



Budget measures and low income households

Evidence for the Treasury Select Committee

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Introduction

The Child Poverty Action Group (CPAG) welcomes the Treasury Select Committee's inquiry into recent budgetary decisions and the removal of the 10p tax rate. CPAG is a campaigning organisation which has campaigned against child and family poverty for many years. We have particular expertise in social policy affecting families and of the function of the benefits and tax credits system. The Child Poverty Action Group is also a leading member of the Campaign to End Child Poverty, through which we are publicly campaigning to demand politicians of all parties keep the promise of ending child poverty.

The Committee's brief for evidence is a comprehensive menu, this evidence does not try to answer each question raised, rather CPAG focuses on those key issues likely to affect low income families with children. Since the Committee launched its inquiry, Alistair Darling's statement to the House of Commons (13th May) gives further details of the government's approach and we make some early comments on the likely impact of the proposal to increase the personal tax allowance.

We are pleased the Committee has chosen to look at the overall impact of the budget changes; CPAG is concerned to ensure that the understandable desire to compensate losers from the 10p change does not divert attention or resources from the target of halving child poverty by 2010 and eradicating it by 2020

In particular we argue:

- The impact of measures needs to be seen in the round, though tax credits are far from perfect recent incomes policy has been progressive for most families with children;
- The government can be criticised for a 'smoke and mirrors' approach to anti-poverty policy, doing good on the quiet and in a way so complex few can grasp the implication of the details (though the move to increase the personal tax allowance is simple and clear). All major political parties are committed to reducing child poverty and politicians should be clearer, louder and prouder about the ambition and achievements;
- The debate around the 10p rate allowed some to argue transfers for children were being paid for by poor adults. CPAG does not accept this logic but the perception damages the anti-poverty agenda. Poverty experienced by children is affected by the poverty of adults. Even where adults are 'childless', they may be non-resident parents supporting children in other households and they may have children in the future.
- The reaction to the 10p abolition showed a public appetite for fairer taxes. Connected with the considerable public support for the proposals to levy a tax on the so-called 'non-doms' this demonstrates disquiet where taxation is seen to be unfair. Shifting the tax burden more towards those more able to pay would have public support;
- The child poverty lobby supported the budget 2008 measures to invest £1 billion to reduce child poverty; this lowered the amount needed to help meet the halving target to £3 billion. That the Chancellor has been able to quickly promise the not dissimilar amount of £2.7 billionⁱ to compensate the 10p rate losers shows how we can afford the resources needed to halve child poverty.

The poverty agenda

One of the greatest successes of the current government has been to put poverty firmly on the map, albeit we are off track - we have an achievable target to halve and to eradicate child poverty; a new road map toward the 2020 ambition;ⁱⁱ and political consensus around the importance of tackling poverty. CPAG welcomes the significant resources which have been devoted to tackling child poverty under the current administration. This section is not comprehensive of CPAG's views on the government's agenda, but it highlights some key challenges and concerns.

Growing employment and the tax credits have helped to reduce the level of child poverty by 600,000 children since 1998/99. Debates on progress tend to get statistical and rarefied – but that is 600,000 children whose living conditions and chances are likely to have been improved by recent policy.

Defined in terms of the internationally accepted 60% of median income – poverty now stands at 2.8 million children before housing costs have been accounted for (the government target) and 3.8 million children after housing costs (CPAG's preferred measure, which is a better indicator of disposable income).ⁱⁱⁱ

- Using the governments measure, 3.4 million children were poor in 1998/99;
- To meet its target this should have been halved by 2010/11, meaning no more than 1.7 million children would then be poor;
- In 2005/06 on this measure, child poverty is 1.1 million children away from the target;
- HM Treasury estimates the measures announced in budgets 2007, 2008 and pre-budget 2007 will lift 550,000 children out of poverty;
- This leaves us 550,000 children behind the target, more if child poverty continued to rise.
- The campaign to End Child Poverty argues that the investment of a further £3 billion by budget 2009 could help to reach the 2010 target.

There have not however been related falls in the poverty rate of working age adults, which is a significant problem given that children live with adults and childless adults may become parents. The inadequate level of out of work benefits (paid significantly below the rate of the safety net) is both seriously at odds with a commitment to eradicate child poverty and counter productive in terms of supporting people into work (low income drives down morale and worsens health). Alongside this, though the tax credits have helped to reduce child poverty they are complicated and, with this complexity, has come poor administration, official error, confusion and claimants having to pay back money they did not know they owed. We recognise the ongoing work to improve the quality of claimants' experience but this remains far from acceptable for families with children.

In the last year of figures (to 2005/06), child poverty rose by 100,000 children. The latest set of figures (covering 2006/07) have been much delayed and CPAG is concerned that at best these will show no improvement and at worst further deterioration. The increase highlights the weakness that at the moment policy is trying to run to stand still – policy makers are rightly seeking to reduce poverty against a relative low income yard stick (60% of median) without seriously

addressing the income inequality which leaves so many far below it. If underlying inequality is not addressed, running up the down escalator will only work when government invests more resources year on year in families with children, if it pauses in this effort, poverty will start to rise. Tackling inequality means addressing income levels, where the tax burden falls, uprating policy, wage levels (and wage inequality) and the drivers of wage levels (such as skill differences and access to decent employment)

The final key weakness is in the over-reliance on employment as 'the' route out of poverty. It is right that access to decently paid, family friendly employment should be opened to those too often denied that choice but employment does not work for all. We have been pleased to see the government accept the logical case that the safety net should lift children out of poverty where their parents cannot work^{iv} but CPAG continues to have great concerns about the ramping up of language, benefits conditions and sanctions we have seen in the last couple of years – this is neither justified nor likely to work to increase the employment rate. The successes of the UK's rising employment rate have been linked to a voluntary engagement approach in the new deals, valuable in building up trust. CPAG is concerned not only that more conditions damage that trust but that more sanctions reduce poor families' already inadequate income.

The budget measures

The broad Treasury changes from both 2007 and 2008 and the recent May statement are mapped in the table in the appendix. Overall:

- Budget 2007, alongside the 10p rate change invested £0.9 billion in child tax credits and estimated the effect of these measures to be 200,000 children lifted out of poverty;
- Pre-budget review 2007 contained a small increase in child tax credit and increased the disregard of child maintenance income for benefit calculations and was estimated to reduce child poverty by 100,000;
- Budget 2008, invested just under £1 billion in a variety of measures particularly around tax credits and child benefit, estimating the effect of this to be 250,000 children removed from poverty.

Prior to the proposed compensation measures the effect of the 2007 budget changes was to:

- increase taxes for those with low taxable earnings;
- reduce income tax for middle income earners;
- increase national insurance for those at the top of the basic rate band who had reached the upper earnings limit but were yet in the upper rate band of income tax;
- increase entitlements to both child and working tax credits, though these were to be withdrawn more quickly (worsening marginal deduction rates slightly).

In cash terms the effect was to double the marginal tax rate (10p to 20p) on the first chunk of taxable income. To estimate the loss, if the 10p rate had been retained and the band been uprated the maximum^v increase in tax for those taxed in this band

would be around additional tax of £232 per year or £4.50 per week.^{vi} The figure is an individual one so couples might (potentially) lose twice.

Writing before the May statement the Institute for Fiscal Studies^{vii} argued that those with incomes between £5,435 and £19,355 would pay more tax under the new system (this is the group which loses more from the loss of the 10p abolition than gain from the reduction in basic rate), those with incomes between £19,335 and £40,000 gaining (maximum gain from the tax change being £337 per year at £36,140) and the alignment of the upper earnings limit with the top tax band dampening the gains for the richest.

Those with children and who were receiving tax credits gained. The child tax credit per child element went up above earnings indexation by £150 (£2.88 per child per week) and first income threshold – the point at which tax credits start to be clawed back with additional income was increased. Treasury claimed the child poverty effect of this to be 200,000 children out of poverty.

The Institute for Fiscal Studies argued there are 5.3 million households losing, most of whom are in the bottom half of the population, highlighting two groups, low income childless singles or couples not qualifying for working tax credits (perhaps on age or hours grounds) and early retirees (60-64 years) who don't qualify for the increase in tax allowance for those aged 65 plus.

The compensation proposals (announced May 13th)

This section gives some early thoughts on the possible impacts of the measures announced on the 13th by the Chancellor. At a cost of £2.7 billion, these were to:

- Raise the personal tax allowance for every taxpayer by £600;
- Offset this gain for upper rate tax payers by changing the point at which they start paying the 40p;
- Backdate the changes to April 2008 by a lump sum in September.

The Chancellor stated the impact of these to be:

- 22 million taxpayers gain £120 (ie, they do not now pay 20% on £600 – it looks like upper rate tax payers are excluded from this);
- 4.2 million households receive the amount or more than they lost;
- 1.1 million households see the loss halved, but would still lose overall.

Alongside these measures the Chancellor rejected rebates or changes to the tax credit system as either too complex or slow to introduce. It appears that the Chancellor has managed to compensate the majority of losers. The 1.1 million households who continue to lose from the measure are likely to be those who lost most from the scrapping of the 10p rate. It is estimated above the maximum per person loss would be around £232 per year and that would accrue to individuals earning at close to the top of the old 10p bracket (say with gross incomes around £7,700), the £120 gain compensates for around half of this loss.

Mechanistically the Chancellor has chosen a (relatively) simple route to achieve his objective, and seems to have reached most of his target. Those he has not reached

are, by definition, those who previously most benefited from the 10p band. The 'deadweight' cost is high - all basic rate taxpayers' gain. Since the measure reduces tax it will also reduce marginal deduction rates for some workers. Since the measure is designed to offset losses for the low paid they do not gain overall – the real winners are those on the basic rate of income tax (say above around £19,000 per year) who gained from both the reduction from 22 to 20p in the basic rate and now gain from an additional £120.

We are pleased that those with children as well as those without gain from the measures. We suggest the Committee ask the Treasury about the impact on child poverty and what groups make up the 1.1 million households who continue to lose after the May announcement. The table contains a (very) rough and ready calculation of the child poverty impact from existing poverty statistics^{viii} based on the premise that full time workers are most likely to gain from the increased personal tax allowance as they are likely to earn more:

Figure 1: Make up of poor child population by parental work

Group	Chances of gaining	After housing costs	Before housing costs
No parent in work (mostly children of lone parents)	Nil	43%	45%
A parent in work	Some	57%	55%
Of which			
All parents in full time work	Very likely	3%	3%
Couples: a parent in full time work (other not working or part time)	Quite likely	21%	18%
Couples: self employed parent	Possible	13%	15%
One of more parent in part time work	Possible but less likely than other groups	15%	14%

Source^{ix} figures do not sum here (or in original, presumably due to rounding).

The tax gain depends on whether earnings are over the personal tax allowance level with the maximum gain accruing to those who current earn more than £600 than the current band (who will gain in full). Using after housing cost figures, that suggests that 43% of poor children will not gain at all, 24% (those with a parent working full time) are very likely to gain. Of the rest, the gain depends on whether parental earnings are above the current personal tax allowance, presumably most will, but those least likely to gain will be those with no or few hours employment who do not pay tax now – often women.

Tax fairness

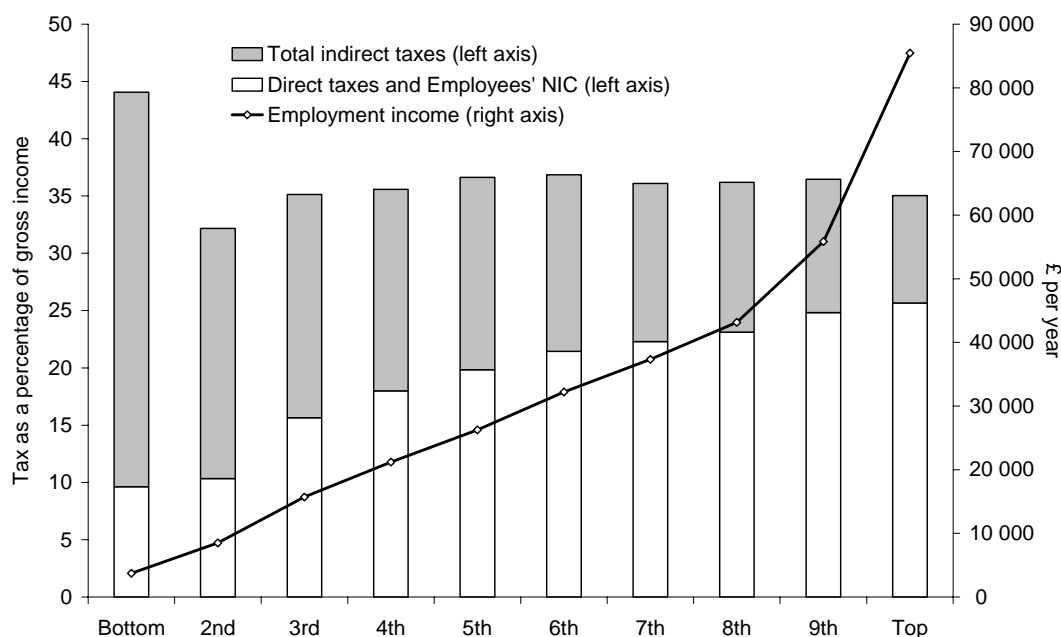
The public reaction to the 10p rate change has demonstrated a clear public appetite for progressive taxation. A similar reaction occurred earlier in the year when the Treasury was investigating the tax regime for the so-called non-doms who were perceived to be benefiting from life in here whilst avoiding British taxes. Last years increase in the inheritance tax thresholds also opens up the question of tax fairness – since the policy implication of the change will be to increase wealth inequality (and also geographic inequality – given differences in house prices).

Despite this widespread support for taxes to be based on ability to pay, the truth (see Figure 2) is rather different. The poorest pay a much higher proportion of gross income as tax than any other group, and even when ignoring this group (some argue the data may be unreliable), the overall effect of taxes are not sharply progressive and the very richest actually pay a lower proportion of gross income in taxes. An increased personal allowance benefits only tax payers and so, by definition, in cash terms it benefits the rich more than the poor (though the May announcement offsets the benefit for upper rate taxpayers so they do not gain from the increased allowance). At the same time low pay workers gain more proportionally as £120 is more valuable to you if you have a gross income of £10,000 than £30,000 (so it is more progressive to increase the personal tax allowance than to reduce the tax rates).

The figures in Figure2 are not directly comparable with the position in 2008 as policy changes and earnings changes will have altered the figures slightly. The figure also does not show the value of tax credits which would increase apparent progressivity. However there are some simple conclusions worth drawing from the chart:

- The IFS estimated those earnings between the personal allowance and £19,335 would pay more tax after the 10p rate was abolished. The IFS figure is an individual one whilst the chart shows household earnings but it is reasonable to assume the losers before the May proposal would have been in the bottom five deciles.
- Where income tax is most progressive is in deciles 2-6. This progressive effect will have been blunted by both the move to scrap the 10p rate and by reducing the basic rate. The proposed increase in the personal tax allowance will reduce tax for all taxpayers except those paying the upper rate, by definition it will not benefit non-tax payers who are often the poorest people but it is proportionally worth most to those with low taxable earnings;
- Even before the 10p changes, indirect taxes (VAT is the largest item) undermines the progressivity of the tax system. Moves to improve tax fairness may be based around income tax but should consider other taxes too.

Figure 2 Gross income and tax (2005/06, UK, non-retired households)



Source.^x Employment income is lower than gross income but the two show the same pattern.

Other measures

The Darling statement makes little mention of other measures that the government may pursue in the 2008 pre-budget review, and indeed rejected looking at altering tax credits or providing a rebate, this section lays out a couple of other policy areas affecting low income working households which would also help reduce child poverty that the Committee might chose to look into:

An increase in the **National Minimum Wage**, perhaps targeted on younger workers (who currently have a lower minimum wage). The impact of tax credits (for those eligible for them) means a general increase in the minimum wage does not quickly show through in reduced child poverty (reduced by clawed back benefits and tax credits). Despite this CPAG supports a more generous minimum wage arguing that wage income is preferable to tax credits for those able to work. Also even where adults do not have children, they may become parents and so ensuring they have an adequate income for decent health and social engagement is important.

In general transfers made through the **tax system as against benefits or tax credits** tend to be less targeted and cost more (as the reforms announced in May demonstrate). That does not inherently mean they are less preferable but to impact on poverty they need to be matched by more progressive mechanisms. Ensuring the real value of benefits and tax credits is at least maintained over time (through uprating policy) is vital in protecting the financial position of those families whose parents cannot work or who are in low pay work. A more **realistic uprating policy** – relating the value of support to the rising cost of living not just to prices is essential to sustaining a reduced long term level of poverty.^{xi}

Reforms to the **tax credit** system are certainly worth exploring, both to reduce the qualifying age criteria for working tax credit (currently 25 years), or the 16 hours

restriction – for instance introducing a **mini-job**^{xiii} step in tax credits to support people working a small number of hours currently, to help people try out work, grow in confidence and manage employment alongside caring responsibilities or a disability. The first overpayment figures to capture the impact of the major reforms announced in December 2005 are expected to be published later in May, if these do not show falls in the levels of overpayments experienced by lower income groups specifically, there may be pressure to reconsider reforms such as removing the child care payments from Working Tax Credit or moving towards a fixed award system. Non take up of the tax credits has been highlighted as a particular problem for childless adults, but many families with children – even on low incomes – also miss out. One in five families entitled to child tax credit miss out, and the overall take up rate of working tax credit (for those with and without children) is just 61 per cent.^{xiii}

Maximising take up is therefore a good way of reaching low income workers and families alike. This requires better publicity, more and better advice, easier routes into the system and it also needs government and politicians to be careful with language – overestimating the problems of benefits fraud create a major stigma and puts genuinely entitled claimants off applying.

Child benefit would clearly not benefit those without children directly but it is an important element of family policy, one which very effectively reaches most children by not being means tested, and so simple and popular. As it does not need to be withdrawn with increasing incomes it does not affect marginal deduction rates or gains to work and so is perhaps of particular help to low income working families. Other measures which affect gains to work for the low pay include the loss of **free school meal** entitlements following the move into work – one possibility here would be to extend entitlements to those low waged families claiming working tax credit.

Conclusion - what are the messages from the 10p revolt?

CPAG hopes the Committee will both look at the technical detail of proposals and will also draw out the key implications for future strategy, especially in the wake of the proposals made by the Chancellor in May. The four key, overarching, messages CPAG emphasises are:

1. Voters want taxes to be progressive - they oppose the idea that taxes should increase on poorer workers especially whilst they perceive that a super rich 'overclass' maintain a privileged low tax position. This is a positive message - the public supports the concept of greater fairness;
2. It is not sustainable for the anti-poverty drive to draw artificial lines between 'deserving' (children and pensioners) and 'undeserving' poor (working age adults). Though the key focus must remain on children, as the group most vulnerable to poverty's short term and long term effects, poverty experienced by children is linked to that experienced by their parents and adults who have no children but may become parents. It is damaging for government to be perceived to be trying to tackle poverty in one group by cycling money from another
3. Building consensus around poverty reduction cannot be done with smoke and mirrors - the effect of the 2007 budget was overall progressive, families with children gained, but the complexity, the use of means tested tax credits and the large number of poorer losers reduce the confidence in policy makers' 'pro-poor' credentials. Though public opinion on 'poverty' often seems (at first glance) stuck in the pages of Charles Dickens, there should be little doubt that people care

about fairness and we urge the Committee to emphasize how the anti-poverty drive should be pushed forward in this light.

4. If it is possible to find £2.7 billion for this important priority, it should also be possible in the pre-budget 2008 and budget 2009 to find the £3 billion CPAG and other members of the campaign to End Child Poverty believe is necessary to reach the target to halve child poverty by 2010.

Appendix

Budget 2007, 2008 and May statement measures

Announced	What?	When?	Revenue impact (- or +)
Budget 2007	Abolished the 10p 'starter rate' of income tax	April 2008	+ £7.3 billion in 2008/09
	Cut basic rate of income tax from 22p to 20p	April 2008	- £8.1 billion in 2008/09
	Aligned the higher rate threshold (upper earnings limit of national insurance with the top tax band)	Phased April's 2008 and 2009	+ £1.1 billion in 2008/09, + £1.5 billion in 2009/10
	Increased per child element of child tax credit by £150 per year above indexation	April 2008	- £0.9 billion in 2008/09
	Increased the point at which tax credits start to be withdrawn by £1,200 per year	April 2008	- £1.3 billion in 2008/09
	Increase the 'taper' combined withdrawal rate for the tax credits from 37% to 39%	April 2008	+ £0.6 billion in 2008/09
Pre-budget review 2007	Increased per child element of child tax credit by additional £25 per year in April 2008 and £25 in April 2010	April 2008 and April 2010	-£0.03 billion in 2008/09; £0.06 billion in 2010/11
	Child maintenance disregard increased to £20 (end of 2008) and then £40 (April 2010)	End of 2008 and April 2010	Not mentioned
Budget 2008	Increased per child element of tax credits by £50 above earnings indexation	April 2009	- £0.3 billion in 2009/10
	Disregarding child benefit income for assessment of housing and council tax benefits	October 2009	- £0.2 billion in 2009/10
	Bringing forward measure to increase child benefit to £20 for the first child	April 2009	-£0.2 billion in 2009/10
May 13 th statement	Increase the personal tax allowance by £600	September 2008 (backdated to April 2008)	-2.7 billion in 2008/09
	Reduce the upper rate threshold to offset gains from increased tax allowance.	September 2008 (backdated to April 2008)	

Source^{xiv}

About CPAG

CPAG is the leading charity campaigning for the abolition of poverty among children and young people in the UK and for the improvement of the lives of low income families. CPAG aims to: raise awareness of the causes, extent, nature and impact of poverty and strategies for its eradication and prevention; bring about positive policy changes for families with children in poverty; and enable those eligible for income maintenance to have access to their full entitlement. CPAG is a founder member of the campaign to End Child Poverty.

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ⁱ Indeed in evidence to the Committee, Robert Chote of the IFS estimated reaching the halving target would cost an even closer figure at around £2.8 billion. See Treasury Committee, The 2008 Budget, House of Commons April 2008, p.38

ⁱⁱ HM Treasury, Ending Child Poverty, everybody's business, 2008

ⁱⁱⁱ Figures are for 2005/06, Department for Work and Pensions, Households below average income, National Statistics, 2007

^{iv} See HM Treasury, Ending Child Poverty, everybody's business, 2008

^v Income less than £7,455 would lose less.

^{vi} =£2,230 [2007/08 band of taxable income] *1.04 [uprated by 4%] /10 [the additional tax]

^{vii} IFS Press release 21st April 2008 www.ifs.org.uk

^{viii} There may also be an effect on the poverty line – the median income, this is defined from net income so all things being equal increasing the allowance will (very slightly) increase the poverty line.

^{ix} Figures are for 2005/06, Department for Work and Pensions, Households below average income, National Statistics, 2007.

^x National Statistics, The effects of taxes and benefits on household income, 2005/06, 2007

^{xi} H Sutherland, M Evans, R Hancock, J Hills and F Zantomio, The impact of benefit and tax uprating on incomes and poverty, Joseph Rowntree Foundation, 2008

^{xii} See Bell, K, Brewer, M, Phillips, D, Lone parents and 'mini jobs', Joseph Rowntree Foundation, 2007

^{xiii} See HMRC, Child Tax Credit and Working Tax Credit take up rates 2005-06, 2008

^{xiv} Budgets 2007 and 2008 and pre-budget 2007 reports, see www.hm-treasury.gov.uk; Alistair Darling MP's statement to the House of Commons, May 13th May 2008