Briefing for 'Welfare cap' debate, 26th March 2014

Introduction

Child Poverty Action Group (CPAG) works to prevent and end poverty among children and families with children. We have particular expertise on the functioning of the social security system through our welfare rights training and policy work. We also conduct research and analysis on a range of policy areas including family incomes, work, low pay, health, housing, childcare and education.

Annually Managed Expenditure (AME) Cap – 'the Welfare Cap'

Child Poverty Action Group is deeply concerned about the Annually Managed Expenditure (AME) cap and we argue for its removal. Our two main concerns, which we will explain further below are:

1. **It may tie governments' hands on the direct action they can take to reduce child poverty, and choke-off any ambition in this policy area**
2. **It fails to address the root causes of pressure on social security expenditure**

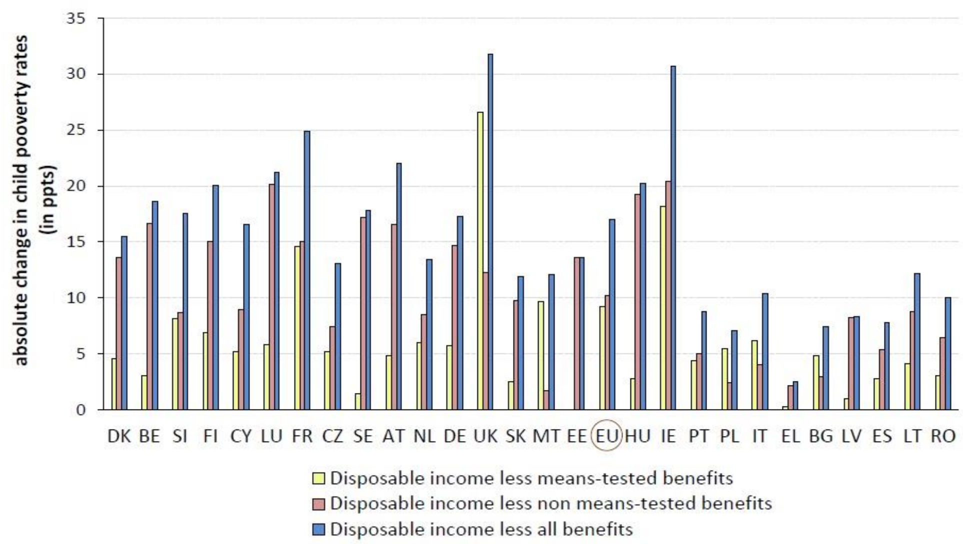
AME cap impacts on child poverty

The AME Cap places a limit on social security, benefit and tax credit expenditure over each of the subsequent four years. The rates of the cap have been established in line with current government spending, which means it will lock-in government spending decisions that the Institute for Fiscal Studies estimate will push up to 900,000 more children in the UK into poverty by 2020[i]. This includes:

- A freeze, then cap, on child benefit uprating, which has reduced its value by 15%
- A three-year 1% cap on uprating of tax credits, housing benefits and other support for low paid working families, jobseekers, disabled people, carers and single parents
- The 'bedroom tax'
- Other cuts to housing benefit, council tax benefit, disability benefits and social security entitlements

[Analysis for CPAG by the Institute for Social and Economic Research (ISER)] helps highlight how the cap could drive up UK child poverty rates. It compares the effect of the 2012 tax-benefit systems on child poverty across the EU. *Figure 1* below shows that redistributive effects of the UK benefits system in 2012 were highest in the EU (the need for which is further explored below). Crucially, it also shows the **EU countries with lowest child poverty rates all use income transfers through social security and benefits** to help achieve their low rates.

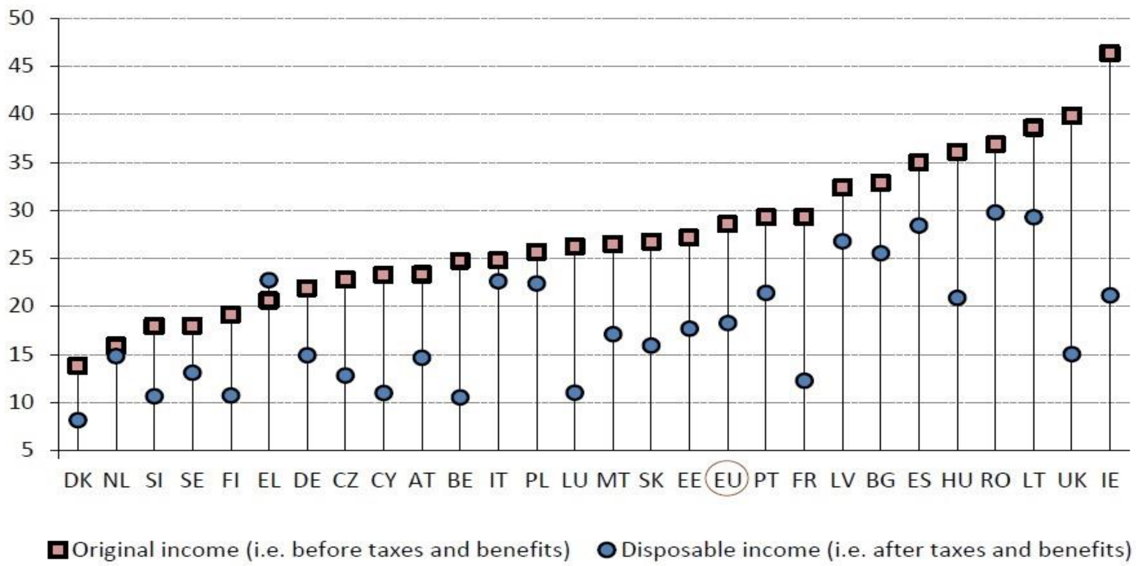
Figure 1. Redistributive effect of benefits, absolute change in child poverty rates (2012)



Country	Abbreviation
Belgium	BE
Bulgaria	BG
Czech Republic	CZ
Denmark	DK
Germany	DE
Estonia	EE
Ireland	IE
Greece	EL
Spain	ES
France	FR
Italy	IT
Cyprus	CY
Latvia	LV
Lithuania	LT
Luxembourg	LU
Hungary	HU
Netherlands	NL
Malta	MT
Austria	AT
Poland	PL
Portugal	PT
Romania	RO
Slovenia	SI
Slovakia	SK
Finland	FI
Sweden	SE
United Kingdom	UK

Figure 2 below shows that **the UK has one of the highest pre-tax and pre-transfer rates of child poverty in the EU**, a narrow second only to Ireland (see page above for country key).

Figure 2. Child poverty rates before and after taxes and benefits (2012)



Notes: Countries are ordered according to child poverty rates before taxes and benefits are taken into account. A key to all the country abbreviations is provided in the Appendix (Table A.1). EU refers to the EU27 average.

Source: EUROMOD version G1.4.

The AME cap may tie the hands of future governments with respect to poverty reduction and choke-off any ambition in this policy area. If we cut social security without taking effective action to bring down our pre-tax and transfer child poverty rate, we potentially leave millions more children exposed to poverty.

The effect may be particularly detrimental for families affected by in-work poverty (which is currently two-thirds of all poor families) and by disability. This is because direct and passported cyclical benefits – the main one being Jobseekers Allowance – are to be excluded from the cap. So the cap will in particular affect tax credits and housing benefit for low paid working families, as well as benefits for disabled people and carers.

Fiscal and economic consequences

The coalition is in danger of allowing the economic costs of child poverty to continue and worsen. **In the medium to long term, this will hinder rather than help to reduce the deficit.** Research commissioned by CPAG and based on methodology developed for the Joseph Rowntree Foundation estimates the UK's current high rates of child poverty place a heavy burden on the economy, costing £29 billion a year. Of this, around £20 billion comes from costs to the Exchequer.

The main drivers of the costs are:

1. **£15 billion spent on services to deal with consequences of child poverty** (e.g. social services, criminal justice, extra educational support)
2. **£3.5 billion lost in tax receipts** from people earning less as a result of leaving school with low skills, which is linked to having grown up in poverty
3. **£2 billion spent on benefits** for people spending more time out of work as a result of low skills, which is linked to having grown up in poverty, having grown up in poverty
4. **£8.5 billion lost to individuals in net earnings** (after paying tax) due to lower earning potential from leaving school with low skills.

If the rises in child poverty projected by IFS were to take place, then the cost of child poverty in 2020 will represent around 3% of GDP.

Sustainable social security – an effective alternative

Social security is of tremendous economic and social value to the UK and therefore **it is essential that social security expenditure is sustainable**. To ensure that it is – and can be sustained at levels adequate to meet basic need and prevent poverty – governments must address the root causes that put pressure on expenditure.

While the government has framed its AME cap as a policy to prevent unsustainable expenditure on social security; **prior to the recession spending on benefits had in fact shown the longest period of stability in the history of the welfare state**[ii].

The analysis makes clear that in the UK we are leaving social security and tax credits to do much more of the heavy lifting than other EU27 countries. Therefore any realistic and evidence-based approach must address the root causes.

The analysis by ISER presented in *figure 2* above demonstrates, before redistribution, the UK's child poverty starting point is very high – too high. Indeed we have the second highest pre-distribution child poverty rate in the EU27[iii]. As a result, **the UK benefits system has to do a lot more 'heavy lifting' in terms of redistribution than it does in many other countries, making up for unaffordable housing costs, low pay and wider inequality in the labour market.**

The cap will also further embed Coalition government policies which are cutting the incomes of most of the poorest half of the population whilst boosting that of most of those in the wealthiest half. This is demonstrated by the Treasury's own chart below which shows the cumulative impact of the Government's tax and benefit spending decisions since 2011. As Chart 2.D below shows, while the richest 10% have had the largest income reduction proportionately, the second largest hit is taken by the poorest 10% and the rest of the pattern across the income spectrum is almost completely regressive. Wealthy households can probably absorb the hit; but for the poorest, these income cuts too often mean making impossible choices between putting food on the table, paying energy bills or getting into debt.

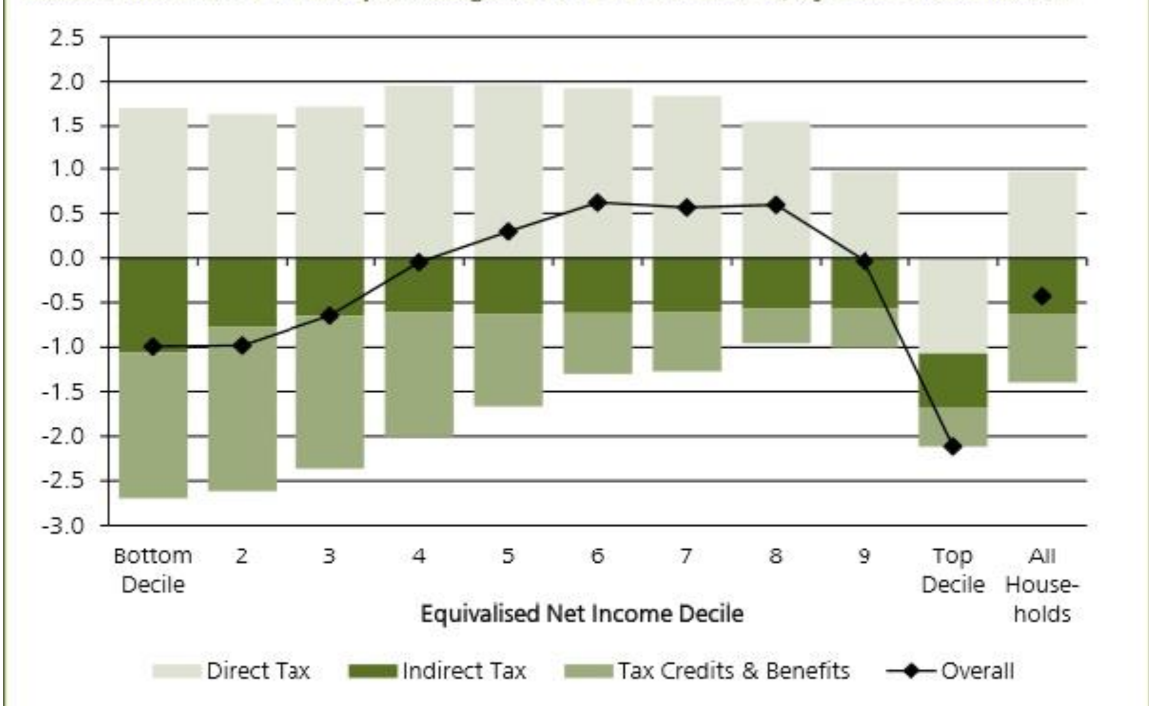


Chart 2.D: Cumulative impact of modelled tax, tax credit and benefit changes on households in 2014-15 as a percentage of 2014-15 net income, by income distribution

Source: HM Treasury tax and benefit microsimulation model

Chart 2.D also shows that:

1. **There is only a token 'progressive' impact:** Aside from the richest decile (top 10%), the cumulative impact of the Coalition's budgets on the incomes of UK households is largely regressive with those at the poorest end taking the greatest hit.
2. **Wealthier households have been made better off:** A majority of people in the wealthiest half of the population have been made wealthier by the government, refuting the claim that "we are all in this together".
3. **Social security and tax credit cuts have been used to pay for tax giveaways:** When comparing the impact of (i) cuts to social security and tax credits for the poorest (the dark green bars below the x-axis) with (ii) tax cuts that have mainly benefit the upper half of the income spectrum (the light green bars above the x-axis), it looks increasingly as if, instead of being used to reduce the deficit, cuts to social security and tax credit support for low earners have really been used to fund tax giveaways that mainly benefit wealthier households.
4. **There are affordable progressive alternatives to social security and tax credit cuts:** Cutting social security and tax credit support for low earners is therefore not a 'tough choice' or a situation in which 'there is no alternative'. The government could, and should have protected basic support for families on low incomes much better, instead of giving special treatment to make wealthier households better-off.

This highlights that the government has more options open to it for reducing the deficit than has been suggested. Fiscal responsibility is not only about controlling spending, it is also about taxing fairly; and it requires a much greater priority to be made of closing the tax gap.

Recommendations

We call on MPs to support the following approach:

- **Vote against the Coalition Government's introduction of the AME cap.**
- **Ensure that income transfers through social security, tax credits and welfare benefits continue to be part of a broad strategy to reduce child poverty.**
- **Manage, rather than cap, social security expenditure and ensure it is sustainable by cutting the pre-transfer poverty rate through:**
  1. **Living wages**: Action to increase the supply of good quality, secure, living wage jobs that reduce reliance on tax credits and in-work benefits like housing benefit.
  2. **Affordable housing**: action to increase the supply of affordable housing, especially new provision of social housing.
  3. **Affordable childcare**: Action to increase the supply of high quality, affordable childcare, which will help to boost the parental employment rate.
- **Taxation: Make the tax system more progressive so that we compete better on tax fairness with those EU27 countries that have the lowest rates of child poverty**

If a form of cap is to go ahead, at the very least it will need substantial safeguards to prevent it driving up child poverty and to ensure that future governments do not find themselves so constrained they cannot meet the requirements of the Child Poverty Act 2010. This could include:

- **The cap should be flexible enough to accommodate government child poverty strategy**. For example, there could be an exclusion from the cap for discretionary spending decisions on child benefit and child tax credit when taken as part of the government's child poverty strategy with the purpose of reducing and preventing child poverty.
- **The annual rates at which the cap is set should be index linked.** This will ensure it is possible for social security, benefits and tax credits to keep pace with rising prices.
- **The cap should be flexible in cases of government policy under-performance** (e.g. if government overestimates the off-flow from the Work Programme, the cap should be amended to align with the actual outcome of the policy, not with the estimate).

END OF BRIEFING – CONTACT DETAILS BELOW

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About CPAG

CPAG promotes action for the prevention and relief of poverty among children and families with children. To achieve this, CPAG aims to raise awareness of the causes, extent, nature and impact of poverty, and strategies for its eradication and prevention; bring about positive policy changes for families with children in poverty; and enable those eligible for income maintenance to have access to their full entitlement.

Child Poverty Action Group is a charity registered in England and Wales (registration number 294841) and in Scotland (registration number SC039339).

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[i] Child and working-age poverty in Northern Ireland over the next decade: an update, January 2014 http://www.ifs.org.uk/publications/7054

[ii] http://www.turn2us.org.uk/pdf/Mythbustingrevised.pdf

[iii] Note on EU27 Child Poverty Rates, Institute of Scotland and Economic Research http://www.cpag.org.uk/sites/default/files/ISER%20note%20on%20EU27%20child%20poverty%20rates.pdf