Policy in Practice

The impact of the two-child limit to tax credits

A BRIEFING PAPER BY
POLICY IN PRACTICE

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Executive Summary:

From 6th April 2017, Child Tax Credit (CTC) support available to families across the UK will be limited to the first two children. This measure will affect all households with two or more children that have an additional child after this date.

The government's objectives in introducing the policy are to:

- reduce public deficit and rebalance the welfare spent
- restore fairness in the benefit system between those receiving benefits and those paying for them, with families relying on public support to make the same financial decisions as those supporting themselves solely through work

This short paper provides an independent assessment of the impact the policy will have and clearly highlights the cost of this measure for the large number of children that will be born into low-income families.

Key Findings:

- Over 1 million children will be hit by this policy by the end of this parliament.
- 2.1m families are at risk of being affected by this policy change should they have another child.
- 70% of these families are in work, reflecting the original intention of Child Tax Credits; to provide financial relief to low earners.
- 104,000 third or additional children will be born to this cohort of households in the next twelve months.
- 8,000 children born this April will miss out on support of up to £2,780 a year.
- Based on the average cost of raising a child, low income families that have a third child will have to make-up a difference of up to £1,737 a year.

This means that as a result of this policy:

- Over a quarter of a million children (256,000) already in poverty today will fall deeper into poverty as a result of this policy.
- 266,000 additional children will be living in poverty by the end of this parliamentary term alone. This represents an increase in child poverty of more than 10%
- 609,000 children in other ordinary working families (low to middle income households) will be pushed closer to the poverty line.

Limiting Child Tax Credit to two children: Analysis by Policy in Practice						
	Households with 2+ children		Households	Average No.	Children impacted	
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Household in poverty	23.2%	487,200	24,128	3.5	84,448	256,000
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Just about managing households	55.9%	1,173,900	58,136	3.5	203,476	609,000
Totals	**100.0%**	**2,100,000**	**104,000**	**3.4**	**357,479**	**1,131,000**
*2019/20 analysis takes into account other policy reforms including NLW, UC, Inflation and Benefit Freeze						

This policy is set to save the government £1bn per year by 2020. The behavioural impact of the policy remains unclear; it is difficult to know how many potential parents are aware of the changes and whether this new legislation will mean low income households are less likely to have more than two children. In the coming months, Policy in Practice will be tracking these and other outcomes as part of a project following over half a million low income households across London.

We do know that the costs of poverty are significant, that children who grow up in poverty have lower productivity as adults and have a higher risk of unemployment. There are also immediate costs to public services that support families on low incomes. Policy in Practice estimates that policies such as the Pupil Premium and Free Early Years Entitlement for two year olds will cost an additional £270m per year by 2020 as a result of the increase in child poverty. We also expect additional pressures on housing services, as some families already struggling to pay their rent are in the same position with another mouth to feed.

Within the wider context of welfare reform, this policy represents another cap on the amount of public spending on welfare. It adds to measures which include a freeze on benefits, tighter limits on housing support and the introduction of an overall benefit cap. These policies move away from the needs-based principles on which the British welfare system is based.

The Government wants to restore fairness to the benefit system. This is a worthy aim, but the cost of this policy will ultimately fall on children in the families affected. The government will need to develop alternative strategies to improve the outcomes of children. The impact of growing up in a family that struggles to provide basic necessities will mean this policy is likely to have financial and social consequences well into the future.

Introduction

This paper provides an independent assessment of the impact of an imminent change in benefit policy, effective from 6th April 2017, which limits eligibility for Child Tax Credit.

The next section of this report outlines the policy detail. This is followed by an assessment of the policy objectives behind this measure: to ensure people on low incomes face the same choices as people on higher incomes and to reduce public deficit, discussing its implications within the wider context of welfare reform.

We then present our analysis of the policy on families likely to be affected over the course of this parliament. We estimate the number of households potentially affected and the impact that a reduction in support will have on child poverty, and the depth of poverty, using the relative income measure of poverty. To consider the overall impact of the policy we also estimate what some of the additional costs could be from an upward demand for local services due to the increasing number of children in need.

The analysis clearly highlights the cost of this measure in terms of life chances for increasing number of children born into low-income families. It remains unclear the extent to which this new legislation will mean low income households are less likely to have more than two children. It is questionable whether many potential parents are aware of how the changes will affect them, with limited publicity of the measure, ahead of its implementation.

Policy overview

From 6th April 2017 the amount of Child Tax Credit (CTC) support available to families across the UK will be limited to the first two children. This measure will affect all households with two or more children that have an additional child after this date. The amount of support no longer available to 3rd children is worth up to £2,780 a year. Support for the first child (if born after 6th April) is also reduced by £545 per year. This measure is excluded from our analysis because affected families will continue to receive support.

Families currently receiving CTC for three or more children will not face any loss in support, however should they have an additional child, their CTC entitlement will remain the same. If a third or additional child is born with a disability, families will still be entitled to receive the disability element of CTC.

There are a number exemptions to the upcoming changes in CTC rules. These include:

- children born to the claimant in a multiple birth, other than the first child;
- children adopted from Local Authority Care;
- children living in a long term formal caring arrangement (including children born to parents under the age of 16, or otherwise likely to be in local authority care)
- children likely to have been born to non-consensual conception

The exemptions have been the subject of much controversy, with the Social Security Advisory Committee having raised a number of concerns related to privacy and safety over what has been called the 'rape clause'[1]. An additional administrative issue means that families with more than two children will not be able to claim Universal Credit until November 2018. They will have to make a claim under the tax credits system.

[1]The Social Security (Restrictions on Amounts for Children and Qualifying Young Persons) Amendment Regulations 2017. The National Archives. Available here: http://www.legislation.gov.uk/uksi/2017/376/made

The Government's Objectives

The legislation limiting Child Tax Credits to two children was announced together with a set of other measures aimed at reducing the overall welfare bill, by the Cameron and Osborne government as part of the 2015 Summer Budget.

In the policy impact assessment published in July 2015[2], the Treasury set out two key objectives in bringing forward this policy change that are summarised below:

- to reduce public deficit and rebalance the finances of the welfare state
- to restore fairness in the benefit system, between those receiving benefits and those paying for them, with families relying on public support to make the same financial decisions as those supporting themselves solely through work

Objective 1 - Reducing public deficit

The introduction of the two-child limit to Child Tax Credits and Universal Credit is expected to save a total of £315 million in 2017/2018, rising to £1 billion by 2019-2020[3]. Through this measure, the Office for Budget Responsibility estimates that by the end of this parliamentary term expenditure on family benefits[4], currently at £42.5 billion, will decrease by £210 million.

Figure 1: Change in welfare spending by 2020

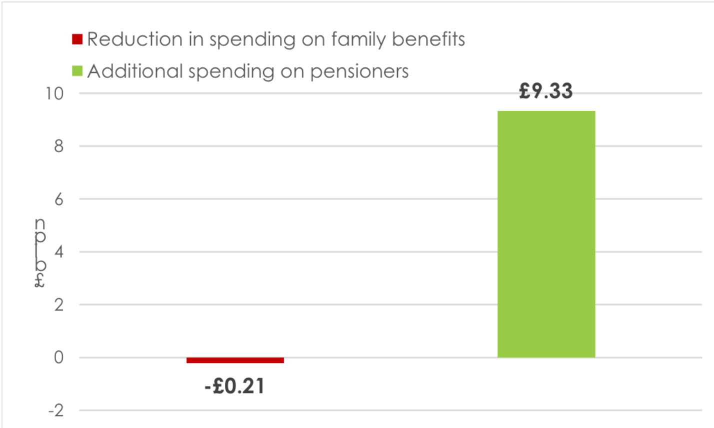

Figure 1 shows that this trend contrasts starkly with the expected increase in spending on pensions. In the same period, the amount of the social security budget spent on pensioners is forecast to increase by almost £10 billion, rising from £97.2 billion to £106.5 billion.

Interestingly, as a proportion of total social security spending, the share assigned to pensions is expected to increase by more than 1% by 2020, rising from 44.5% to 45.7%. During this period expenditure on family benefits is set to decrease by around 1.3%, from 19.4% to 18.1%. These figures signal the strong commitment by the government to pursue deficit reduction through tightening spending on working age benefits while ring-fencing pensions.

Within the wider context of welfare reform, the change in CTC legislation represents another cap on the amount of public spending on welfare, adding to similar measures such as the extension of the local housing allowance system to both the private and social rented sector and the introduction of an overall benefit cap. Through these measures the government is

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[2] Welfare Reform and Work Bill: Impact Assessment of Tax Credits and Universal Credit, changes to Child Element and Family Element. UK Parliament. Available here: http://www.parliament.uk/documents/impact-assessments/IA15-006E.pdf

[3] Summer Budget 2015: policy costings. HM Government. Available here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/443195/Policy_costings_summer_budget_2015.pdf

[4] Office for Budget Responsibility, Economic and fiscal outlook – November 2016. OBR. Available here: http://budgetresponsibility.org.uk/efo/economic-and-fiscal-outlook-november-2016/

setting a limit to the amount of support available to low-income families, moving away from the needs-based principles on which the modern British welfare system was developed. Later in this report we look at some of the costs this policy is likely to have on other parts of the public sector.

Objective 2 - Restoring fairness in the welfare system

The Government views this measure as a means of restoring fairness in the system, forcing households on benefits to be confronted with the same financial decisions as those that are not. Parents relying solely on their earnings have to consider the additional cost of caring for an extra child when making the initial decision of whether to have more children. This policy change ensures that those that are dependent on benefits have to do the same.

Further, the Treasury points to the added value of an active decision by affected households in terms of positive effects on overall family stability. It is argued that the new legislation will improve the life chances of children, by ensuring that households will base decisions on their circumstances rather than on welfare support, increasing the financial resilience of the family[2].

This policy objective to restore fairness in the welfare system is rooted in the assumption that changes in benefit regulations will change the family planning decisions of affected families. Conversely, the Treasury admits a lack of evidence in support of the idea that family planning decisions are made on the basis of available welfare support[5].

For people to make different decisions, they need to be aware of policy changes, in this case families planning to have another child needed to be aware of the change in policy up to nine months before the policy came into effect. Without an awareness of this policy it is difficult to see how it could have any impact on a family's decision to have a child.

Evidence on the impact of this policy on birth rates will help to inform future policy, and what can be done to best improve the life chances of children. With no change in birth rates, the cost of this policy will be borne by those children who will miss out on support, often going to families struggling to provide basic necessities.

Policy in Practice will be tracking the changes in demographic and economic circumstances of half a million low-income households across London, this will allow birth rates and other outcomes, including movement into work, or the need to move home, to be tracked at scale, both before and after this policy takes effect[6].

The Money Advice Trust[7] estimates the cost of providing for a child under 16 is around £2,448 per year. With no support from Tax Credits, low-income families with three or more children will only be able to rely on £711.60 a year from Child Benefit to support their youngest child, having to make-up a difference of £1,737 between their needs and their benefit entitlement.

After the changes to CTC legislation, households that have a third or additional child will have to bridge a gap of £1,736 per year in their finances (either through their earnings or by budgeting), in order to support their extra child.

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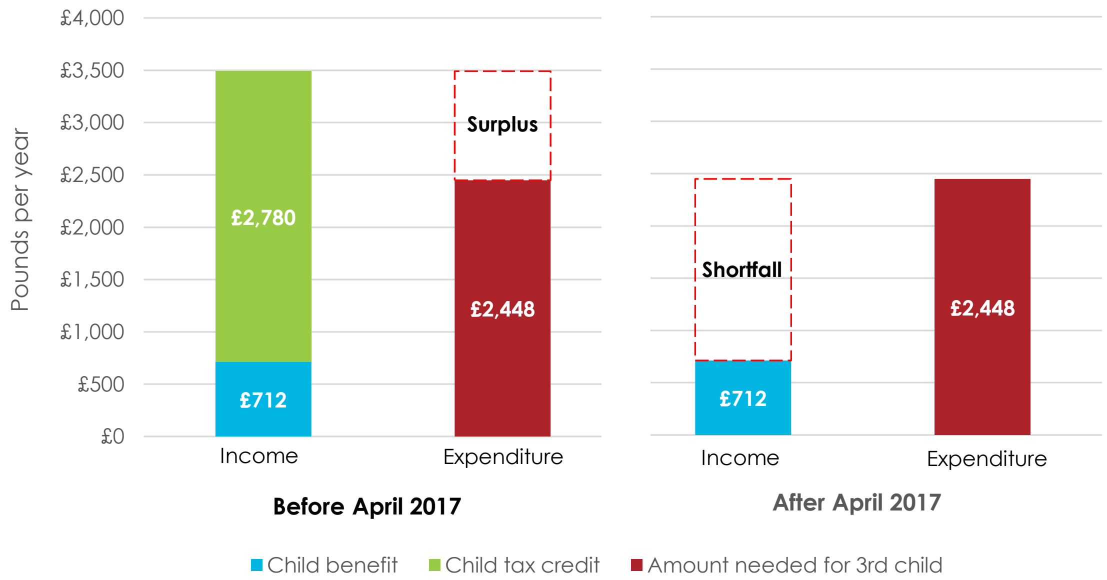
[5] Welfare Reform and Work Bill: Impact Assessment of Tax Credits and Universal Credit, changes to Child Element and Family Element. UK Parliament, p.5. Available here: http://www.parliament.uk/documents/impact-assessments/IA15-006E.pdf

[6] For more information about this project, visit http://policyinpractice.co.uk/low-income-londoners/

[7] Common Financial Statement. Money Advice Trust. Available here: http://www.cfs.moneyadvicetrust.org/

Figure 2: The benefits received for a third child versus the cost, before and after April 2017



The graph above shows that, after these changes, many families are going to struggle to support their additional child. This will have a knock on impact on the newborn child, and their siblings. The Joseph Roundtree Foundation[8] has found that children who grow up in poorer families underachieve in school, limiting their opportunities in later life.

The Effects on Child Poverty

Having discussed the key objectives and exposed some of the inherent contradictions of the new changes to CTC regulations, this section shifts its focus to assessing the impact that the new legislation will have on households affected.

Families at risk and numbers of children affected

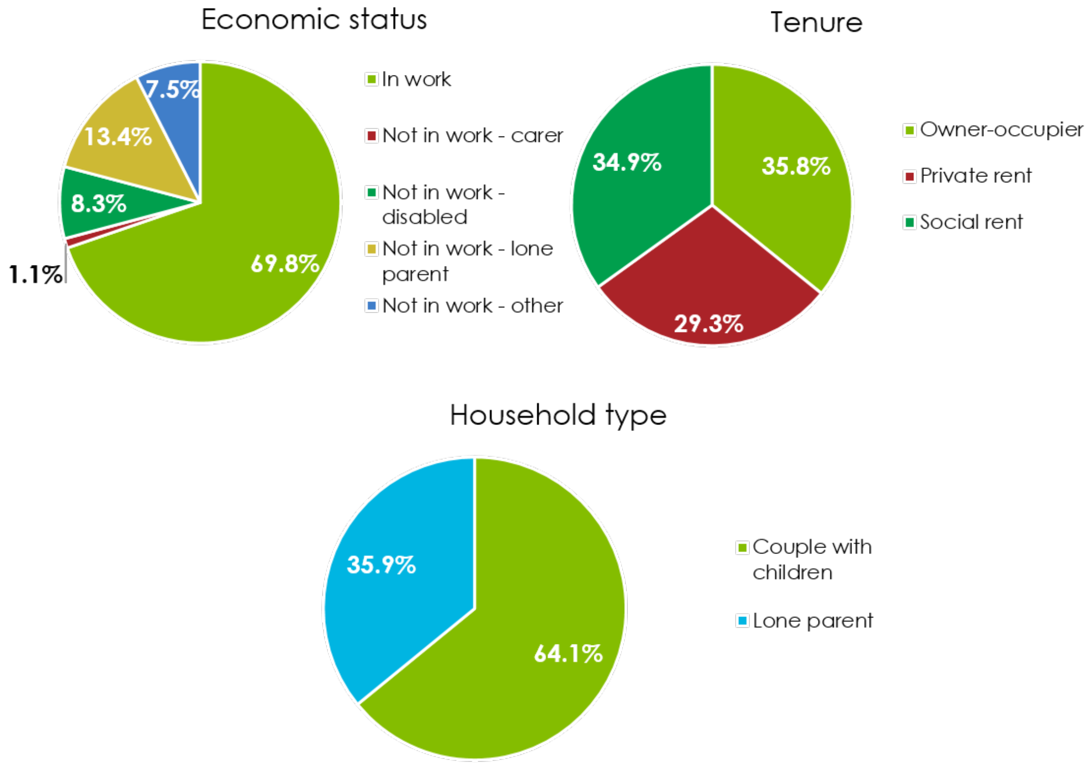
Based on national data collected yearly in the Family Resource Survey (FRS)[9], Policy in Practice found that a total of 2.1 million families are at risk of being affected by this policy should they have another child. These are all families currently receiving Child Tax Credits or households eligible for the child element of Universal Credit.

Interestingly, almost 70% of these families are in work. This reflects the original intent of Child Tax Credit as a benefit introduced to provide financial relief to low earners. Only 7.5% of this group are unemployed households facing low barriers to work, with the remaining 22.7% being out-of-work families with disability, parenting or caring responsibilities.

[8] Poorer children's educational attainment: how important are attitudes and behaviour. Joseph Roundtree Foundation. Available here: https://www.jrf.org.uk/report/poorer-children%E2%80%99s-educational-attainment-how-important-are-attitudes-and-behaviour
[9] For a comprehensive account of the methodological approach of this analysis, see Annex I

The average income (including benefits and earnings) of these families is £26,268 pounds per year. 35.9% of this cohort are lone parents, and just below two thirds of them are tenants.

Figure 3: Characteristics of households at risk



Looking at data for the last year, we identified 104,000 third or addition children born within this cohort of households. If we assume that a similar number of children will be born in the year ahead, then our analysis finds that an estimated 104,000 children born between now and April 2018 will miss out on up to £2,780 of tax credit support. In the month of April, we can expect approximatively 8,000 newborn babies affected by this policy change.

If the demographic composition of the households 'at risk' is reflected within those 104,000 families likely to have a third or additional child in the next twelve months, then 72,500 children who will miss out on support will be born in a household with a least one parent in work, and 37,300 children will be born in a lone parent household.

The rise in child poverty

The Office for National Statistics figures on relative poverty show that households in the UK need an extra £286 a month, per extra child, to remain above the poverty line[10]. Currently that sum is covered by the support received through Child Tax Credits (£232 per month) and through Child Benefit (£59 per month for second or additional children). With the limit of Child Tax Credit Support to two children, families affected by this reform will thus face a monthly shortfall of £227 each month (£286 cost per child, less £59 Child Benefit).

Policy in Practice projections estimate that, due to the reduction in support available for large families on low-incomes, an additional 21,900 households are likely to fall below the

[10] Based on people, population and community. ONS. Available here: https://www.ons.gov.uk/peoplepopulationandcommunity/ and economic and fiscal outlook. OBR. Available here: budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2017 :

relative poverty line in the year ahead, bringing an additional 70,000 children to the 2.3m currently living at below 60% of median income.

If the same birth rate is maintained in the years leading up to 2019-2020, then we expect to see a total of 266,000 additional children living in poverty by the end of this parliamentary term. This represents an increase in child poverty of more than 10% from the current national figures.

Our analysis estimates that in the same time period, a total of 256,000 children living in families already below the poverty line will be pushed deeper into poverty. Similarly, the changes to CTC entitlements effective from April will bring 609,000 children living in ordinary working families (low to middle income households) closer to the poverty line.

Summing these together, over 1.1 million children will be hit by this policy by the end of this parliament.

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	Share	Number	losing CTC	of Siblings	2017/18	2019/20*
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Totals	**100.0%**	**2,100,000**	**104,000**	**3.4**	**357,479**	**1,131,000**
*2019/20 analysis takes into account other policy reforms including NLW, UC, Inflation and Benefit Freeze						

The cumulative impact of welfare reforms

This number is likely to increase further when other changes in welfare policy are taken into account, as shown in Welfare Reform Roadmap below.

Policy in Practice finds that the combined effects of the freeze of benefit rates, the roll out Universal Credit and higher living costs, including rents, will make low-income families worse off by £2,500 a year in 2020[11]. Larger families in work and in the private rented sector will be among the hardest hit[12].

[11] 'Just About Managing' families hardest hit by welfare reforms in 2020. Policy in Practice. Available here: http://policyinpractice.co.uk/just-managing-families-hardest-hit-welfare-reforms-2020/

[12] The cumulative impacts of welfare reform: a national picture. Policy in Practice for the Local Government Association. To be published in April / May 2017.

While this report focuses on the damaging effect of the new Child Tax Credit rules on families and on child poverty, the overall picture for the living standards of low income households is likely to be bleaker.

Costs of child poverty

It is acknowledged by many organisations that there is both a financial and a human cost of poverty. Personal suffering is not the only consequence, there is a huge monetary cost of child poverty that some have attempted to measure. The Child Poverty Action Group (CPAG) report that the cost of child poverty was as high as £25 billion a year in 2008 and £29 billion in 2013[13]. Much of this cost stems from evidence that children who grow up in poverty have lower productivity as adults and have a higher risk of unemployment. This may be due, in part, to the finding that those who grow up in poverty struggle to gain the same level of education as those that do not[13].

There are certain immediate costs of poverty that are less difficult to measure than the future costs. The CPAG found around half of the (£29bn) cost arises from the need for additional public spending. This includes extra education costs due to the Pupil Premium and the extension of free early year's entitlement to two year olds in low income families. Loughborough University[14] estimated that, in 2013, the cost of these services amounted to £1.9 billion and £0.8 billion respectively. With a projected increase in child poverty of 10% in the coming three years, the total costs of these services is likely to rise from £2.7 billion to £3 billion.

The immediate need for other services is likely to increase with higher numbers of children falling into poverty. Local authorities and other organisations involved in the provision of welfare services at the local level, who already face funding pressures, will face an increase in the demand for housing, personal budgeting services and food banks. For some households, the growing gap between households' income and expenses will increase rent arrears and general indebtedness, leading to increasing homelessness and widespread financial difficulties.

Conclusion

Limiting Child Tax Credits to two children is intended to make the system fairer, while reducing benefit spending. However, while the principle behind the policy is clear, its measures of success have not been well defined.

Policy in Practice will assess the consequences of this policy through rigorous scrutiny of the outcomes for those it affects. We will be tracking changes in demographic and economic circumstances for over half a million low-income households across London. This will allow for birth rates and other outcomes, including movement into work, or the need to move home, to be tracked at scale, both before and after this policy takes effect[15].

Policy in Practice was founded to make government policy simple to understand, to help people make the decisions that are right for them. We know that if the government wants to change behaviour, it needs to communicate policy to the people that may be affected. If people are unaware of these changes, there is even less chance that people will take policy into account when making decisions.

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[13] An estimate of the cost of child poverty in 2013. CPAG. Available here: www.cpag.org.uk/content/estimate-cost-child-poverty-2013

[14] An estimate of the cost of child poverty in 2013. Loughborough University. Available here: http://www.cpag.org.uk/sites/default/files/Cost%20of%20child%20poverty%20research%20update%20(2013).pdf

[15] Low income Londoners and Welfare Reform, Policy in Practice funded by Trust for London. For more information about this project, visit http://policyinpractice.co.uk/low-income-londoners/

If, as seems likely, fertility rates do not change significantly, the costs of this policy will ultimately fall on children in the families affected. The impact of growing up in a family that struggles to provide basic necessities will mean this policy is likely to have financial and social consequences well into the future.

For this policy to be a success, the government needs to define what success looks like. This needs to be both through the expected change in fertility rates they hope this policy will have, and through improvements in life chances and outcomes they expect for children growing up in families affected.

We believe that if the government persists with this policy, it will need to develop alternative strategies to improve life chances for children over the long term. The consequences of failing to do so will be long term fiscal costs, and social consequences that will be felt across the next generation.

Annex I - Methodological Approach

The quantitative analysis presented in this report was carried out using information from the Family Resources Survey 2014/15.

We identified all households with two or more children currently in receipt of Child Tax Credit or potentially eligible for Universal Credit as reported in the survey, and found 2.1m households at risk of being affected by this policy.

In the previous year, we observed 104,000 third or additional children born to this same cohort of low income households. It is fair to assume that a similar number of births are likely to be recorded again in the period between April 2017 and April 2018, based on ONS demographic projections that show a yearly increase in the UK population of 0.7%[16].

To assess the impact that this policy has on child poverty, we use relative income poverty (i.e. 60% of median income). Based on the ONS 2015 figures of median income[17], we set the current poverty line at 60% of £26,826 per year, or £16,092 per year. This figure applies to households composed of two adults with no children, and it takes into account all sources of income, including benefits. Having equivalised this figure for different household sizes[18], we apply it to the cohort of 2.1m families 'at risk'. We find that 23.2% of these families are already below the poverty line, while 76.8% are not.

The ONS figures on relative poverty show that households in the UK need an extra £286 a month, per extra child, to remain above the poverty line[10]. Currently that sum is covered by the support received through Child Tax Credits (£232 per month) and through Child Benefit (£59 per month for second or additional children). With the limit of Child Tax Credit Support to two children, families affected by this reform will thus face a monthly shortfall of £227 each month.

Among the group of households 'at risk', We identified 487,000 households (23.2%) of households in poverty, 440,000 households (20.9%) with a monthly income of less than £227 above the poverty line and 1,176,000 households (55.9%) with a monthly income more than £227 above the poverty line.

Limiting Child Tax Credit to two children: Analysis by Policy in Practice

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The average number of children per household in each cohort was 3.5, 3.2 and 3.5 respectively. We therefore estimate an additional 69,000 children will be living in poverty by April 2018. These are children living in families with monthly income of less than £227 above the poverty line. If they had an extra child their family would be pushed into relative income

[16] Overview of the UK population: March 2017. ONS. Available here: https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/articles/overviewoftheukpopulation/mar2017
[17] Nowcasting household income in the UK. ONS. Available here: https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/nowcastinghouseholdincomeintheuk
[18] Households Below Average Income (HBAI) Quality and Methodology Information Report – 2013/14. DWP. Available here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/437251/households-below-average-income-quality-methodology-2013-14.pdf

poverty as a result of the drop in Child Tax Credit support. This would affect all children in the household, not only the newborn.

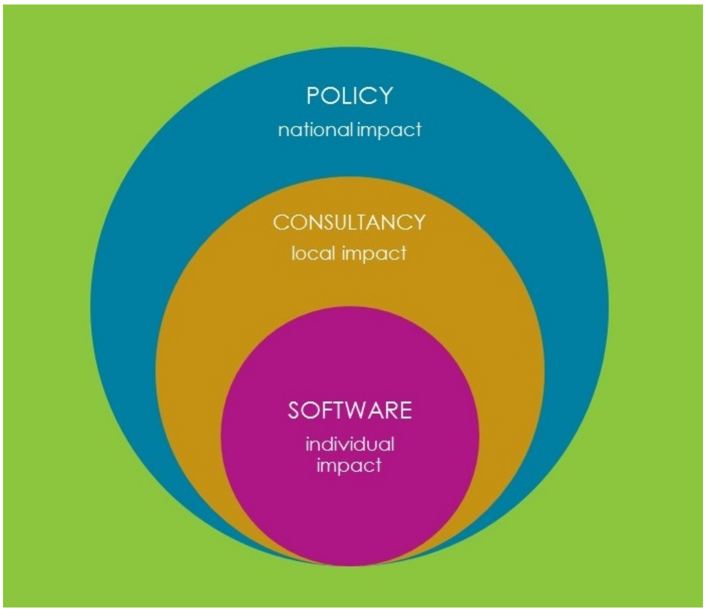
We apply the same methodology to derive the number of children pushed deeper in to poverty and the impact on low to middle income households with children in the years leading up to 2020.

About Policy in Practice

Policy in Practice was founded to make the welfare system simple to understand, so people can make the decisions that are right for them.

We are a team of policy experts, led by one of the architects of Universal Credit. We believe government services can be help people toward greater independence if they are simple for people and organisations to understand.

Our software models how the policies of four government departments combined affect households on low incomes. This helps people to understand how government policy affects them, so that they can make better decisions and lead more fulfilling lives.



Our household level analysis can pinpoint how each household in a local area is affected by all policy changes, now and in the future. This helps local authorities to target resources, meet their statutory obligations and spend money more effectively.

We empower people to take control, and support them to independence.

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