

## CHILD POVERTY DURING THE RECESSION AND BEYOND

In 1999 the Government pledged to eradicate child poverty in the UK by 2020 and, in the meantime, to halve it by 2010. Robert Joyce, of the Institute for Fiscal Studies (IFS), assesses the outlook for child poverty in the short and long term.

### *Defining child poverty*

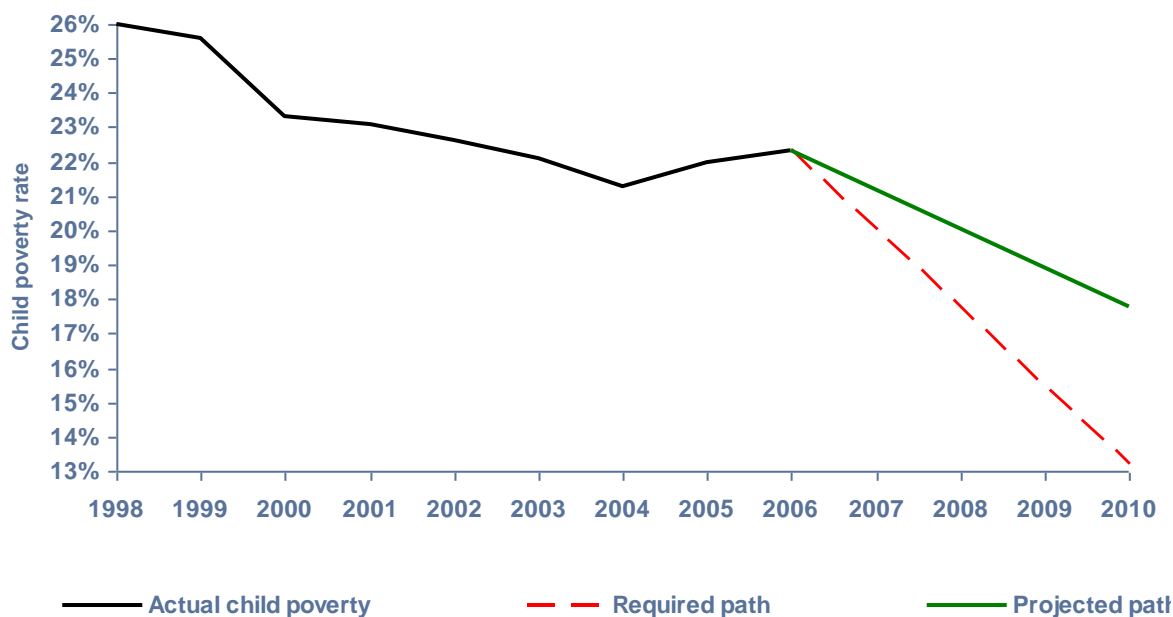
All poverty measures define a ‘poverty line’, which separates those in poverty from everyone else. For example, when measuring child poverty by looking at family income, a poverty line of ‘£270 per week’ implies that a child is in poverty if their family’s weekly income is less than £270. This would be an *absolute* poverty measure since the poverty line does not depend on the income of other families in the population. However, the measure of child poverty currently most cited is not absolute but *relative*, with the poverty line defined as ‘60% of the median family income’ (if you order families from highest to lowest income, the median family is the one in the middle). The poverty line therefore moves when median income moves, so a child’s position is assessed by looking at the income of its family relative to the income of other families. The Government’s foremost child poverty target uses this relative income measure.

There are good reasons not to look exclusively at relative poverty. With a poverty line that increases with median income, it is better for relative poverty if median income is lower (other things being equal) – but lowering the median income is not most people’s idea of desirable policy! During recession, when incomes across the board are likely to struggle, we should keep a close eye on *absolute* living standards. If all incomes fall, but median income falls fastest, then relative poverty will decline – but this would not be a laudable achievement.

### *Short-term prospects*

For the Government to meet its upcoming target, the number of children in poverty in 2010 would need to be no more than 1.7 million, or 13%. Figure 1 shows the actual path of child poverty until 2006 (the last data available), the required path for the Government to hit its 2010 target, and the path projected by recent IFS work if current policies continue. Under current policies, the child poverty rate in 2010 would be 18%, which corresponds to 2.3 million children in poverty – 600,000 above the Government’s target.

**Figure 1: Child poverty to date and prospects for 2010**



Sources: Brewer, Browne, Joyce and Sutherland (2009), 'Micro-simulating child poverty in 2010 and 2020', IFS Commentary 108; and Department for Work and Pensions (2008), *Households Below Average Income: An Analysis of the Income Distribution 1994/95-2006/07*, London: DWP.

It was not anticipated that the target would loom with the economy in recession. How does the recession affect child poverty? Remember that the Government's target relates to *relative* poverty. During a recession, income from benefits (which tends to be more important to low-income families) may grow faster than earned income (which tends to be more important to the median family). This is because benefits are paid by the state, whereas earned income is fully exposed to the effects of recession – specifically, the lower demand for goods and services by consumers reduces the demand for labour by employers, pushing down real wages and therefore earned income. When benefits grow faster than earned income, lower incomes catch up with the median, which *reduces* relative poverty.

However, the lower demand for labour during recession also means fewer parents with jobs. Some children who were previously above the poverty line will therefore fall below it when their parents lose their earned income. This *increases* relative child poverty.

These two consequences of recession for relative child poverty act to offset each other, so the net effect may be small. But the story does not end there. Before the recession, work at the IFS had suggested that the Government would need to spend £2.8 billion on additional child tax credits on top of planned expenditure in order to meet the 2010 target. Child tax credits (CTCs) are payments to families with children. They are means-tested so that lower-income families get higher payments. In updated projections which take account of the recession, this cost has risen from £2.8 billion to £4.2 billion.

Why has the cost of hitting the target risen if the number of children in poverty has stayed similar? The answer is that the cost of hitting the target depends not only on how many children are below the poverty line, but also on how far below the poverty line those children are - the further below the poverty line, the more additional money they need in order to be brought above it. This average 'poverty gap' - the distance between family income and the poverty line for those children in poverty - has increased. An explanation for this is that the recession increases the number of non-employed parents, and their children tend to be in deeper poverty than children with working parents. This is a reminder that the recession will be hitting children's absolute living standards, even if it has a small impact on relative poverty.

### ***What might the Government do about child poverty by 2010?***

The Government's debt is set to increase rapidly during the recession, so how likely are they to find anything like the money required to hit the 2010 target? Economic theory provides two reasons why this is more likely than it sounds.

First, the Government could present the additional spending as a 'fiscal stimulus'. The objective of a fiscal stimulus is to raise the level of demand (and thus output) in the economy. This can be done by increasing the amount of money people have to spend (their disposable incomes), by reducing the amount of tax they pay or by increasing the amounts of benefits and tax credits they receive. Such policies will succeed in raising demand if they are targeted at people who actually spend that additional money, rather than save it - people who have a high *marginal propensity to consume*, in economists' jargon. Poorer families tend to have higher marginal propensities to consume. Why? Poorer families are often *credit constrained* - banks won't lend them money because of the perceived risk that they won't be able to repay it. Giving those families more income therefore allows them to spend money that they wanted to borrow from a bank but were unable to. Increasing the income of richer families may not affect their spending much because they were *already* able to spend more than their income by borrowing from a bank. Since CTC payments are skewed towards lower-income families, who tend to have higher marginal propensities to consume, increased CTCs could be presented as a fiscal stimulus to revive demand during the recession.

Normally, there would be a drawback to increasing CTCs. Since it is means-tested the CTC payment you receive is larger if your income is smaller. This means that if your income grows you lose some of your CTC; an additional £1 earned in wages will not actually make you £1 richer. This reduces the financial gain of additional work for recipients of CTC and in response they may choose to work less. So, their earned incomes fall and this offsets some of the impact of higher CTCs on raising incomes.

However, a recession typically means a lack of labour demand, not a lack of labour supply. In other words, employment is relatively low because employers do not want to employ people, not because potential employees do not want to work. There are already more people looking for work than there are jobs available, so a few less people looking for work will have a relatively small impact on employment. This is another reason why, during the recession, the government may feel more inclined than it otherwise would to introduce a large CTC package.

### *The longer term problem*

The policies that have the most immediate effect on child poverty are those that change the tax and benefit system in such a way as to make low-income families with children richer. The hypothetical rise in CTC is an example of such a policy.

However, in addition to the imminent 2010 target, the Government also plans to eradicate child poverty by 2020. Although the effect of higher CTCs on holding down employment (by reducing work incentives) may be small during the recession, the effect will be larger when employers' demand for labour picks up afterwards. It would look very strange if the Government raised CTC during the recession and later cut it back when it starts to worry about work incentives. So there is a delicate balancing act to be struck. Too much short-term emphasis on means-tested benefits and tax credits could hinder progress towards the longer term target by reducing the number of employed parents in the next decade.

Recent IFS projections showed that meeting the 2020 target simply by raising benefits and/or tax credits would be hugely expensive, costing at least £19 billion, and possibly double that, depending on the precise definition of 'eradication'. The long-term strategy will therefore include policies that try to raise the *private* (i.e. not state-provided) incomes of low-income families with children. This could be done by increasing the earnings potential of these families by, for example, raising their education levels or training them with skills that employers value. In countries where relative child poverty has historically been low, such as Sweden and Finland, it is not just because the state has a generous welfare system. It is also because the *private* incomes of lower-income families are less far behind the median family than in the UK.

The effects of policies that change private incomes tend to take a long time to show up. For example, it takes a generation for children currently being educated to grow up, get a job with higher earnings than they would otherwise have got, and have children who are therefore not in poverty when they would otherwise have been. So to meet its 2020 target using such measures, the Government needs to act quickly.

We have seen that the 2010 and 2020 child poverty targets probably require different policy responses if they are to be met. Since some of these responses may conflict with each other, government policy will have to strike a delicate balance between the short and long term.