the UK government (and indeed social researchers) to find out more about user responses to various system features.

Some of the issues that will be particularly important to ask about are the following.

- Views of the 'plateau and cliff versus gentle slope' issue discussed under Question 6 above. Are people willing to accept a steep withdrawal rate in certain ranges of income in exchange for stability at most parts of the income scale? Do they accept the justice of such an option?

- Views on the timing of payments, referred to under Question 8. Are British claimants, like Canadians apparently are, willing to trade less frequent involvement of the tax and benefit authorities for a more rough and ready approach to the timing of payments?
- Views on the use of the tax system. Many in Britain have assumed that filling out a tax form would be an onerous task for all adults to be asked to do. But might they see advantages in having less to do with the DSS and prefer such a responsibility to the alternative bureaucracy of the benefits system?

4 Conclusion: the political economy of benefits for children

Redistribution appears to have long since faded from the political vocabulary, and to be alive and well in political practice and political expectations.

People with comfortable means appear less willing than they once were to see their taxes being spent on supporting less fortunate groups. There is a particular reluctance to accept this kind of support if it seems to create 'welfare dependency'. So, redistribution per se is talked about rarely by mainstream politicians. Yet, in practice, people continue to expect public money to be spent on meeting the needs of certain groups, which effectively amounts to a redistribution of the incomes derived from market earnings. They strongly expect this to occur in moving money from working-age groups to retired people, through the payment of pensions. They expect solid public support for social priorities such as education and health care, in a way that distributes resources very differently from how they would be distributed were everybody to buy these services out of their own incomes. And their longstanding support for some redistribution in favour of households who are bringing up children has developed into an acknowledgement that poor children are particularly vulnerable in today's world and that some extra support to their families' incomes would bring important social dividends.

A twist to this story is that, as constraints on the spending of public money have become tighter, the pressure to target resources on the poorest groups (and hence to become more redistributive) has grown.

International experience has shown some helpful ways through this complicated political landscape, in developing new ways of making payments to families with children. The trick has been to make such support feel as little as possible like redistributive welfare as traditionally constructed, even though it is concentrated on poor families.

Simply relabelling a benefit as a tax credit may prove to be only a limited step in that direction, even though there is a significant psychological benefit in such a distinction. During the 1980s, there were very different political attitudes towards the growth in the respective burdens of Housing Benefit and of mortgage-interest tax relief on the Exchequer. Even though both represented housing-related transfers to households, the latter was seen more as a relief from the burdens of the state, the former as part of the welfare burden. The eventual abolition of mortgage tax relief in the 1990s, however, showed that such payments are, over the long term, at risk if they are not seen as fair and going to a group who merit social support.

So, the long-term sustainability of a new system of benefits for children depends not just on its cosmetic labelling but also on its capacity to sustain political legitimacy.

Australia, Canada, the US and the UK are all making a particular judgement in this sense. They are not only relabelling means-tested benefits for children, but also integrating them into a system that pays more for the poor but also something to the better off. The judgement is that this can both seem fair by being weighted to the needy and gain sufficient support from the middle classes by including them in the payment. Also, in the US in particular, linking benefits to work incentives helps build their legitimacy. If, in introducing the ICC, the UK can create a clear and simple enough system to enable the public to understand these fundamental purposes, it will have taken one step towards creating the long-term support that is needed.

A second crucial step may be less easy. This is to ensure that in-work benefits do not have unduly perverse effects on incentives. The risk created by the Working Families Tax Credit was that low-earning working families would have high effective marginal tax rates over such a wide range of incomes that there would be little incentive, for example, for the second adult in a couple to work. The reforms planned for 2003 do not address this problem overall, even though the child element of the payment is initially protected from withdrawal from rising income. A significant danger is that the sharp withdrawal of in-work benefits will distort the labour market because low pay will become even more acceptable. Australians worry that the increases in redistribution and the growth in earnings inequality that they have experienced in the past 20 years have in fact reinforced each other (although inequality has grown less fast there than in the UK).

The government's responses to all of these matters will certainly be strongly influenced by economics (what can be afforded) and politics (what sounds popular). But it will be important that they are also informed by an understanding of how changes are viewed among the people affected. For example, poor people have always tended to dislike the humiliation of benefits based on a means-test. Yet, income taxes have always involved means-testing. Everybody's income is assessed; the poor pay the least. Turning to the tax system rather than benefits to operate a means-test may thereby help make targeting more acceptable for recipients, just as it may make the payment itself seem less like an undesirable 'handout' for the public at large.

But none of these matters are easy to prejudge. Over the three years in which the UK develops its own system, it will do well to continue looking closely at the still new but closely parallel structures in other countries, particularly in Canada and Australia but also in the United States. It is rare that policy developments in different countries are so close that they offer such useful laboratories for each other as in this instance.

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