

CHILD BENEFIT REFORM: DEALING WITH THE DEFICITS TO PUT STABLE FAMILIES FIRST

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This short paper supports the principle of ending Child Benefit payments to wealthier families, but it criticises the details of the Government's muddled and faulty reform proposal. As the current proposal stands, the Government would undermine stable families by hitting couple formation and marriage, and thereby also jeopardising its own positive commitment about shared parenting. We offer clearer and more credible options for targeting Child Benefit on lower-earning households, including the replacement of universal Child Benefit with a new Child Benefit element of Child Tax Credit.

CHILD BENEFIT REFORM: AN END TO UNIVERSAL PAYMENTS

Universal Child Benefit payments are coming to an end. As part of its deficit reduction programme, in 2013 the Government will cease paying the benefit to families with one higher rate taxpayer, which will equate to households in which an individual(s) earns more than £42,735 a year. According to the latest data, 1.5 million families (of a total of 17.9 million families) will lose their Child Benefit as a result of the changes and £2.4 billion of public expenditure savings will be realised, reducing the annual Child Benefit bill of £12 billion.ⁱ

Table 1: Breakdown of impact of Child Benefit reforms by family size ⁱⁱ

Family size	Number of families affected	Annual financial loss per family
One-child family	600,000	£1,056
Two-child family	700,000	£1,752
Three or more children	200,000	£2,449

The Centre for Social Justice (CSJ) has long argued that regardless of national economic conditions, some benefits are unnecessarily paid on a universal basis. We have also warned against a creeping culture of entitlement and dependency which the benefit system can cultivate. Most recently the CSJ challenged the political fear of reforming such benefits like Winter Fuel Payments and bus passes for older people, which could be targeted much more effectively for those who need such direct financial support.ⁱⁱⁱ

In view of our belief in the need to re-think universal entitlement to certain benefits, we believe that the Government is right *in principle* to stop paying Child Benefit to higher earning families – many of whom welcome but do not depend on its financial support. In a healthy economic climate there would be a strong case for reform, but in the midst of Britain's current economic storm, and the need to deal with the deficit, such a move is realistic and necessary.

A FLAWED GOVERNMENT PROPOSAL

Although the CSJ supports the principle of ending the payment of Child Benefit to wealthier families, there are several fundamental flaws in the approach the Government has outlined to achieve this aim. These include the problem that a number of wealthier families will retain their child benefit while others on much lower incomes will lose it, and within this, there is a risk of further erosion of the stable foundation two-parent families provide within society. And whilst the CSJ engages less with policy debates about issues affecting middle- or high-income families, we are doing so on the basis of this risk and the inherent injustice of the proposal.

A new penalty for marriage, couple formation and fathers

It is well established that the withdrawal mechanism proposed by the Coalition to enact its reform of Child Benefit is unfair. Given that the new system will be based on individual income and taxation, rather than household income, it will create a sharp cliff edge by removing Child Benefit from couples with a single earner income of £43,000 per year (just above the higher rate tax threshold) but retain it for dual earner couples where two individuals earn £42,000 each (just below the higher rate tax threshold), or £84,000 per year.

Beyond the obvious and inherent unfairness of this, such an unthinking system will further undermine stable family formation:

- **It penalises a decision to get married:** in visibility terms married couples with at least one higher rate taxpayer will be unable to avoid losing their child benefit, while those who are cohabiting will face a choice between being financially worse off if formally declaring their relationship (or marrying), or deciding to commit fraud by denying their relationship status.
- **There is a broader couple penalty:** Flowing from the point made above, as there is far less clarity about when cohabitation begins, this measure discourages putting relationships on a more formal footing. There is often ambiguity about whether couples are cohabiting or 'living apart together' and this will create a strong disincentive to raising children together. A higher rate taxpayer's income will be hit by explicitly forming a new household (as he will have to notify HMRC that the household is in receipt of child benefit). His significantly higher tax bill thereby penalises him for forming a co-residential relationship with a lone parent (usually a mother). As he will often be the children's father, this fundamentally damages the Coalition's stated commitment to 'encourage shared parenting'^{iv} because of the beneficial outcomes including greater stability for children who grow up living in two parent families.^v It also flies in the face of evidence that demonstrates the impact of an existing couple penalty in the tax and benefit system, which renders lower-earning couples financially and materially better off if they choose to live separately rather than together.^{vi} Furthermore, such a penalty encourages fraud: the Institute for Fiscal Studies (IFS) has found that 200,000 more lone parents claim tax credits than appear to exist in the UK.^{vii}

The cliff edge

Another problem with the Government's reform is that it will create a sharp cliff edge, over which many people will fear to tread. It will clearly introduce a situation where families with one earner earning a little below the higher income tax threshold would actually be made worse off after a pay rise. This also means that those who have only just crossed the higher rate tax threshold will be better off if they were paid less.

Increasing complexity

Based on the nature of the Government's proposed reforms to Child Benefit, a new system will be required to administer the means-testing of higher rate taxpayers. This mechanism will inevitably insert another layer of complexity to an already mystifyingly complicated system. This sits uncomfortably with its wider reforms to simplify the benefit and tax systems.

DEALING WITH THE DEFICITS

Action to deal with the Britain's national budget deficit must be urgent, but it must also be pursued fairly and thoughtfully. The current reform package for Child Benefit fails to offer a credible and rational solution for public expenditure savings – it is full of its own deficits.

A fairer system

The CSJ suggests that the Government considers one of the following two options for its reform of Child Benefit, using the Child Tax Credit mechanism (and later Universal Credit) to gradually taper, what we recommend would be referred to as the Child Benefit element, away on the basis of *joint* income from better off households. This would recognise the high regard the British public has for supporting children with a specific benefit, eliminate the cliff edge, end the unfairness for single earner households (including lone parents) and remove the couple penalty. Crucially, it would also achieve equivalent or greater public expenditure savings depending on its implementation, which could then be reinvested in other support for families.

Option one:

- As the IFS has proposed, the simplest option for withdrawal is to taper Child Benefit immediately after Child Tax Credit, using the same taper rate (41 per cent). This would affect more families than current proposals to use the tax system as a cut-off point, but it would save the government an additional £2.7 billion compared with the Government's current proposal, keep support focused on lower income households and maintain the simplicity of the benefit system under Universal Credit.^{viii}

Option two:

- Alternatively, and the CSJ's preferred option, the Government could use the Child Tax Credit mechanism, but withdraw what we refer to as the Child Benefit element of Child Tax Credit away at a higher income threshold. For example beginning to taper the Child Benefit element at annual household incomes of £40,000 in order to end Child Benefit entitlement at approximately the higher rate tax threshold, could save an additional £1 billion.^{ix} It should be noted, however, that this new taper would add another layer to the tax and benefit system if it were retained under Universal Credit.

Both options, depending on the threshold adopted in option two, would deliver increased public expenditure savings which could be used to invest in additional support for families and children as highlighted above and below.

CONCLUSION

As it stands, the current proposal for reform of Child Benefit is faulty, even though the principle targeting it on lower-income families is bold and sensible. The Government should move quickly to redesign its proposal – in order to present a mechanism which promotes family stability and progress, rather than weakens them as the present model would. In using the Child Tax Credit system to distribute Child Benefit payments – with different options of flexibility and taper rates – the flaws of the proposal will be redressed and additional public expenditure savings could be reinvested in alternative forms of support for families, such as a transferable tax for married couples with young children to send a signal about stability,^x an expansion of effective early intervention programmes^{xi} or improving the quality of childcare.

ⁱ See Institute for Fiscal Studies, *Green Budget 2012*, London: Institute for Fiscal Studies, 2012 and ONS, *Families and Households in the UK 2001 – 2010*, London: ONS, 2011

ⁱⁱ Institute for Fiscal Studies, *Green Budget 2012*, London: Institute for Fiscal Studies, 2012

ⁱⁱⁱ Centre for Social Justice, *Age of Opportunity*, London: Centre for Social Justice, 2011

^{iv} HM Government, *The Coalition: our programme for government*, London: HM Government, 2010, p20

^v The Millennium Cohort Study found that 60 per cent of ‘closely involved’ but not cohabiting parents had split up by the time a child is 5, compared with 26 per cent of cohabiters

^{vi} Centre for Social Justice, *Dynamic Benefits*, London: Centre for Social Justice, 2009, Chapter Four

^{vii} Institute for Fiscal Studies, *Poverty and Inequality in the UK: 2009*, London: Institute for Fiscal Studies, 2009

^{viii} For example, withdrawal of Child Benefit would begin at earnings of £32,554 for a family with two children, and be fully withdrawn at earnings of £36,840. See Institute for Fiscal Studies, *Green Budget 2012*, London: Institute for Fiscal Studies February 2012, pp227-231

^{ix} Based on CSJ calculations

^x See for example: Centre for Social Justice, *It is time to back marriage*, London: Centre for Social Justice, 2012

^{xi} See for example: Centre for Social Justice, *Making Sense of Early Intervention*, London: Centre for Social Justice, 2011