

# THE EMPLOYMENT EFFECTS OF THE WORKING FAMILIES TAX CREDIT

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# The Employment Effects of the Working Families' Tax Credit

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## Introduction

Recent research at IFS has examined the likely impact of the Working Families' Tax Credit (WFTC) on labour market participation. From October 1999, the WFTC has replaced Family Credit (FC) as the main package of in-work financial support for families with children. The WFTC is more generous than FC in several ways (see IFS Briefing Note no. 3/99, <http://www.ifs.org.uk/research/personal/wftc.pdf> for full details). The government hopes that this extra generosity will help 'make work pay' for many families currently not in work and induce more entry into the labour market amongst the target groups. Several research projects at IFS have used simulation techniques operating on microeconomic data to assess the impact of the WFTC on the participation of target groups (such as lone parents and married women with children). This note compares the results from three separate IFS studies:

- a) Research by Paul Gregg (Bristol University and CEP), Paul Johnson (FSA) and Howard Reed (IFS), funded by the Joseph Rowntree Foundation (Gregg, Johnson and Reed, 1999);
- b) Research by Richard Blundell (UCL and IFS), Alan Duncan (Nottingham and IFS), Julian McCrae (IFS) and Costas Meghir (UCL and IFS), funded by the Bank of England and the ESRC Centre for the Microeconomic Analysis of Fiscal Policy at IFS (Blundell, Duncan, McCrae and Meghir, 1998);
- c) Research by Gillian Paull (IFS), Ian Walker (Warwick and IFS) and Yu Zhu (Keele University) funded by the Nuffield Foundation (Paull, Walker and Zhu, 1999).

Table 1 shows the predicted impacts of the WFTC on employment from the three studies. Each study uses a different methodology and data, which we discuss briefly below.

**Table 1. Predicted impact of the WFTC, from recent IFS studies**

Group	Gregg et al.		Blundell et al.		Paull et al.	
	Number	%	Number	%	Number	%
Single parents	28,600	1.85	34,000	2.20	24,700	1.60
Married women, partner not working	14,610	1.75	11,000	1.32	—	
Married women, partner working	-29,050	-0.83	-20,000	-0.57	—	
Married men, partner not working	16,820	0.48	13,000	0.37	—	
Married men, partner working	1,790	0.05	-10,500	-0.30	—	
<i>Total employment effect</i>	32,770		27,500			

Note: The studies calculate the effects of the WFTC scheme as originally announced in the 1998 Budget but do not include the effect of the increases in credit payments for dependent children announced in the 1999 Budget.

## Results and methodologies used

This section compares the methods used by each study and discusses how the results compare with each other in the light of these methodological differences. Although each study uses a different data source and a slightly different methodology, there is broad agreement on the impact for most of the client groups. The first two studies reported in the table cover all groups, while the third study is only for single mothers.

The results show an unambiguous positive impact on the participation of single mothers. There is also a sizeable positive impact on participation for married women with unemployed partners. As would be expected, there is a moderate negative impact on married women with employed partners. This partially offsets the positive impact on single women, but if the aim is to reduce the number of families with no earners then this may be less important. To this end, the impact on non-working married men with spouses who do not work is equally interesting. Here again, there is a fairly large positive impact on employment. Finally, for men with partners who do work, there is more disagreement across models – in fact, this is essentially the main reason why the totals differ. For this group, the effect of an increase in the wife’s income leads to a *negative* impact on participation in the study by Blundell et al. The study by Gregg et al. does not find a negative effect; however, this may be because it only looks at entry into work and does not directly model exit from work. Hence it does not pick up the effect of

previously employed men moving out of work in response to the WFTC. However, focusing on families without earners, the first study shows a net increase in participation of 60,030 while the second predicts some 58,000 additional workers.

The methodologies used in the various studies were as follows:

- a) The Gregg et al. study uses a transitions model of labour market entry based on data from the Labour Force Survey for the period 1994–95. The model estimates a relationship between the probability of moving into work over a period of one year and the financial incentives to enter work at the wages earned by actual work entrants. Assuming that the rate at which men and women already in work are leaving work does not change, it is possible to derive estimates of how the WFTC will affect employment.<sup>1</sup>
- b) Blundell et al. use data from the Family Resources Survey to estimate a discrete choice model of hours of work and employment for separate samples of married women and single women, all of whom have children.
- c) The results from the Paull et al. study only refer to single mothers, and the main emphasis of the work is on reform to child support. The simulations are based on labour supply estimates from a pooled sample of approximately 4,000 single mothers from the 1978–91 Family Expenditure Surveys. These are then reweighted using the 1997 Family Resources Survey and used to simulate pre- and post-reform behaviour.

## Conclusions

For most of the family types looked at in these three pieces of research, the predicted employment effects of the WFTC are roughly in line with each other. This is an encouraging finding which gives us more confidence that the results of these studies capture the potential effects of the WFTC with reasonable accuracy. The one exception to the agreement between studies is the case of married men with working partners, where

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<sup>1</sup> This study models entry rates, and the figures reported in the table are long-run estimates calculated under the assumption of constant exit rates in each period. These estimates differ from those reported in Gregg, Johnson and Reed (1999), which assumed a constant number of men and women exiting over the period and produced higher long-run participation numbers.

Blundell et al. predict a fall in participation whereas Gregg et al. predict a slight increase. This is probably due to the fact that Gregg et al. assume that exit rates from work are unchanged by the reform and do not predict any extra movement out of work by married men who are employed prior to the reforms. The Blundell et al. study predicts that exit rates among married men with working partners *will* increase as a result of the introduction of the WFTC.

## References

Blundell, Richard, Alan Duncan, Julian McCrae and Costas Meghir (1998), *The Labour Market Impact of the Working Families Tax Credit*, IFS Report to Bank of England Monetary Policy Committee, December.

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