



POLICY SUBMISSION

Policy Priorities for Reducing Poverty in Budget 2002

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Introduction

The run-in to Budget 2002 has begun and already there is plenty of advice to the Minister for Finance as to his policy options. The expectations of this year's Budget will be particularly high from an anti-poverty perspective, as it will coincide with the launch of the revised National Anti-Poverty Strategy (NAPS 2). This article highlights the policy choices facing government if it is to deliver on the frequently reiterated NAPS commitment to use the benefits of economic growth to reduce poverty.

The Budget envelope

A key starting point is the likely resource package available in Budget 2002. There are two key issues here: first, making proposals for welfare improvements without taking into account the quantity of resources available is unrealistic; and second, the welfare cost should be seen as one side of the total Budget package, including tax reductions. Tax and welfare are simply instruments of income distribution and the outcome to the exchequer is similar whether in terms of public expenditure or income foregone. Indeed, recent policy reports have advocated a greater integration of the tax and welfare systems. These issues are well illustrated in recent government Budget policy. Thus, while the welfare allocation has almost doubled since 1998, the tax package has grown even more, with the result that far more income is available for redistribution to taxpayers and, by extension, the better off.

The economic context for Budget 2002 is considerably less favourable than last year. The rate of economic growth is slowing down, which will result in a lower than expected government surplus (down £1 billion). Meanwhile, government expenditure has been growing at a higher than expected rate (24%). The effect of these two trends is to constrain the exchequer finances and to intensify the pressure on government to avoid a repeat of last year's expansionary Budget, as counselled by various national and international bodies. A further consideration is the political pressures to increase health expenditure, which may shrink resources available for tax/welfare measures.

It is likely therefore that the resource allocation for Budget 2002 will be less than 2001, probably of the order of £1 to £1.5 billion (as compared to £2 billion last year). The tax/welfare division of the Budget envelope assumes even greater importance given a smaller pot of resources.

An indexation benchmark

Turning now to the policy options, a crucial issue determining the situation of welfare recipients is the mechanism used to uprate welfare payments. The traditional policy stance can be described as 'inflation plus': increasing payments in line with the consumer price index, with perhaps a small top-up. While an admirable position in terms of ensuring the position of those on low incomes is improved in real terms, it is inadequate if the goal is to equally share the benefits of economic growth. To achieve the latter, the policy choice must be to index welfare payments with wage growth. In a significant (if unheralded) policy breakthrough, the principle of earnings indexation was accepted by government in Budget 2001. It is important that Budget 2002 retains this policy approach. One outstanding issue is whether gross or net wages are used as the benchmark. Net wages would seem the appropriate choice as tax reductions are a planned component of wages policy under successive social partnership agreements.

A similar wage indexation of taxation policy is also advocated. This helps to avoid generating problems relating to work incentives and is distributionally neutral, in that the share of total income for various income categories remains unchanged. Furthermore, it maintains an equilibrium between government revenue and expenditure as a proportion of national income. Based on forecast wage growth of

8%, this would cost in the order of £750 million to implement in a full year. This then halves the amount of resources available for allocation in Budget 2002.

Policy priorities for Budget 2002

Before exploring other policy options for tackling poverty in Budget, it is well to be reminded of existing policy commitments. The main one here is reform of child benefit, which is set to increase by £25 per month as part of a three-year investment programme. Another commitment is a target of £100 per week for pensions by 2002 and for all welfare payments by 2003. This target is quite modest and will be largely achieved by indexing welfare payments in line with wages. Allowing for the cost of the child benefit increase, this leaves a resource envelope of £400 to £500 million. How might these monies be use to improve the position of those in poverty?

- *make child income support adequate to meet basic costs.* Even after the proposed child benefit increase, welfare payments for children will still be too low to meet basic living costs. Two options present themselves here: a targeted increase in the lower rates of CDA (£13.20 and £15.20) or an even greater increase in child benefit. Politically, the latter option is the most likely given the freeze on CDAs since 1993. However, as child benefit increases are very costly, a more targeted approach might be to focus resources on the higher rate of child benefit (based on the rationale that larger families have a higher poverty risk).
- *increase the adult welfare rate in accordance with the (still unpublished) recommendations of the adequacy benchmarking and indexation group.* This report is likely to recommend a new adequacy standard for welfare payments to reflect rising living standards in recent years. This could be of the order of £5 to £10 over indexation. However, a parallel increase in tax allowances might be required to minimise the possible disincentive effects of a higher welfare payment.
- *target resources on the adult dependant allowance so as to increase the equivalence scale to 70%.* Recent research has shown that the additional payment for couples is too low to maintain basic living standards. A higher adult allowance would have a knock-on benefit for families.

Time to say no to further tax cuts?

All of the above assumes that the available resources can be claimed for welfare improvements. This would go against recent practice and involve saying no to further tax reductions (beyond indexation). Alternatively, it could mean that any additional tax reductions should be conditional on compensatory changes in other aspects of the tax system. An example might be to abolish the threshold for employee's PRSI, which would be logically in light of the abolition of the employer ceiling in Budget 2001.

A key imponderable in the policy scenario outlined above is that Budget 2002 will be the government's last Budget prior to a general election. There will obviously be political pressures to spread the largesse around, especially among taxpayers who represent the 'more likely to vote' and 'swing' elements of the electorate. Would it not be positive though if a government could go to the country with an explicitly anti-poverty Budget? It would set the context for an election policy debate which has social justice and not personal greed as its core value. Perhaps that's a challenge for politicians and opinion makers in society to take up.

Jim Walsh, Policy and Research Analyst

***Agency's submission on Budget 2002:
discussion paper on policy priorities*****September, 2001****Introduction**

The Agency makes an annual submission to the Minister for Social, Community and Family Affairs on the Budget in accordance with its statutory advisory role. This covers both welfare and taxation matters, along with items of social expenditure. This short paper sets out the parameters for drafting the Agency's submission, for discussion by the board of the Agency at its meeting on September 6th. (The submission is also being discussed with staff and with Agency-funded programmes.)

From an anti-poverty perspective, the expectations on Budget 2002 will be very high, especially as it will mark the launch of the revised NAPS and NAPincl. It is also noteworthy as being the government's last Budget prior to a general election.

Budget envelope

A key starting point in preparing our submission is to calculate the resource package available in Budget 2002. Making proposals without taking this into account is unrealistic. In previous years, the Agency has put forward various resource scenarios, with last year's ambitious package being in line with the amount actually allocated for welfare expenditure. We have also put forward a total tax allocation, but this has been extremely conservative in terms of the actual outcome (with the result that the budgetary impact on income redistribution has been regressive and the tax/GNP ratio has fallen to dangerously low levels). The overall envelope is more important this year as the economic context for Budget 2002 is considerably less favourable than last year's. The rate of economic growth is slowing down, which will result in a lower than expected government surplus. In addition, various national and international bodies have advised the government not to repeat last year's expansionary budget. A third consideration is the political pressures to increase health expenditure. It is likely therefore that the resource allocation for Budget 2002 will be less than 2001 (£2,000 million, including £1,200 m in tax cuts and £800 m in welfare increases). The resource envelope for Budget 2002 is estimated therefore to be c £1,500 m.

Indexation

There should be an agreed benchmark for uprating tax and welfare changes. The traditional starting point - that tax and welfare policy remains unchanged in real terms - is unrealistic and misleading. An alternative approach is to index welfare and taxation rates in line with a common benchmark which would lift all income categories by a similar amount as a first step in budgetary policy. Last year the Agency recommended indexation in line with wage growth. Based on wage growth of c 8%, this would cost in the order of £750 m to implement in a full year. This then halves the amount of resources available for additional allocation in Budget 2002.

Policy context for Budget 2002

Before considering possible policy options for tackling poverty in Budget 2002, two other issues must be considered:

- tax/welfare balance, ie how might the remaining £750 m be divided between tax and welfare expenditure. Recent Budgets have prioritised available resources (after indexation) on tax reductions, often of the order of 80% +. Based on this precedent, this would only allow a maximum of £150 m for welfare initiatives over and above wage indexation. This balance between the welfare and tax elements in the Budget is crucial in determining the effect on income distribution.
- existing policy commitments, ie what is the government already committed to doing in Budget 2002? On the welfare side, the main commitment is to increase child benefit by £25 per month, at a cost of £330 m. Other PPF commitments fall within an indexation policy, eg a target figure of £100 per week for welfare payments by 2003 would require an increase of £8 in this year's Budget. In regard to tax policy, the main political and PPF commitments are to have only 20% of taxpayers on the higher tax rate, to reduce the higher tax rate to 40% and to remove all those earning the minimum wage from the tax net (now £4.70 per week).

Policy priorities for Budget 2002

Allowing for cost of child benefit, this would leave a resource envelope of £400 - £450 m. The key issue is to what extent these resources can be claimed for further welfare improvements. This would involve saying no to further tax reductions, including cuts in tax rates, increases in tax allowances and widening of bands (even on an individualised basis). Alternatively, it could be argued that any additional tax reductions should be conditional on compensatory changes in other aspects of the tax system. Assuming this argument is made, when then might be the policy options:

- making child income support adequate to meet basic costs: even after the proposed child benefit increase, welfare payments for children will still be too low to meet basic living costs. A further increase is required. Two options present themselves here: a targeted increase in the lower rates of CDA (£13.20 and £15.20) or an even greater increase in child benefit. Politically, the latter option is the most likely given the freeze on CDAs since 1993. However, as it would be very costly, an approach which focuses additional resources on the higher rate of child benefit might be the better option (based on the rationale that larger families have lower incomes and therefore a higher poverty risk).
- increase the adult welfare rate in accordance with the (still unpublished) report of the adequacy benchmarking and indexation group. This report is likely to recommend a new benchmark for welfare payments as a set proportion of industrial wages. This could be of the order of an addition £5 to £10 over indexation. However, a parallel increase in personal tax allowances might be required to minimise the possible disincentive effects of a higher welfare payment.
- target resources on the adult dependant allowance so as to increase more rapidly the equivalence scale from 60 to 70%. This would have a knock on effect for couples with children.

Further work is required to work out the specific costs of these policy options. In addition, the distributive effect of this policy options will be examined using the SWITCH tax/benefit simulation model.

Other expenditure issues to be considered in the Agency's submission include:

- improvements on education-related welfare schemes (eg school meals, clothing and footwear);
- assistance with childcare/pre-school costs for low-income families;
- introduction of a savings incentive scheme for low-income households;
- increase funding on local government-related programmes (eg tenant participation).

Jim Walsh
Policy and Research Analyst

Income redistribution: the policy priority for Budget 2001

This document outlines the Agency's advice to the Minister for Social, Community and Family Affairs and the Government on the broad tax/welfare policy options for income redistribution and poverty reduction in Budget 2001. Radical income redistribution in favour of those on low incomes is central to reducing poverty and creating an inclusive society. The National Anti-Poverty Strategy, the official policy statement on tackling poverty, commits the Government to

ensuring that the impact of very rapid economic, social and demographic change reduces social inequalities and social polarisation.....(and) that the benefits of social economic management and growth are distributed fairly and, in particular, are used to tackle the underlying causes of poverty and social exclusion.

This commitment to income redistribution is reaffirmed in recent government policy statements, including the *Action Programme for the Millennium* ('We want everyone to share the benefits of economic growth') and the *Programme for Prosperity and Fairness* ('substantially increase the resources allocated to social exclusion'). Recently, the Taoiseach noted that economic growth was not an end in itself, but must be directed to social ends, with social inclusion the key goal, while the Minister for Social, Community and Family Affairs has stated that 'having achieved economic growth, the challenge for us now is to ensure that the benefits are shared fairly'.

Five strategies for sharing the benefits of economic growth

The key mechanism for sharing our growing wealth is the annual Budget. Recent Budgets have conferred the greatest gains on better-off households, as significantly more resources were spent on tax reductions over welfare improvements. The challenge in Budget 2001 is to reverse this pattern and to ensure that tax and welfare reforms redistribute resources in favour of the least well-off in society. The Agency advocates a strategic approach to income redistribution in Budget 2001 based on the achievement of five key tax/welfare policy objectives. These would cost in the region of £1.46 billion, equally divided between tax cuts and welfare expenditure, including £317 million allocated to universal child benefit.¹

- ***Index tax and welfare payments in line with wage increases in 2000 (7.6%)***
- ***Provide additional improvements for households on the lowest welfare payments***
- ***Target surplus resources at low and middle income households with children***
- ***Provide an equitable system of support for the childcare costs of families***
- ***Bring forward welfare increases, including child benefit, to the start of the year***

The policy context for Budget 2001: wealthier but more unequal

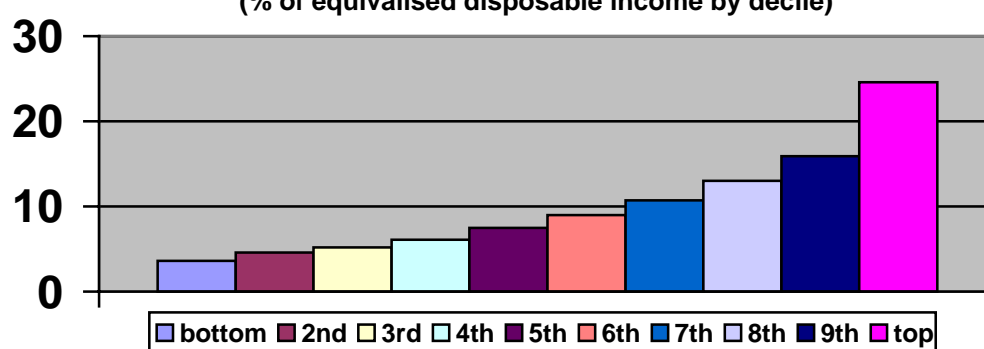
The Irish economy continues its upward spiral, with the latest forecasts suggesting a growth rate of 8 per cent in 2000, leading to an increase of 4.2 per cent in employment (78,000) and a rise in personal disposable income of 11.8 per cent. This

¹This publication includes results based on SWITCH, the SRI tax/benefit model, described in T Callan et al (1998), *Simulating tax and welfare changes*, Dublin: ESRI. All calculations and accompanying commentary are the exclusive responsibility of the Agency and no responsibility for the results is accepted by the ESRI or by the authors of the model software.

strong economic performance is reflected in the exchequer finances, with a surplus of almost £2 billion in prospect due to higher tax revenues and lower welfare payments.² The one economic downside is inflation, which is now expected to exceed 5 per cent for the year. There are also indications of a decline in the quality of life, as evidenced in traffic congestion and environmental degradation. This highlights the need to rebalance the focus from economic growth to sustainable improvements in economic and social wellbeing.

A key component of wellbeing is ensuring our increased wealth is shared out among the population. Diagram 1 reveals the share-out of equivalised disposable income for Irish households in 1997.³ The bottom 6 deciles all get a disproportionately smaller share of disposable income, from 3.6 per cent for the bottom decile to 9 per cent for the sixth. In all, the bottom sixty per cent of households account for just over a third of all income. In sharp contrast, the more affluent 40 per cent of households have two-thirds of disposable income, with the top decile alone accounting for a quarter. The income ratio between the bottom and the top fifth of households is a massive 1:5. In a European context, Ireland is one of a group of EU countries with relatively high inequality. Furthermore, the trend since 1994 indicates that the income share going to poorer households has fallen by almost 1 per cent. It is clear then that our unprecedented economic growth is not lifting all boats in an equitable manner. Those not in the paid labour force, low paid workers and those with dependants are not gaining to the same extent as other types of households.

Diagram 1: Income distribution in Ireland, 1997
(% of equivalised disposable income by decile)



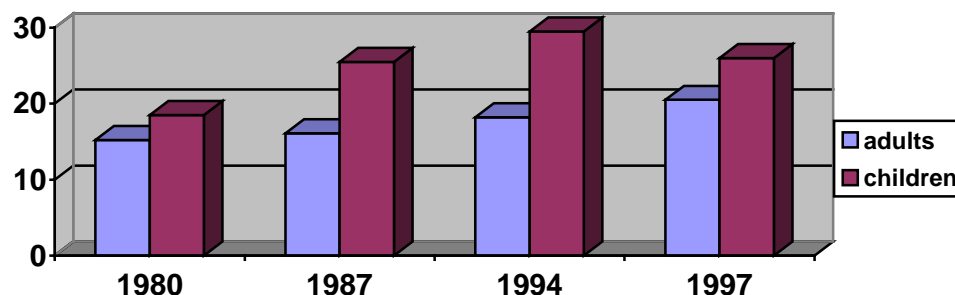
Extreme income inequality is reflected in high relative income poverty rates: a quarter of children and a fifth of adults are in households with less than half average income.⁴ Again, the figures reveal an increase in relative income poverty in recent years, though this is compensated for by a fall in severe poverty as measured by a combination of income poverty and deprivation of basic necessities. Thus, while living standards at the bottom are improving, they are not keeping pace with the rest of society. Households most at risk of income poverty are those headed by an unemployed or disabled person, home-workers or a retired person.

² McCoy, D, D Duffy, and D Smyth (2000), *Quarterly economic commentary, September 2000*, ESRI

³ Nolan, B, B Maitre, D O'Neill and O Sweetman (forthcoming 2001), *The distribution of income in Ireland*, Dublin: Oak Tree Press in association with the Combat Poverty Agency

⁴ Nolan, B (2000), *Child poverty in Ireland*, Dublin: Oak Tree Press in association with the Combat Poverty Agency

Diagram 2: Adults and children in poverty, 1980-97
(% below 50% of average household income)



Of particular concern is Ireland's rate of child poverty, which is not alone higher than for adults, but is amongst the highest among EU and OECD countries. The significance of child poverty is clearly set out by UNICEF:

The persistence of child poverty in rich countries undermines both equality of opportunity and commonality of values. It therefore confronts the industrialised world with a test both of its ideals and of its capacity to resolve many of its most intractable social problems.⁵

It is important to note that income inequality and poverty are not inevitable features of industrialised society: Ireland is more unequal and has higher poverty rates than comparable countries. This suggests that our poor performance on these issues is primarily of our own making, arising from the concentrated nature of unemployment and the limited redistributionary impact of tax and welfare policies. How can Budget 2001 begin to reverse this pattern of inequality and income poverty?

Achieving an equitable Budget: lessons from recent experience

Recent Budgets are noteworthy for having worsened rather than ameliorated income inequality, despite the huge amounts of money available for redistribution. The negative redistributive impact of Budget 2000 is outlined below, measured against a neutral benchmark of uprating tax and welfare policy in line with wage growth. Despite allocating a record £1.6 billion, the average gain for the bottom fifth of households was less than 1 per cent. By contrast, the incomes of households in the 3rd to 7th deciles grew by between 2 and 3 per cent. However, the biggest gainers were the richest households, whose incomes increased by 4 per cent. Thus, better-off households gained by about four times more than poorer households, despite their already disproportionate larger share of total income.⁶ There is no social or economic rationale for favouring better-off households. Indeed, such a policy may be counter-productive for economic growth by exacerbating current inflationary pressures.

How can the Government redress the inequitable outcomes of recent policy when framing Budget 2001 and achieve its stated goal of fair shares for all citizens?

- First, there should be a more balanced budgetary allocation as between tax cuts and welfare expenditure. For example, Budget 2000 spent three-times as much on tax reductions (£1,200 million) as on welfare increases (£400 million). In addition, the allocation of tax reductions should be altered, from a focus on cutting rates and widening bands to increasing personal and PAYE allowances.

⁵ UNICEF (2000) *Innocenti Report Card No 1* ; Florence: UNICEF

⁶ T Callan and B Nolan, *The Irish Times*, December 1999

- Second, the surplus in government finances should be used to introduce structural reforms in the tax/benefit system, notably in regard to child income support and individualisation of tax and welfare. Central to such reforms should be a greater integration of the tax and welfare systems to achieve policy goals.
- Third, there should be an agreed benchmark for uprating tax and welfare changes. The current starting point - that tax and welfare policy remains unchanged in real terms - is unrealistic and misleading. An alternative approach is to index welfare and taxation rates in line with a common benchmark which would lift all income categories by a similar amount as a first step in the reform of budgetary policy.
- Fourth, analysis of the outcomes of budgetary policies would be better informed if based on a simulated representative sample of the population, not on atypical illustrative examples (eg 'couple on average industrial wages' is a tiny minority).
- Finally, Ireland now has among the lowest tax take as a percentage of GNP among EU member states as a result of reduced tax rates across a range of measures: company profits, personal incomes and capital assets. This policy should be reversed as it has long-term implications in terms of future government expenditure on public services and physical infrastructure.

Towards a redistributive Budget strategy

The Agency proposes the following tax/welfare policy framework for Budget 2001.

➤ *Index tax and welfare payments in line with wage increases in 2000 (7.6%)*

The Agency has identified three possible benchmarks for tax and welfare changes in Budget 2001 which would have the effect of maintaining the income relationship between workers and welfare recipients: inflation, wages and personal incomes. Inflation can be seen as a minimum improvement, despite its rise in 2000. Rapid growth in incomes, arising from higher wages and recent tax reductions, suggests that a more ambitious benchmark is required if all income categories are to share equally in the benefits of economic growth. From a macro-economic perspective, using wages as the reference point would keep government revenue and expenditure roughly constant as a proportion of national income. A third alternative, personal disposable incomes, is the most inclusive measure. However, both its cost and its diverse components make it a more challenging and complex index measure.

The Agency advocates the starting position in Budget 2001 should be to index tax and welfare payments in line with wages. This will result in a rise in disposable incomes for all groups of 2.35 per cent after inflation (forecast at 5.25 per cent). For those at work, it will ensure that the value of wage increases translates into net incomes. Meanwhile, welfare recipients will maintain their position vis-à-vis those at work.

Table 1: Revenue implications of various budgetary policy benchmarks⁷

<i>Indexation benchmark</i>	<i>Social welfare cost</i>	<i>Taxation cost</i>	<i>Total cost</i>
Inflation (5.25%)	£238.5m	£268.8m	£507.3m

⁷ These and subsequent calculations are based on the ESRI SWITCH model (see footnote 1).

Wages (7.6%)	£348.3m	£381.3m	£729.6m
Incomes (11.8%)	£538.7m	£575.7m	£1,112.4m

➤ ***Provide additional improvements for households on the lowest welfare payments***

The second policy priority is to target additional resources (c £120m) at households most in need, namely children and adults on the lowest rates of payment. There remain many inequities within the welfare system in terms of differential payment rates by category of recipient. For children there is the additional problem that payment rates fall far short of what is seen as a minimally adequate payment (estimated at £34) or provided in comparable official income supports (eg fostercare allowance is £71.55 and UK child payment is £41). Furthermore, the above average rate of child poverty warrants the allocation of significant resources for children in line with the National Anti-Poverty Strategy. These should be focused in five areas:

- Increase weekly child dependant allowances rates to £16 (under 12s) and £19 (12 and over) as part of a strategy to achieve a minimum adequate payment for children (additional increases in child benefit are outlined later) (cost £31m);
- Enhance school-related welfare programmes (school meals, school clothing and footwear and school books) by £20 million in order to minimise the financial barriers to participation in primary and secondary education;
- Incorporate a childcare allowance/disregard in family income supplement where both parents work or are on a temporary employment programme in order to increase the incentive to work among low-paid families (£5 million);
- Provide a means-tested pre-school allowance for children aged 3 and 4 years as a targeted and cost-effective measure to prevent incipient educational failure, in line with the commitment of the White Paper on early childhood education.

There is also a need to improve the position of adults on the lowest welfare payments who face a high risk of poverty. In this context, the *Programme for Prosperity and Fairness* has set out an official target figure of £100 per week as a minimum welfare payment to be achieved in three years. In addition, income inadequacy is exacerbated in households where a second adult gets only a proportion of the personal rate. A government working group on the treatment of households highlighted the need to raise the additional welfare payment for adult dependants to a minimum of 70 per cent of the personal rate in order to achieve minimum living standards (most payments are c 60 per cent of the personal rate).⁸ The Agency proposes two actions:

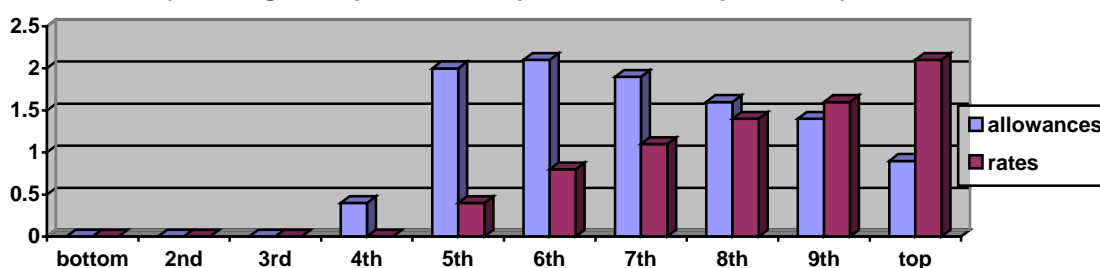
- Increase the lowest payments by a minimum of £8 per week (equivalent of an additional £2 on top of indexation by wage growth), representing a third of the gap between the current lowest rate and the £100 minimum target;
- Raise the adult dependant allowance to 65 per cent of the personal rate as part of a two-year process aimed at bringing the adult dependant allowance to 70 per cent.

⁸ Working group examining the treatment of married, cohabiting and one-parent families under the tax and social welfare codes (1999), *Report*, Dublin: Stationery office

➤ **Target surplus resources at low and middle income households with children**

There is widespread agreement that surplus government tax resources should be targeted at low-paid workers, in particular those on the minimum wage. In accordance with this goal, the social partnership agreement prioritises improvements in standardised tax allowances in delivering tax reductions. Increasing allowances are a more effective way of targeting resources at those on low incomes than cutting rates or widening bands. The distributive impact of alternative tax reduction packages with similar costs (a £1,066 increase in personal allowances and a 2 per cent reduction in the standard and higher rates of tax) are illustrated below. The diagram shows that channelling resources into tax allowances is more equitable than cutting rates. Gains from increased personal allowances are greatest for middle income groups, while the main beneficiaries of tax rates are higher earners.

Diagram 3: Distributive impact of increase in personal allowances vs cut in tax rates
(% change in equivalised disposable income per decile)



While tax allowances are more progressive, three caveats must be noted. First, the lowest income deciles gain nothing as they have insufficient income to benefit from tax reductions. Second, higher income groups still claim the greatest share of the total resources allocated for tax allowances: 38 per cent goes to the top two deciles, as compared to 26.5 per cent for the 5th and 6th deciles. Third, tax reductions make no allowance for households with children, beyond a limited and ill-targeted benefit for one-earner married couples. This suggests that tax reductions of whatever form are an inefficient mechanism for redistributing resources to low and middle income groups, especially those with children. In this context, it is worth recalling that 30 per cent of poor children are to be found in low-paid households, mainly those headed by an employee. The Agency therefore proposes that a proportion of tax resources should be re-allocated into child income support. Here, the preference is for child benefit as it avoids the efficiency problems associated with family income supplement and is in accord with the goal of a £100 child benefit payment for larger families set out in the *Programme for Prosperity and Fairness*. This figure should be contextualised by setting out the proportion of the basic costs of a child to be met through child benefit. The Agency therefore proposes the following package of tax/child benefit measures:

- Increase the personal allowance by £800 and the PAYE allowance by £200 inclusive of wage indexation (£213.4m)
- Increase child benefit to £13 and £17 per week (£56.33 and £73.67) per month inclusive of wage indexation (£138m), with a long-term goal of meeting two-thirds of basic child-rearing costs.

➤ ***Provide an equitable system of support for the childcare costs of families***

The Government is committed to an equitable strategy to assist all parents with their childcare costs. The current system of support for childcare is based on the transfer of allowances and bands for one-earner married couples and the home carer's allowance. These tax breaks can be seen as discriminatory and inequitable, as they do not benefit families outside the tax net, non-married families or families who purchase childcare services. In addition, both measures have negative effects on the labour market participation of mothers. Recent government reports by the Commission on the Family and the Working Group on the tax/welfare treatment of households have developed alternative proposals which provide for the equitable treatment of the childcare costs of all households. These are based on a two-prong tax/welfare package of independent personal taxation and increased child benefit. This strategy was in part adopted in last year's Budget (tax individualisation), with the failure to provide a compensatory child support measure drawing considerable criticism. Counter-proposals have been made for the introduction of tax relief as a means of childcare support. The Agency advises against such an approach as being divisive, socially inequitable and of little economic benefit. UK research shows that childcare tax relief confers the greatest benefit to those at the higher end of the income distribution, with the largest gains going to two-earner couples already in employment.⁹ By contrast, extending the tax band for single people would recognise in a fairer way the additional financial costs for working couples who have to purchase childcare.

The Agency recommends the following tax/welfare package for childcare:

- Extend the tax band for single people by £3,000 (£202.9m);
- Introduce a child benefit supplement for children under 5 of £10 per week or a parental payment for families with a child under 5 of £20 per week (cost £133m).

These expenditures could be off-set against savings derived from freezing the value of transferable tax bands for married couples and abolishing the home carer's allowance as it applies to children (saving c £80m). The focus on children under 5 can be justified by the absence of equivalent state childcare provision for this age group and the higher indirect labour market costs associated with care of younger children. These proposals offer a more inclusive approach to childcare support, with a payment going to all children/families regardless of income or method of childcare. This universal approach would complement current policy direction in favour of a single transparent cash payment targeted at the needs of children and paid to mothers as the primary caregivers. There is a choice as between a per child payment of a flat parental payment. A child benefit supplement links the level of support with the number of children being cared for. By contrast, a parental benefit provides a higher rate of payment for families irrespective of the number of children.

➤ ***Bring forward welfare increases, including child benefit, to the start of the year***

The government has recently indicated its intention to bring forward budgetary tax and social welfare changes to the beginning of the calendar year by 2002. Currently, there is a delay of a month before the implementation of welfare increases as

⁹ Duncan, A and C Giles (1996), 'Should we subsidise pre-school childcare and if so, how? *Fiscal Studies*, Vol 17, No 3, pp39-61.

compared to tax improvements, while child benefit changes do not come into effect for five months. Given the higher than expected inflation figures for 2000 (5.25 per cent as compared to the 3 per cent forecast in Budget 2000) and the consequent devaluation of welfare payments, the Agency proposes that welfare payments, including child benefit, are brought forward to the start of 2001. This would help to compensate welfare dependants for the fall in real incomes arising from inflation in a more immediate manner than a proposed savings bond. In addition, child benefit should be paid more frequently, initially on a fortnightly basis and eventually weekly. These changes would have a one-off cost estimated to be in the region of £100m.

Budgetary outcomes: affordable, equitable, pro-children and work

The full year cost of the Agency tax/welfare budgetary package is £1.46 billion (with a one-off charge of £100m to bring forward welfare increases on a calendar basis). This cost is deliberately set at less than the amount allocated last year on the basis that additional resources are required for investment in key public services. The £1.46 billion is evenly broken down between expenditure (social welfare and child benefit) and tax reductions. In this context, it is important that child benefit be seen as separate to normal welfare expenditure in that it benefits all families with children, therefore combining both a welfare and a taxation function. This package is clearly within the parameters of last year's Budget and the targets set out for tax and welfare measures in the *Programme for Prosperity and Fairness*.

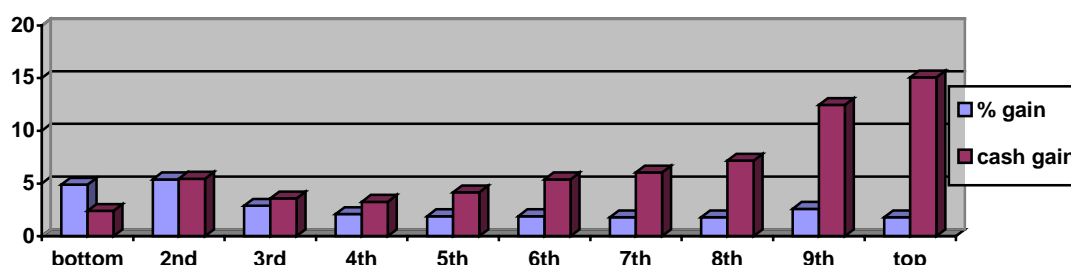
Table 2: Costings of Agency's tax/welfare proposals

	Social welfare	Child benefit	Taxation	TOTAL
Benchmarking by wages	£306.1m	£42.2m	£381.3m	£729.6m
Social welfare additions	e£120m	-	-	e£120m
Tax/child benefit	-	£138m	£213.4m	£351.4m
Childcare/individualisation	-	£137m	£122m*	£259m
TOTAL	£406.1m	£317.2m	£716.7m	£1,460m

* gross figure is £202.9m, but estimated savings of £80.9m by restricting the HCA

The redistributive outcome of this package of tax/welfare measures is outlined below.¹⁰ This is assessed against Budget 2000 policy indexed by wages, as representing a neutral budgetary benchmark. The highest percentage gains go to those in the three lowest deciles: between 3 and 5.5 per cent, while all other deciles get around 2 per cent of an increase. This is a complete reversal of the pattern achieved in last year's Budget, when the poorest categories got 1 per cent and the richest 4 per cent. However, high-income groups still get most in actual cash amounts, rising to £15 for the top decile. Similarly, better-off groups scoop the largest share of the total available resources (42 per cent of the pot goes to the richest twenty per cent). However, this is an inevitable by-product of the income distribution structure and should be borne in mind when discussing Budget gains. The key point is that in percentage terms, income is being redistributed towards poorer households, though the rich still receive the majority of additional resources.

**Diagram 4: Distributive impact of Agency strategy against
2000 policy indexed to wages**
(% and £ change in equivalised disposable income per decile)



Those on the lowest welfare payments will receive a minimum gain of £8, plus a further £7.60 for an adult dependant. For a couple on short-term unemployment assistance, with will represent a combined increase of 13 per cent. For households with poor children there will also be significant gains from this strategy. For example, an unemployed family will receive an additional £9 per week for an older child (£19 child dependant allowance and £13 child benefit, giving a total of £32). This will narrow the gap to a minimum adequate child payment (£34) to just £2. On top of this, there will be further gains through enhanced non-cash school benefits and a universal childcare subsidy of £10 for children under 5. The universal nature of some

¹⁰ Not all of the Agency's recommendations are included in the SWITCH analysis. The main components are: wage indexation of tax and welfare; minimum £8 increase in personal welfare rate; increase in qualified adult allowance to 65 per cent; child dependant allowances standardised at £16 (not adequate information to apply £19 rate to older children); child benefit raised to £13 and £17, with additional £10 for under 5s; increase of £800 and £200 respectively in personal and PAYE allowances; individual tax band widened to £20,000; reduction in the home carer's allowance to £1,000. Omitted are pre-school voucher, educational benefits and childcare disregard in family income supplement. The cost of the modelled package is £729.6m (wage indexation) plus a £685m as follows: £85.8m for additional welfare expenditure; £275.5m on child benefit; and £324.6m on (net) tax reductions.

of the child income support changes will benefit all children, representing a significant redistribution of public resources towards families across the income spectrum

The employment implications of this enhanced child income support strategy, along with the increases in personal allowances and widening of tax bands, should be positive. By emphasising universal child income support and also keeping means-tested child payments in line with average payments under family income supplement, the package should have positive incentive effects. In addition, the childcare disregard under family income supplement and the means-tested pre-school allowance should greatly encourage low-income families to maximise employment opportunities, especially for mothers. Lowering marginal tax rates for low paid and second earners will also have a positive outcome on labour market participation. Finally, there should be positive educational outcomes from the package of child income support, which will help to curtail the reproduction of child poverty into future generations.

Policy priorities where welfare resources are less than proposed

The Agency has been asked to indicate its policy priorities if the resources available for social welfare expenditure, including child benefit, are less than what is proposed above. It should be noted that a similar imbalance between tax and welfare allocations as last year would fundamentally undermine the redistributive strategy outlined above and worsen income inequalities. Such an outcome would be directly counter to the objective of the National Anti-Poverty Strategy, as recently highlighted in the 1999/2000 report of the inter-departmental policy committee (p64). With this reservation, the table below outlines the Agency's priority expenditure items based on a broadly equivalent welfare allocation to last year (£450 million), with the proposal that any additional resources should be targeted at child benefit in the first instance.

<i>Welfare priorities based on £450 million allocation</i>		
£31m	Indexing of social welfare payments in line with wages	£348m
	Increases in child dependant allowances to £16/£19	
	Improvements in school-welfare schemes + FIS	£10m
	Ensuring minimum increase of £8 in lowest payments	e£30m
	Increase in qualified adult payment to 70 per cent	e£10m
	Increase in child benefit (+ any additional resources)	£11m
	TOTAL	£450m