

Memorandum on estimates of the costs of meeting the Government's child poverty target in 2010/11

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1. On 29 March 2007, the Chancellor was asked about estimates of the cost of meeting the Government's child poverty target, for child poverty in 2010/11 to be half its 1998/99 level. Such estimates were first produced in 2006 by a team of researchers funded by the Joseph Rowntree Foundation: ¹ the particular set of reforms to tax credits proposed by the Joseph Rowntree Foundation was estimated to cost £4.3 billion a year in 2010/11 (in 2006/7 prices: the cost in 2010/11 corresponds to 0.3% of GDP).
2. Budget 2007 announced additional spending on tax credits which will serve to reduce child poverty. Researchers at the Institute for Fiscal Studies agree with the assessment made by HM Treasury that child poverty will be 200,000 lower than it would have been had the Budget 2007 not announced any changes.² This calculation reflects the changes to income tax and national insurance, as well as those to tax credits, and also reflects any impact that the Budget 2007 changes might have on median income, as well as on the incomes of low-income families with children. The new forecast, reflecting the measures in Budget 2007, is that child poverty in 2010/11 will be 2.5m, compared to its level in 2005/6 of 2.8m, and the target in 2010/11 of 1.7m. The forecast "shortfall" on presently announced policies is therefore 800,000 children, and the Government has less than three years in which to announce changes to tax credits and benefits that can close this gap (the latest opportunity that a government would have to affect income in 2010/11 would be the 2009 Pre-Budget Report, when means-tested benefits and tax credit rates from April 2010 are due to be set).
3. Researchers at the Institute for Fiscal Studies have also updated the estimate of what more needs to be done for the Government to have a 50:50 change of meeting its child poverty target in 2010/11, and now estimate that, following the changes in Budget 2007, additional spending of £3.8 billion a year by 2010/11 (on increases in the child element of the child tax credit, and introducing a large family premium in the child tax credit) will be needed.
4. One key question is the extent to which increased employment amongst low-income families with children will contribute to further reductions in child

¹ Brewer, M., Browne, J. and Sutherland, H. (2006) *Microsimulating Child Poverty in 2010 and 2020*, York: Joseph Rowntree Foundation. Please note that this is not an "IFS" forecast: not all of the authors of the paper are from the Institute for Fiscal Studies: Professor Holly Sutherland is from the University of Essex. Furthermore, the researchers made considerable use of demographic and employment projections produced by teams led by Professor Phil Rees (University of Leeds) and Professor Paul Gregg (University of Bristol) when forecasting child poverty in 2010/11 and 2020/21.

² This does not mean that child poverty will fall by 200,000 from its current level, but that child poverty in 2010/11 will (probably) be 200,000 lower than it would have been had no changes to tax credits or benefits been announced in Budget 2007.

poverty. The original modelling of child poverty in 2010/11 and 2020/21 took into account forecasts of:

- the overall employment rate;
- the employment rate of lone parents;
- the proportion of couples with children with no adult in work (sometimes known as the proportion of couples who are workless).³

5. Given the perceived importance of employment patterns amongst parents in determining the level of child poverty, the modelling of child poverty in 2010/11 and 2020/21 used three employment scenarios for families with children, each specifying an employment rate for lone parents and a worklessness rate for couples with children (these were chosen because the Government has a number of welfare to work policies that are directly targeted at these groups; by contrast, the Government has fewer welfare to work policies that can be used to encourage second earners in couples with children to work, and none that is precisely targeted at this group). These scenarios were devised by Professor Paul Gregg and colleagues, based on what is known about trends in the characteristics of lone parents, and the impact of existing and likely welfare reforms on employment, and are repeated in the table below.

Table 2: Scenarios for parental employment in 2010 and 2020

	2010	2020
<i>Lone parents: % in work</i>		
Demographic changes only	63	65.6
Demographic changes plus welfare to work policies	67.5	70
Demographic changes, welfare to work and up-rating Working Tax Credit in line with earnings	70	73
<i>Couples with children: % workless</i>		
Demographic changes only	4.75	4.5
Demographic changes plus welfare to work policies	4.5	4
Demographic changes, welfare to work and up-rating Working Tax Credit in line with earnings	4.5	4

Note: Based on Gregg et al (2006)

³ Gregg, P., Harkness, S. and MacMillan L. (2006), *Welfare to work policies and child poverty*, York: Joseph Rowntree Foundation.

6. When asked about the estimates that around £4 billion a year of extra spending would need to be announced for 2010/11 to put the Government on track to halve child poverty, the Chancellor of the Exchequer said that:

"they [IFS] are making assumptions about the numbers of people who will return to work and we have just changed the assumptions over the last few days by our publications..."
7. Budget 2007 did announce new welfare to work measures and changes to tax credits that were not anticipated in the central employment scenarios used when forecasting child poverty in 2010. However, those new measures fall some way short of those considered necessary by Professor Paul Gregg and his colleagues for the lone parent employment rate to reach 70%, the most optimistic scenario used in the original forecast. We therefore feel it appropriate to continue to use the central employment forecast.
8. However, it should be noted that even the most pessimistic scenario – that the lone parent employment rate will reach 63% in 2010/11 – now looks rather optimistic, given that only 56.5% of lone parents were working in 2006 (this data was not available when the scenarios were being devised, and the change from 2005 represents a slow-down in the growth in lone parent employment rate).
9. Although it is clearly too soon to predict with any certainty what will be the employment rate of lone parents in 2010/11, it turns out that it may not matter much because our modelling has shown that the level of child poverty in 2010/11, and the cost of hitting the Government's targets in 2010, are both remarkably insensitive to the lone parent employment rate:
 - Under the policies in place before Budget 2007 (ie, those considered to be the “baseline” set of policies when the original forecast was made in 2006), a rise in lone parent employment from 63% to 70% in 2010/11 (corresponding to roughly 140,000 more LPs in work) was estimated to reduce child poverty in 2010/11 by just 0.5 ppts (around 60,000 children).
 - The previous estimate of what would be needed for the Government to be on track to hit its target in 2010/11 falls by only £0.2bn a year in 2010/11 if the lone parent employment rates rises from 63% to 70% in 2010/11.⁴
 - We now estimate that extra spending of £3.8 billion a year would be needed to put the Government on track to meet its target in 2010/11 under the central employment scenario; if the lone parent employment rate were to rise to 70 per cent in the next four years, then this cost would fall to £3.6bn. On the other hand, if the lone parent employment

⁴ See, respectively, Tables 3 & 4 in Brewer, M., Browne, J. and Sutherland, H. (2006) *Microsimulating Child Poverty in 2010 and 2020*, York: Joseph Rowntree Foundation.

rate were to rise but just to 63%, then the cost rise only slightly to £3.9bn.

9. This finding – that welfare to work measures can make little difference to the cost of reducing child poverty – can be counter-intuitive. The following three factors can help explain this result:
- Although the risk of child poverty is particularly high for children with a non-working lone parent, such children are a minority of all children in poverty: in 2005/6, half of children in poverty lived in a family with at least 1 parent in work, and 60 per cent of children in poverty lived in a couple family.⁵ There is clearly a limit on the extent to which welfare-to-work policies targeted at lone parents can reduce child poverty overall. Although the Government may wish for more couples families with children to have two earners rather than one, it has very few ways at present of specifically targeting this group; furthermore, increases in the per child element of the child tax credit – such as were announced in Budget 2007 – unambiguously worsen the financial incentive for second earners in couples with children to work.⁶
 - The difference in the (average) risk of poverty for a child with a non-working and a part-time working lone parent is less now than it was in 1998/9. This means that the impact on child poverty of getting a certain number of lone parents to enter work is less now than it was in 1998/9. This is a direct result of the Government's success in reducing the risk of poverty for children with non-working lone parents, chiefly due to the substantial increase in the amount of benefits and tax credits paid in respect of children.
 - The total value of net transfers (ie entitlements to benefits and tax credits less income tax and national insurance liabilities) paid to a low-earning working lone parent are little different from – and can be greater than, at very low paid jobs or if the lone parent claims the childcare element of the childcare tax credit – those paid to a non-working lone parent. So there is often little short-term impact on the Exchequer of a lone parent moving into work.
10. We therefore think that, although there are economic and social reasons for the Government to make it easier and more rewarding for lone parents to work, the current toolkit of welfare to work policies can make only a marginal contribution to hitting the Government's ambitious target for child poverty in 2010/11. By far the most important policy decision will be that taken by whoever is Chancellor of the Exchequer in 2009 on the generosity of tax credits, income support and child benefit in April 2010.

⁵ See p35 of Brewer, M., Goodman, A., Muriel, A. and Sibieta, L. (2007) *Poverty and Inequality in the UK: 2007*, IFS Briefing Note 73, London: Institute for Fiscal Studies.

⁶ See, for example, the results in chapter 5 of Adam, S. and Brewer, M. (2006) *The poverty trade-off: work incentives and income redistribution in Britain*, Bristol: The Policy Press.