findings

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Reforming children's benefits: international comparisons

The UK is preparing a radical reform of the benefits paid to families with children, with the introduction of the Integrated Child Credit (ICC) in 2003. Several other countries have been going down similar routes. A JRF study looked at experiences in Australia, Canada and the United States, alongside those of the UK, and drew lessons for policy.

- **The Integrated Child Credit represents a radical change in the way payments are made to families with children. For the first time there will be a common means-tested benefit for low-income families regardless of whether they are working. It will separate out the payments intended to meet children's needs from other benefits. (But Child Benefit will continue, outside the ICC.)**

- **Australia and Canada have both successfully introduced systems that give a common family benefit or tax credit regardless of work status. These benefits are higher for low-income families, but middle-income households with children also get some benefit. Such conditions have helped finance spending on children in ways that are relatively free of stigma and connotations with 'welfare'.**

- **The United States has concentrated support on working families, having no general safety-net benefit. However, its long experience with tax credits contains useful lessons for the UK.**

- **These countries' systems cannot be directly transferred to the UK, but their experiences can help policy-makers address some key decisions around the introduction of the ICC. In particular, they underline:**

  - **the importance of a *stable system* of children's benefits (ie benefit payments plus tax credits/allowances) that reaches most families. The long-term sustainability of the ICC will depend on the system being perceived as both fair and inclusive.**

  - **the case for having bands of income over which *entitlements are stable*, rather than withdrawing them continuously as income rises, to give greater predictability to payments destined for spending on children.**

  - **the feasibility of *combining joint family means-testing of children's entitlements with individual assessment of tax liability* in a single system. However, the UK faces a unique problem of how to integrate taxes and benefits without making every adult fill out a tax return as in other countries.**

  - **the value of *simple structures* of entitlement, even where they are less immediately sensitive to changing needs. When other countries have asked claimants their views, they have often found a preference for 'rough justice' to a meddlesome and detailed welfare system.**

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Background

In the 2000 Budget, the Government confirmed that from 2003 it intends to reform the system of benefits and tax credits for families with children. At present, there are three main entitlements on top of Child Benefit (which is paid to everyone): child allowances in income support (paid to non-working families); Working Families Tax Credit (WFTC - paid to low-earning families); and, from 2001, the Children's Tax Credit (paid to all taxpaying families not paying higher rate tax). The plan is to retain a separate Child Benefit, but to combine other children's entitlements into a single payment to the person who looks after them. For low-earner families, the part of the WFTC based on adult needs will arrive separately through the pay packet, as an Employment Tax Credit also available to low earners without children.

This for the first time offers the same means-tested payment to people in and out of work. It should in principle provide a more stable and less complex payment to people on low incomes, while continuing to make some provision for families whose incomes rise. But the durability, feasibility and overall effectiveness of the new system will rely on the detail of its design and delivery. Other countries that have adopted similar strategies in recent years offer useful lessons. This study looked at three other countries with systems and recent developments most similar to the UK's.

Three other systems

In **Australia,** a single 'family tax payment' is paid as a cheque to all but the richest 10-15 per cent of families. About half of these receive the payment at a top rate, most of the rest at a single lower rate. Families with only one earner get more; this supplement is higher for those with children under five. This system, introduced in 2000, is the product of years of reform and simplification. Although people on low and middle incomes get stable payments for their children, other benefits and taxes for people on lower incomes are sharply redistributive, with steep withdrawal rates as income rises. Australia has thereby managed to limit the growth in inequality after taxes and benefits, while avoiding over-sharp means-testing of payments destined for children.

In **Canada,** a federal Child Tax Benefit is paid directly by cheque to the great majority of families – soon it will be about 90 per cent. Only the poorest, on below 46 per cent of average family income get the maximum rate, but the withdrawal rate is very low by international standards, only 2½ per cent of marginal income for one-child and 5 per cent for multi-child families. This federal benefit is progressively replacing more stigmatising provincial social assistance payments, which go only to low-income households. By making benefits to children available to a large majority of families, Canada is aiming to promote social cohesion. The anonymous administration of the benefit through the income tax system avoids stigma.

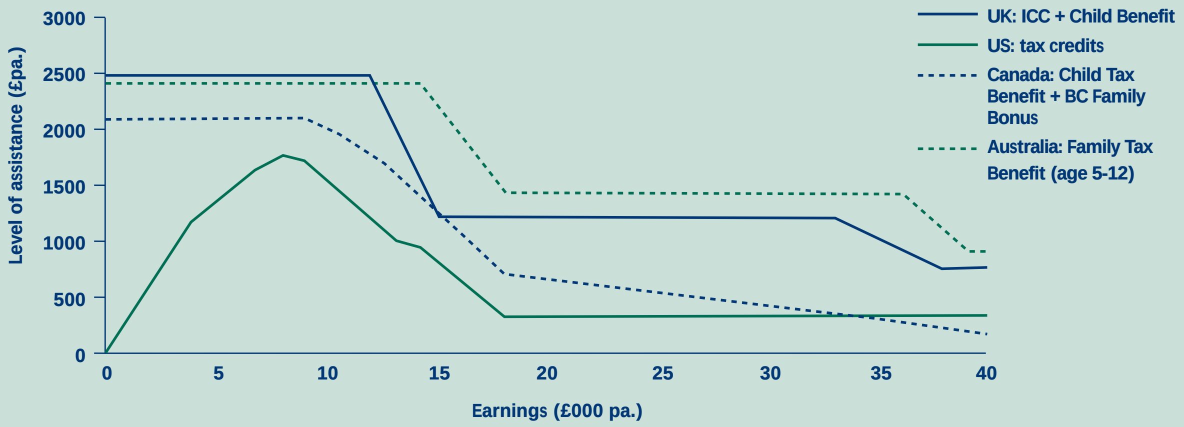
The **United States** has no single benefit catering for children. Taxpayers get a tax-free allowance of $2,750 per child, worth most to higher-rate payers, plus a credit against income tax liability of $500 per child, worth the same to all. In addition, families on low earnings are eligible for the Earned Income Tax Credit which initially rises with income, but declines after it reaches a maximum. There is no universal equivalent of the Income Support safety net, but states give various forms of assistance to non-working parents and to those participating in welfare-to-work programmes, for example those participating in an approved job placement. This system puts great emphasis on encouraging and rewarding work, but little on relieving poverty per se. It has worked reasonably well in times of plentiful jobs, but has not yet been tested (since the 1990s welfare reform) in a downturn or recession.

Key issues for the ICC raised by international experience

- **How to construct an *adequate* and *stable* system**

Recent budgets have greatly increased the level of support available for children in low-income families, to a level close to what is actually required to cover a child's basic needs. Can such support be consolidated and maintained? Overseas experience has shown that support is most durable where it is based on a sense of shared values, in terms of giving a social priority to support the next generation. In recent years the emphasis has been on preventing child poverty, yet societies continue to see transfers to a wider range of families with children as being equitable. Where everyone, or the great majority, has some stake in a

Figure 1: Benefits at different income levels for a lone-parent, one-child family



single unified system, its legitimacy is strengthened. However, unlike the UK, Australia and Canada have not had to ponder why a very rich family gets a payment from the state - because the best-off 10 per cent are excluded. An interesting exception in Australia is a wife of a very high earner who has no income of her own, who continues to get some child benefit.

- **How to *structure* payments and their withdrawal as income rises**

Figure 1 illustrates the pattern of children's payments received by a lone parent with one child in each of the four countries in the study. (This is a simplified representation of children's entitlements, showing the pattern of withdrawal rates of the main payments specifically destined for children. It compares sterling values on the basis of purchasing power parities, ie rates of exchange based on the cost of living.)

An interesting choice illustrated by this graph is whether to withdraw payments gently but over a wide band of income (as in Canada) or to have more abrupt but short bands of withdrawal (as in the UK and Australia). The case for the latter is that it creates long 'plateaux' of income in which children's payments are constant. Even though for lower-income families in these two countries there remain sharp marginal rates of withdrawal of each extra pound that reaches an earner's pay packet, a constant element for children in the family budget appears to be highly valued. The illustrative plans for the Integrated Child Credit indicate that it could provide this stability – not only where earnings change but also where parents move in and out of work.

- **How to *administer and assess* an integrated child credit**

Canada and Australia both use assessments of income for tax purposes to operate family means tests for children's benefits. Even though income tax is imposed on individual incomes there is nothing to stop the tax authorities from asking about a spouse's income, or matching tax records. In Canada, a quarter of a century's experience of using the tax system to deliver family-assessed social benefits has not caused major administrative difficulties or controversy, even though it sometimes produces technical inconsistencies. So family-based children's entitlements can co-exist in a tax system with individual tax liabilities. A harder issue for the UK is whether integration is desirable if it requires everyone to fill in a tax return. It would be unwise to dismiss this possibility out of hand: a simplified tax form may be no more onerous than some of the benefit forms that claimants presently must fill out, and would reduce the stigma of a divided system.

- **The *timing* of payments**

In other countries, payments to low-income families with children have been assessed and paid over much longer periods than in the UK – often being based on the tax year. There is legitimate concern that this could cause hardship without special provision for initial claims. But the UK's 'responsive' system - in which entitlements must be immediately reassessed with every change in circumstance (as in the Income Support system) - could usefully be modified in the case of the ICC, especially because most changes in income level or employment status will not change the entitlement. Other countries are finding that families much prefer stability in what they receive from the state, in a non-intrusive system, even if it entails some 'rough justice'.

Conclusion

The Integrated Child Credit is an ambitious attempt to consolidate and legitimise a highly redistributive system of payments to children, at a time when redistribution is not seen as a popular political objective. Other countries have shown that it is possible to build support for such systems by making them less like residual programmes for those on the lowest incomes. This can be done by genuinely integrating relief for the poorest children with more general family payments (but not simply by relabelling benefits as tax credits). The sustainability of systems is likely therefore to depend not just on commitment to poverty relief but on whether some general redistribution towards families with children is seen as socially just. Three further critical elements are: that the system makes sense to users; that family payments interact logically with other tax and benefit provisions; and that they favour rather than erode work incentives.

About the study

The Joseph Rowntree Foundation and the Caledon Institute for Social Policy in Ottawa, Canada, commissioned four country reports on benefits for children. The country experts who wrote these reports and contributed to the international comparison exercise were: Australia – Peter Whiteford; Canada – Ken Battle and Michael Mendelson; United Kingdom – Professor Jane Millar; United States – Professor Daniel Meyer. These reports were carefully designed, through extensive liaison among their authors co-ordinated by Michael Mendelson for the Caledon Institute, to report the complex systems of each country in a common framework.

In June 2000 a high-level group of international and senior UK government officials met in London to discuss the Integrated Child Credit in light of other countries' experiences.

How to get further information

The implications for the UK, summarised in these *Findings,* are set out in **A credit to children: The UK's radical reform of children's benefits in an international perspective**, by Donald Hirsch. This report is published for the Foundation by YPS (ISBN 1 84263 006 7, price £10.95).

The full international study, including the country reports and comparative analysis, will be published in December 2000 by the Caledon Institute as **Benefits for children: A four-country study** by Ken Battle, Jane Millar, Michael Mendelson, Daniel Meyer and Peter Whiteford. It also available from YPS (ISBN 1 894598 31 8, price £12.95 plus £2 p&p). Further details can also be found at http://www.caledoninst.org.

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