Children, well-being and taxes and benefits: Part II

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In the previous edition, we argued that governments might care about child poverty for reasons of equity and efficiency, and we introduced the concept of an equivalence scale as a way to help compare well-being across different sorts of households. In this article, we look at the changing level of cash transfers to families with children in the UK since 1975, and what this has done to the level of child poverty, as defined by the present Government.

In the previous edition, we argued that there are two reasons why governments might care about child poverty: first, as part of its concern with poverty in general, since families with children tend to have both lower incomes and higher needs than families without children; and second, because children from poor families are more likely to be associated with social problems such as unemployment, ill health and crime when they grow up, and this can impose costs on the rest of society which we would like to avoid. Certainly, the present Government seems to care about it: in 1999, Tony Blair, the Prime Minister, declared that "our historic aim will be for ours to be the first generation to end child poverty" (Beveridge Lecture, May 1999). So what have governments since 1975 done to support children, and what has happened to child poverty as a result?

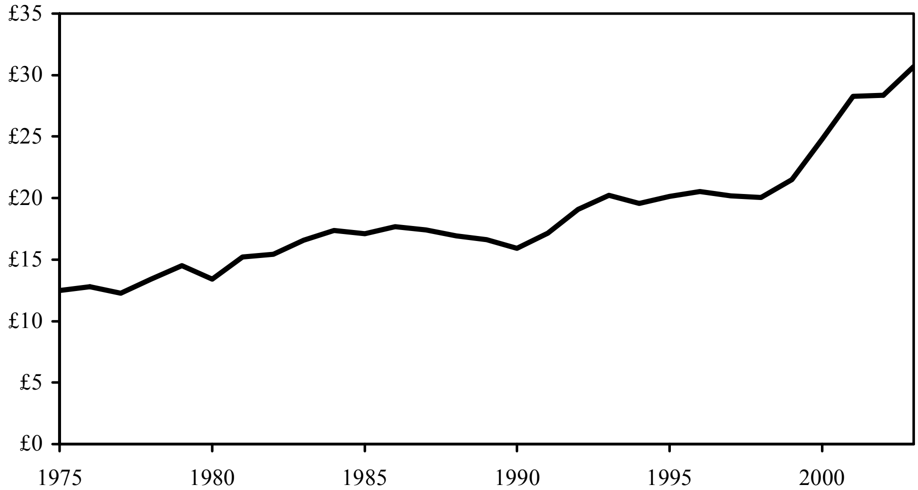
State support for children can take a variety of forms. Not all of these involve cash transfers: a lot of support is provided through public services such as state education and free sight and dental checks. Here, however, we will focus on financial support paid to parents because they have children. This financial support can vary in a number of ways: it can be universal (paid to all families with children), means-tested (paid only to families with low incomes) or contributory (paid only to families that have previously paid National Insurance contributions); it can be paid in cash, into a bank account, or as a tax cut; it can be paid to the mother or the father or allow couples to choose who receives it; and it can vary according to the age of the child, how many other children are in the family, and whether the child is living with one parent or two. We will not discuss here the relative merits of all these different alternatives or the detailed structure of support in the UK, but it is worth briefly noting the main features.

At the moment, 89% of financial support for children is paid through three main programmes: child benefit (a universal benefit, usually paid to mothers, which accounts for around half of all support for children); income support/income-based jobseeker's allowance (the main 'safety net' means-tested benefit, which is higher for families with children); and the working families' tax credit (a means-tested benefit which tops up the income of some families with children in which one adult is working).

This structure of support for children is not fixed, however. Since 1975, financial support for families with children in the UK has become increasingly means-tested (and decreasingly contributory), increasingly paid to the main carer (usually the mother), and increasingly biased towards younger children and towards the first child in a family. In April 2003, the way the tax and benefit system supports families with children will change yet again, with a new child tax credit replacing three existing schemes.

The changing generosity of support for children since 1975 is shown in Figure 1. On average, financial support for children increased slowly (after allowing for inflation) from 1975 to 1990; it then rose sharply in the early 1990s and even more sharply from 1999. However, cash support for children has not risen by anything like as much when compared to how average incomes or average earnings have grown over the same period, and the importance of this will be made clear below.

Figure 1: Average cash support per child from Government transfers (£/week) since 1975



Notes: Mean entitlement per child; 2002 prices.
Source: authors' calculations using IFS's micro-simulation model of the UK tax and benefit system (TAXBEN) run on various years' data from the Family Expenditure Survey.

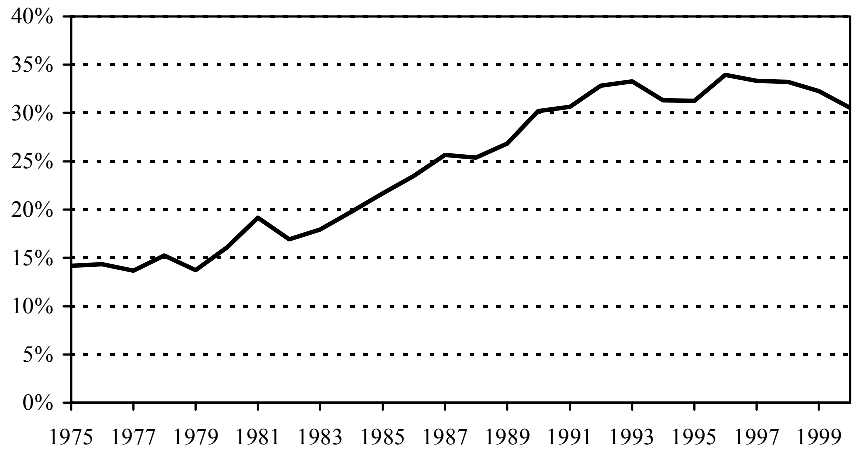
What effect have all these changes had on child poverty? Well, first, we need to decide how to define and measure child poverty. The annual publication that is used for the Government's main measure of poverty in the UK says that "[we] use household disposable incomes, adjusted for household size and composition, as a proxy for material living standards or, more precisely, for the level of consumption of goods and services that people could attain given the disposable income of the household in which they live." (*Households Below Average Income*, London: Department for Work and Pensions). As the quotation suggests, the reason that we look at someone's income is that it is a pretty good determinant of their overall well-being. But remember that, to economists, extra income is just a means to an end - increased utility – it's just that income is easier to measure than utility.

But income alone is not enough. As the quotation above indicates, and as we argued in our previous article, household income must be adjusted for household size and composition, because the living standards a household can afford depend as much on the household's needs as on its income. In our previous article we introduced the concept of equivalence scales as a way of capturing the different needs of different households numerically. The equivalence scale used by the Government is called the McClements scale, and is used to adjust household incomes by a ratio which depends on the number of adults and the number and age of children in the household (a couple with no children is given a weight of 1). For example, and the income of a couple with an 11-year-old child is divided by 1.26 to make it comparable to the income of a childless couple: this means that if a couple with an 11 year-old child has 26% more income than a couple without children, they are considered to be equally well off.

The definition and measurement of poverty is a hotly disputed topic. There is no 'right' way to measure poverty: it is a question of which measure best captures each person's concept of what poverty is. The Government counts children as poor if they live in households with less than 60% of median income (where housing costs are subtracted from income, and it is then adjusted for family size, as described above). That this measure of poverty is defined relative to average income is important. If median income rises, a family can be reclassified as poor even while its own living standards improve. The poverty line rises when average incomes rise, and so it is more an indicator of being unable to afford things that the rest of society can afford, rather than of being unable to reach a specific and unchanging standard of living. The Government's measure also looks solely at how many households fall below the poverty line – it does not ask by how much.

The changing rate of child poverty, on this definition, is shown in Figure 2. The rate of child poverty was fairly stable until 1979, and then rose steeply over the following 16 years. There has been a substantial fall in the number of children in poverty since 1997, but it is small relative to the historic rise.

Figure 2. Child poverty rates since 1975



Notes: Poverty line is 60% of contemporary median household equivalised income after housing costs across the whole population.
Source: IFS analysis using Family Expenditure Survey (until 1993) and then Family Resources Survey.

Given the large increases in support for children shown in Figure 1, why was the rise in child poverty in the 1980s and 1990s so big, and why is the recent decline so small? The key reason is the choice of a poverty line that rises with real incomes and earnings. Many families in poverty or on the verge of it are not working and do not benefit from rising real earnings. Other things being equal, then, rising earnings will raise the poverty line but not raise the incomes of the poor. Between 1979 and 1999, Government spending on child support rose by 46% in real terms, but so did average earnings. Only recently has the pace of rising government support for children outstripped the pace of rising earnings. The Government is chasing a moving target: unless transfers increase as quickly as earnings, or there is a radical change in parents' work patterns, poverty measured in this way is always liable to increase.

The work discussed in this and the previous article is explained in greater depth in "The Government's Child Poverty Target: How Much Progress Has Been Made?", Mike Brewer, Tom Clark and Alissa Goodman, IFS Commentary 87, http://www.ifs.org.uk/inequality/childpov.pdf, and "Understanding the Relative Generosity of Government Financial Support to Families With Children", James Banks and Mike Brewer, IFS WP 02/02, http://www.ifs.org.uk/workingpapers/wp0202.pdf.