

4. What do the child poverty targets mean for the child tax credit?

The child tax credit will be introduced in April 2003. When fully operational, it will represent the majority of government financial support for children. It is designed to help reduce child poverty and is means-tested against family income.

The Labour government has an explicit target for the level of child poverty – defined in terms of relative incomes – for 2004–05. This chapter therefore examines whether the government’s current commitments are likely to enable it to meet this target, and what it might cost to reduce child poverty further by increasing the rates of the child tax credit or through other means in and beyond April 2004. Our calculations suggest that around £1 billion of further spending might be needed to meet the target – a sizeable amount of money given the current state of the public finances, but small compared with the total increases in spending on benefits for families with children since 1997. Yet, regardless of whether the government is able to find more for families with children, child poverty in 2004–05 should still be substantially lower than it was in 1996–97.

4.1 Child poverty under Labour

In his Beveridge speech at Toynbee Hall in March 1999, the Prime Minister announced a radical ambition – to ‘eradicate child poverty within a generation’. Subsequently, the Treasury set out further objectives: to eradicate child poverty by 2020, to halve it by 2010 and to ‘make substantial progress towards eliminating child poverty by reducing the number of children in poverty by at least a quarter by 2004’.¹

The government has yet to specify how we might tell whether poverty has been eradicated in 2020 and what measure of poverty is due to be halved by 2010, although the Department for Work and Pensions has been consulting on a new measure of poverty and is due to announce its conclusions shortly.² But the government’s target for 2004–05 is more specific: ‘the target for 2004 will be monitored by reference to the number of children in low-income

¹ From HM Treasury, *Spending Review 2000: Public Service Agreements 2001–04*, Cm. 4808, Stationery Office, London, 2000 (www.hm-treasury.gov.uk/Documents/Public_Spending_and_Services/Public_Service_Agreements_2001-2004/pss_psa_whitepaper.cfm). The target was initially a joint Public Service Agreement target for HM Treasury and the former Department of Social Security accompanying the 2000 Spending Review, and was carried forward in the 2002 Spending Review. In this, and the rest of the chapter unless otherwise specified, ‘child’ means ‘dependent child’ – a child under 16, or under 19 and in full-time education.

² Department for Work and Pensions, *Measuring Child Poverty: A Consultation Document*, London, 2002 (www.dwp.gov.uk/consultations/consult/2002/childpov/childpoverty.pdf).

households by 2004/5. Low-income households are defined as households with income below 60% of the median, as reported in the Households Below Average Income (HBAI) statistics ... Progress will be measured against the 1998/9 baseline figures and methodology'.³ The data to assess these targets should be available in early 2006. In the HBAI statistics, children are considered poor depending on the total income of the household in which they live, leaving aside the question of whether money channelled to low-income families with children is actually beneficial to the children themselves.

The wording of the government's target does not specify whether income is to be measured before housing costs (BHC) or after housing costs have been deducted (AHC), nor whether self-employed households are to be included. In practice, ministers' statements have tended to focus on progress on the AHC measure including the self-employed.⁴ As there were 4.2 million children in poverty in 1998–99 on this definition, there will need to be fewer than 3.1 million children in poverty in 2004–05 to meet the target.⁵

What has happened to date? Between 1996–97 and 2000–01 (the latest year for which data are currently available), the number of children in households below 60% of median AHC income fell from 4.4 million to 3.9 million.⁶ This implies that if the government is to reach its target in 2004–05 (AHC), child poverty will have to continue to fall each year by an average of around 200,000 – faster than in the period from 1996–97 to 2000–01. Measuring poverty BHC, the target level is 2.3 million children, and the government is closer to reaching its target for 2004–05, having seen a decline from 3.1 million in 1998–99 to 2.7 million in 2000–01.⁷ As Figure 4.1 illustrates,

³ HM Treasury, 'Technical Note for HM Treasury's Public Service Agreement 2003–2006', London, 2002, www.hm-treasury.gov.uk/mediastore/otherfiles/tech_notes.pdf. The median household is the one for which half the rest of the population has an income higher than it does and half has an income lower.

⁴ For example, page 87, box 5.3 of HM Treasury, *Budget Report 2001: Investing for the Long Term*, London, 2001 (www.hm-treasury.gov.uk/Budget/Budget_2001/Budget_Report/bud_bud01_repchap5.cfm?).

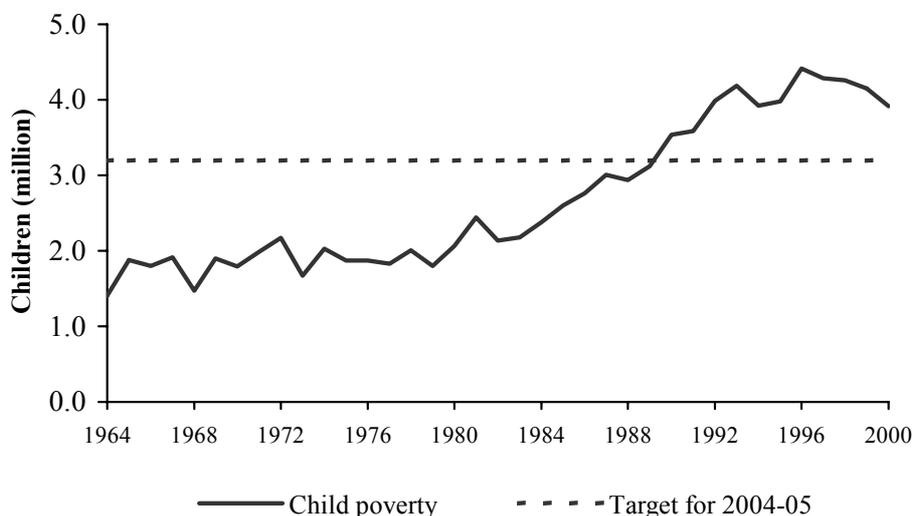
⁵ The data in this chapter on children in poverty up to 2000–01 come from M. Brewer, T. Clark and A. Goodman, *The Government's Child Poverty Target: How Much Progress Has Been Made?*, Commentary no. 88, IFS, London, 2002 (www.ifs.org.uk/inequality/childpov.pdf), or M. Brewer, T. Clark and A. Goodman, 'What really happened to child poverty in the UK in Labour's first term?', *Economic Journal*, forthcoming. Some of the numbers can also be found in Department for Work and Pensions, *Households Below Average Income 1994/95 to 2000/01*, Corporate Document Services, Leeds, 2002 (www.dss.gov.uk/asd/hbai/hbai2001/hbai2000_01.html).

⁶ Tests reveal that the fall in child poverty since 1996–97 is statistically significant – in other words, it is unlikely to be driven by random variations in the data used to analyse poverty rates.

⁷ Poverty is lower when measured BHC than when measured AHC because housing costs are a larger proportion of total expenditure of low-income families with children. Because the government and commentators tend to focus on measuring incomes AHC when thinking about the bottom end of the income distribution, we do so in this chapter, reporting the results BHC only where they are substantially different.

the fall since 1996–97 follows a very long period during which child poverty grew substantially.⁸

Figure 4.1. Child poverty (children in households with less than 60% median income AHC)



Notes: The poverty line of 60% median income AHC is a fraction of the contemporary median household income across the whole population (i.e. not just for children). Data up to and including 1992 are for calendar years, while those thereafter are for financial years, so 1993 should be read as 1993–94, and so on. Changes in the income definitions make comparisons before and after 1993–94 difficult.

Source: Authors' calculations based on Family Expenditure Survey for years until 1993 and on Family Resources Survey thereafter.

4.2 The child tax credit

The structure of new tax credits in April 2003

In Budget 2002, the government confirmed that it will be introducing two new tax credits from April 2003: the child tax credit and the working tax credit.

The child tax credit will bring together three parts of the existing tax and benefit system that support families with children. Separately, the working tax credit will support adults with or without children in low-paid work, as well as providing subsidies for certain childcare expenditure for some working parents (see Box 4.1).

⁸ See also P. Gregg, S. Harkness and S. Machin, 'Poor kids: trends in child poverty in Britain, 1968–96', *Fiscal Studies*, 1999, vol. 20, pp. 163–87.

Box 4.1. The new tax credits from April 2003

- **What is being abolished?**

The *children's tax credit* reduces the income tax bills of around 5 million income-tax-paying families with children under 16. It was introduced in April 2001 and will be subsumed within the child tax credit in April 2003.

The *working families' tax credit (WFTC)* provides support to 1.34 million low-paid families with dependent children working 16 or more hours a week. It will be subsumed within the child tax credit and the working tax credit in April 2003.

The *childcare tax credit* subsidises some eligible childcare costs of 167,000 families who also receive the WFTC. It was introduced in October 1999 as part of the WFTC and will be subsumed within the working tax credit in April 2003.

Child allowances in income support provide extra money to 1.18 million families with dependent children claiming income support and income-related jobseeker's allowance. The child allowances will be subsumed within the child tax credit in April 2004.

- **What is new?**

The *child tax credit* will provide income-related support to the main carer. By April 2004, around 5.75 million – all but the richest 10% – of families with dependent children should receive it. The *working tax credit* will provide in-work support to around 1 million single people or couples in low-paid work. Both will be introduced in April 2003, although families on income support will not be affected by the reforms until April 2004.

- **What is staying?**

Child benefit is a universal, non-means-tested payment. All 7 million families with dependent children in the UK are entitled to receive it. It will be unaffected by the reforms.

Note: A dependent child is one under 16, or under 19 and in full-time education.

Sources: Inland Revenue, *Working Families Tax Credit Statistics Quarterly Enquiry, May 2002*, London, 2002 (www.inlandrevenue.gov.uk/wfctables/wftc_may_02.pdf); Department for Work and Pensions, *Income Support Quarterly Statistical Enquiry, August 2002*, London, 2002 (www.dwp.gov.uk/asd/asd1/qse/aug2002/is_aug2002_pub.pdf); HM Treasury, *The Child and Working Tax Credits*, The Modernisation of Britain's Tax and Benefit System no. 10, London, 2002 (www.hm-treasury.gov.uk/mediastore/otherfiles/new_tax_credits.pdf).

Budget 2002 announced that, in April 2003, the child tax credit will consist of two components:⁹

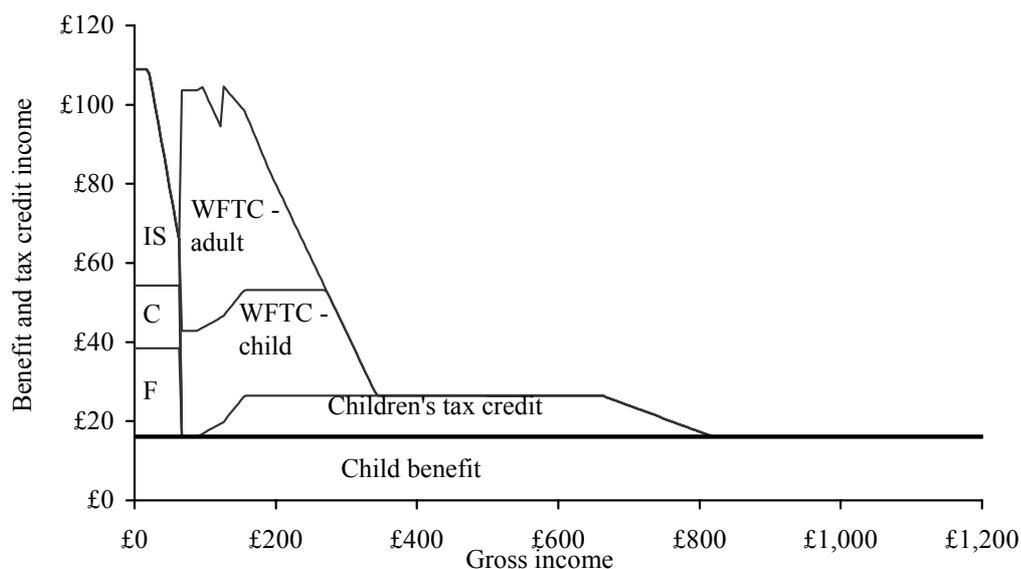
⁹ This chapter does not discuss how these tax credits work in detail; for that, see HM Treasury, *The Child and Working Tax Credits*, The Modernisation of Britain's Tax and Benefit System no. 10, London, 2002 (www.hm-treasury.gov.uk/mediastore/otherfiles/new_tax_credits.pdf), or D. Thurley, 'Tax credits and income changes', *Welfare Rights Bulletin*, no. 169, Child Poverty Action Group, August 2002. Childcare subsidies are also discussed in Chapter 7. M. Brewer, T. Clark and M. Myck, *Credit Where It's Due? An Assessment of the New Tax Credits*, Commentary no. 86, IFS, London, 2001 (www.ifs.org.uk/taxben/taxcred.pdf), and

- a family element of £10.45 per week, doubled in the financial year of a child's birth;
- an amount per dependent child of £27.75 per week.

Families with incomes below £13,230 p.a. (£254.42 p.w.) are entitled to the full amount. Incomes above £13,230 p.a. reduce entitlement to the per-child elements at the rate of 37p in the pound until a family is left with just the family element (this happens at £17,130 p.a. for a one-child family and at £21,030 p.a. for a two-child family).¹⁰ Incomes above £50,000 p.a. (£961.54 p.w.) reduce entitlement to the family element at the rate of 6.7p in the pound, meaning that families with children with incomes over £58,110 (or £66,221 if they have a child under 1) will be entitled to child benefit only.

Around 90% of families with children will be entitled to some child tax credit: around half of families will be entitled to the per-child element and the family element, and around 40% will be entitled to the family element only. The structures of the existing system and of the new tax credits are illustrated in Figures 4.2 and 4.3.

Figure 4.2. Financial support for a family with one child under the outgoing system (£ per week)

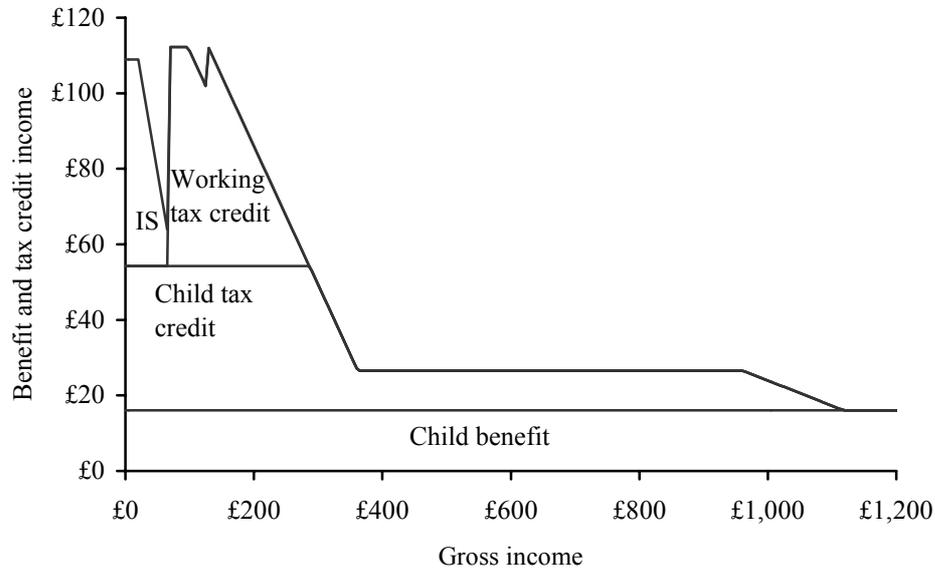


Notes: IS is adult allowance, F is the family premium and C is the child allowance in income support. The figure uses hypothetical April 2003 rates for the WFTC and the children's tax credit. It does not show childcare tax credit.

chapter 5 of A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2002*, Commentary no. 87, IFS, London, 2002 (www.ifs.org.uk/gb2002/chap5.pdf), (both written before the government confirmed the precise structure of the new tax credits) analysed the likely impact of the new tax credits on work incentives, incomes and take-up.

¹⁰ These three annual thresholds are higher if a family qualifies for extra credits for working at least 30 hours a week, having disabled adults or children, or receiving help for childcare costs.

Figure 4.3. Financial support for a family with one child under the new tax credits (£ per week)



Notes: The new tax credits are annual systems but this figure assumes them to be weekly. It also assumes that the new tax credits are implemented fully in April 2003 and that a family qualifies for working tax credit at 16 hours of minimum-wage work (£67.20 p.w.) and for the 30-hour premium at £126 p.w. It does not show support for childcare costs. It assumes one dependent child aged at least 12 months.

The future structure and rates

The structure of the child tax credit effectively means that the government has two targeted instruments with which to redistribute to families with children (as well as child benefit). The family element can be used to direct money to the vast majority of families in a near-universal way, regardless of income or family size. The child element, on the other hand, is focused on low- to middle-income families, and also helps larger families more than smaller ones.

This suggests that, for a given level of expenditure, increasing the per-child element will have a larger direct impact on poverty than increasing the family element (we show this in Section 4.4). Perhaps for this reason, the government has promised to increase the per-child element (£27.75 p.w.) in line with average earnings growth until the end of this Parliament. This means that the rate from April 2004 will be around 63p higher in real terms than the rate in 2003 if earnings rise in line with their trend of recent years.¹¹ This is a much smaller annual increase in child-related payments than families saw between

¹¹ The average annual growth in nominal earnings between 1998 and 2001 is 4.74%. This would imply a per-child element of £29.05 in April 2004. The inflation rate averaged over the same period is 2.43%, implying that the real rise is some 63p.

1996 and 2003, and equates to a real increase in incomes of only 0.7% for the poorest couple with two children (0.8% for a lone parent with two children).¹²

4.3 Is the government likely to meet its child poverty target in 2004–05?

The government has chosen to target a relative measure of child poverty rather than an absolute one. Whether a household is judged to be poor depends not only on the cash value of its income, but also on how much it has relative to the median household. This means we cannot judge whether the government is going to meet the target simply by looking at the impact of its own policy reforms on the incomes of poor families with children. We also need to assess the likely impact of economic and demographic factors on the incomes of poor families and on the median income against which they are to be compared.

This distinction is sometimes overlooked. For example, in Budget 2001, the Treasury claimed that reforms introduced from 1997 to 2001 would reduce the number of children in poverty by 1.2 million. This number was widely believed to be a forecast of how much child poverty would fall. But the Treasury subsequently had to clarify that it was only an estimate of how much higher child poverty would have been if the government had only increased benefits and tax credits in line with inflation.¹³ In other words, it abstracted from the impact of economic and other demographic factors on poverty rates.

Changes in these other factors are important for two reasons. First, some changes – such as increased employment amongst mothers – will increase the incomes of low-income families with children and directly reduce child poverty.¹⁴ Secondly, changes in median income can have a large impact on child poverty by ‘moving the goalposts’. Figure 4.1 shows that child poverty fell by only 500,000 between 1996–97 and 2000–01, based on a relative poverty line. If the government had instead chosen to fix the poverty line at its 1996–97 level in *cash* terms, then it could have claimed that child poverty had fallen by 1.4 million.¹⁵

Unfortunately, accurately forecasting what might happen to the distribution of income by 2004–05 is very difficult. Median household income is affected by

¹² Total income defined as income support, child benefit and the child tax credit.

¹³ See HM Treasury, *Tackling Child Poverty: Giving Every Child the Best Possible Start in Life*, London, 2001 (www.hm-treasury.gov.uk/mediastore/otherfiles/TacklingChildPoverty.pdf).

¹⁴ D. Piachaud and H. Sutherland, ‘Changing poverty post-1997’, CASEpaper 63, London School of Economics, Centre for Analysis of Social Exclusion, 2002, show that changes in employment patterns amongst families with children were very important in reducing child poverty between 1996 and 2000.

¹⁵ See M. Brewer, T. Clark and A. Goodman, *The Government’s Child Poverty Target: How Much Progress Has Been Made?*, Commentary no. 88, IFS, London, 2002 (www.ifs.org.uk/inequality/childpov.pdf), or M. Brewer, T. Clark and A. Goodman, ‘What really happened to child poverty in the UK in Labour’s first term?’, *Economic Journal*, forthcoming.

numerous factors, including growth in earnings and unearned income, as well as changes in the population, household composition, patterns of employment, tax and benefit policies, and take-up of means-tested benefits and tax credits.

To make our forecast, we assume that the population, employment rates and household composition do not change from their 2000–01 values, but that real earnings grow in line with past trends. (We assume that all workers benefit from real earnings growth of 2.3% between April 2000 and April 2004, the average annual rate between 1998 and 2001.) Our model estimates that this growth in real earnings increases median income – and thus the poverty line – by an annual average of 1.96%, or 8.05% over four years; real median income grows by less than real earnings because earnings are not the only source of income for the median household, and the progressive nature of the income tax system will tend to make net earnings grow more slowly than gross earnings.¹⁶ Other things being equal, a rise in median income resulting from a uniform increase in earnings for all workers will tend to worsen child poverty. This is because earnings are a less important source of income for poor households with children than they are for the median household, and non-earned income sources (except pre-announced changes in taxes and benefits) have not been increased in real terms in our forecast.

Table 4.1 shows our overall assessment of likely changes in child poverty between 2000–01 and 2004–05. Column 1 shows the actual level of child poverty in 2000–01. Column 2 shows our estimate of the change in child poverty over the following four years arising solely from the government’s tax and benefit reforms.¹⁷ In other words, adjusting suitably for likely price changes over that period, it shows how different child poverty would have been in 2000–01 had the 2004–05 tax and benefit system already been in place then. We estimate that these reforms to personal tax and benefits could reduce the number of children in households with incomes below 60% of the median by 0.8 million.

Column 3 gives our forecast of the impact of three years of real earnings growth, pushing around 0.2 million children back below the new, higher poverty line. Column 4 shows the predicted overall impact of both policy changes and earnings growth. Applying this to the actual child poverty data in the first column gives us the predicted level in 2004–05 (column 5). The bottom line is that child poverty is likely to reach 3.3 million children in 2004–05 (AHC), slightly adrift of the government’s target of 3.1 million.

For comparison, we also show estimates for other poverty lines the government could have chosen relative to median income. If it had stated that

¹⁶ Actual average growth in median income in recent years has been higher than 1.96%, but our estimate is in line with those of other researchers who performed similar calculations (see D. Piachaud and H. Sutherland, ‘Changing poverty post-1997’, CASEpaper 63, London School of Economics, Centre for Analysis of Social Exclusion, 2002).

¹⁷ This change is actually calculated from an estimate of child poverty in 2000–01 generated by our model, which simulates tax payments and benefit entitlements rather than drawing on actual tax payments and benefit receipts as the HBAI methodology does. The model gives numbers of children in poverty of 2.4 million (50% median), 4.0 million (60% median) and 5.2 million (70% median). Although these starting levels are fractionally different from the HBAI estimates, the calculated changes can reasonably be applied to the actual figures.

the target was to be assessed by measuring incomes before housing costs (not shown in the table), our estimate is that child poverty would reach 2.3 million children by 2004–05, precisely meeting the target on that definition.¹⁸

The estimates in Table 4.1 have attempted to take into account likely real earnings growth between 2000–01 and 2004–05. But many other things could affect child poverty over this period, such as the number of families and children, and the employment rates of parents and other adults. In addition, our assumptions may be incorrect: for example, earnings growth may differ between low-paid and high-paid workers (although recent evidence supports our assumption of uniform earnings growth¹⁹), or take-up of means-tested benefits and tax credits may change. This means that there is a considerable degree of uncertainty around the estimates in Table 4.1. But, on our central forecast, the government will need to do more to help low-income families with children in order to hit its after-housing-costs child poverty target for 2004–05. We quantify how much more in Section 4.4.

Table 4.1. Possible changes in child poverty (AHC), 2000–01 to 2004–05 (millions of children)

Poverty line	(1) Actual child poverty, 2000–01, HBAI	(2) Change due to tax and benefit reforms, 2000–01 to 2004–05	(3) Change due to earnings growth, 2000–01 to 2004–05	(4) Total change, 2000–01 to 2004–05	(5) Estimate for 2004–05 using HBAI values for 2000–01
50% median	2.5	–1.0	+0.1	–0.9	1.7
60% median	3.9	–0.8	+0.2	–0.6	3.3
70% median	5.0	–0.6	+0.1	–0.5	4.6

Notes: Column 4 = column 2 + column 3; column 5 = column 1 + column 4. Column 3 assumes annual real earnings growth of 2.31%. Numbers are rounded to the nearest 100,000, as is the custom in HBAI, but this should not be interpreted as a measure of accuracy. Changes are based on unrounded numbers. Numbers may not sum due to rounding. Source: Authors' calculations from IFS tax and benefit model, TAXBEN, using 2000–01 Family Resources Survey.

¹⁸ D. Piachaud and H. Sutherland, 'Changing poverty post-1997', CASEpaper 63, London School of Economics, Centre for Analysis of Social Exclusion, 2002, use a similar methodology. Their results (page 26) are less optimistic than ours, as they estimate that policies introduced between 2000–01 and 2003–04 might reduce child poverty by 0.6 million (AHC) – a slightly smaller number than our estimate for policies introduced between 2000–01 and 2004–05 – and that real earnings growth between 2000–01 and 2003–04 might increase child poverty (AHC) by around 250,000 – a slightly larger number than our estimate of the impact over the period 2000–01 to 2004–05. The differences in estimates are due to differences in the data-sets, in the tax and benefit models or in the assumptions about take-up of benefits and about future real earnings growth.

¹⁹ D. Piachaud and H. Sutherland, 'Changing poverty post-1997', CASEpaper 63, London School of Economics, Centre for Analysis of Social Exclusion, 2002, find that earnings growth at the bottom of the full-time earnings distribution was around as high as that at the median.

Nonetheless, it is important to remember that, if the estimates in Table 4.1 are realised and the government misses its target, this would still represent a substantial fall in child poverty from its 1996–97 level. Child poverty would still be at its lowest level since 1990, having fallen by 1.1 million children from its peak of 4.4 million in 1996–97.

4.4 What would it cost to reduce child poverty further?

So how generous does the child tax credit need to be for the government to achieve its child poverty target in 2004–05? The rates of the child tax credit for April 2003 have been pre-announced, so the earliest date from which an increase could take effect is April 2004. We have estimated the number of children that would be taken out of poverty by various increases in the per-child element of the child tax credit in April 2004 above the default option of increases in line with earnings growth (which has already been included in the public finance forecasts). By way of comparison, we have also shown the implications of increasing child benefit or increasing the family element of the child tax credit (together with the extra child tax credit for families with babies in their first year). The results are shown in Table 4.2.

Table 4.2. Effect of possible increases in per-child element of the child tax credit in April 2004

Increase in per-child element of child tax credit in April 2004 (£ p.w.)	Weekly per-child child tax credit rate, 2004 prices (£ p.w.)	Number of children taken out of poverty (60% median income AHC) (millions)	Cost per year, 2004 prices (£ million)
Average earnings growth +£2	31.05	0.1	660
Average earnings growth +£3	32.05	0.2	1,000
Average earnings growth +£5	34.05	0.4	1,690
Average earnings growth +£10	39.05	1.0	3,460
Other possible changes in April 2004 (£ p.w.)			
£3 on child benefit	n/a	0.2	2,000
£6 on the family element of child tax credit	n/a	0.2	2,100

Notes: ‘Number of children taken out of poverty’ is rounded to the nearest 100,000 and ‘Cost per year’ is rounded to the nearest £10 million, but these should not be interpreted as measures of accuracy. Changes are based on unrounded numbers. The poverty line was allowed to move if the reform altered median household income.

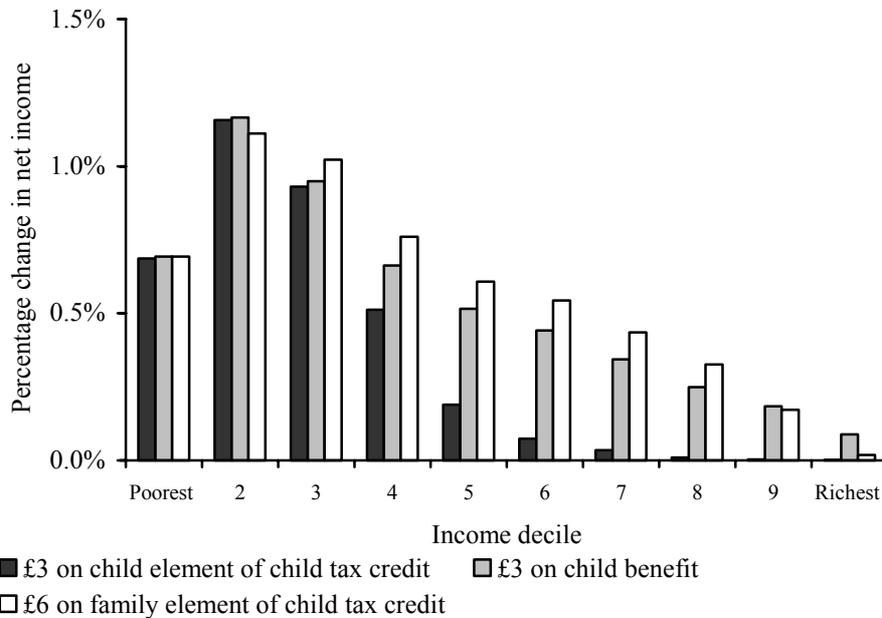
Source: Authors’ calculations from IFS tax and benefit model, TAXBEN, using 2000–01 Family Resources Survey.

To reduce child poverty from 3.3 million to the target level of 3.1 million, our estimates suggest that the per-child element of the child tax credit would need to be increased by around £3 per week in addition to the indexation in line with earnings growth that has already been promised. This would cost approximately £1 billion (in 2004 prices). According to our calculations, the

results from the Piachaud and Sutherland study²⁰ suggest that more expenditure than this may be required. Equivalent reductions in child poverty could be achieved by increasing child benefit by £3 per week or by increasing the family element of the child tax credit by £6 per week. But both these options would cost around twice as much, because both would benefit well-off families with children and not just those on low-to-middle incomes.²¹

Figure 4.4 shows the average percentage income increase in each decile of the population for three of the options in Table 4.2. We can see that the child element of the child tax credit is a well-targeted instrument for tackling child poverty, with the gains concentrated in the bottom half of the income distribution. (The estimated gains have been averaged over all families, whether or not they contain children: the bottom decile gains by less than the second decile because there are fewer children in the bottom decile than in the second decile.)

Figure 4.4. Distributional effects of different increases in child-related benefits and tax credits in April 2004



Notes: The figure shows gains in addition to the increase to the per-child element of the child tax credit in line with earnings growth in April 2004 to which the government is already committed. Income deciles are derived by dividing all families (with and without children) into 10 equally sized groups according to income adjusted for family size using the McClements equivalence scale. Decile 1 contains the poorest tenth of the population, decile 2 the second poorest and so on, up to decile 10, which contains the richest tenth.

Source: IFS tax and benefit model, TAXBEN, based on 2000–01 Family Resources Survey.

²⁰ D. Piachaud and H. Sutherland, ‘Changing poverty post-1997’, CASEpaper 63, London School of Economics, Centre for Analysis of Social Exclusion, 2002.

²¹ All families with children gain from increases in child benefit, and increases in the family element of the child tax credit by £6 p.w. would benefit all but around half a million families with children with a combined gross income of over £62,830.

It is important, though, to remember that the government may have other considerations when thinking about increasing further the amount paid per child. For example, the amount of extra income that parents receive from the government because they have children has increased substantially since 1997: the poorest families now receive more for their first child than a young jobseeking adult is entitled to receive for him or herself.²² Secondly, increases in the child tax credit also have small but adverse effects on parents' work incentives; these could be counteracted with changes to the working tax credit, but this would increase the cost.²³ These factors will need to be considered alongside the desire to reduce child poverty.

4.5 Conclusion

Despite its commitment to increase the per-child element of the child tax credit by more than the rate of inflation in April 2004, the government is more likely than not to miss its target of reducing child poverty by a quarter from its 1998–99 level by 2004–05, on an after-housing-costs basis. Once the likely effect of future earnings growth on median income and child poverty is taken into account, around £1 billion of extra spending in 2004–05 may be required for the government to hit this target, although there are considerable uncertainties around this estimate. But if this extra money cannot be found, and if our forecasts for the level of child poverty in 2004–05 are correct, then the government could still point to a substantial fall in child poverty to its lowest level since 1990. Furthermore, if a before-housing-costs definition of child poverty is adopted, our results indicate that the government may indeed hit its target.

Mike Brewer and Greg Kaplan

²² See S. Adam, M. Brewer and H. Reed, *The Benefits of Parenting: Government Financial Support for Families with Children Since 1975*, Commentary no. 91, IFS, London, 2002 (www.ifs.org.uk/taxben/c91.pdf). The weekly jobseeker's allowance (JSA) for an adult under 25 will be £43.25 from April 2003, compared with £54.25 in child-related payments that will be received by a non-working family on income support or JSA for their first child – a gap which will widen as the child element of the child tax credit increases in line with earnings growth while there are no real increases in JSA.

²³ There are two impacts: increases in any part of the child tax credit reduce the need for parents to work; and increases in the per-child element of the child tax credit widen the range of incomes over which parents can face a marginal deduction rate of 70% (they only receive 30p extra income for each £1 of extra earnings), which reduces the cash gain from working.